Participating business in India: where do we go from here?

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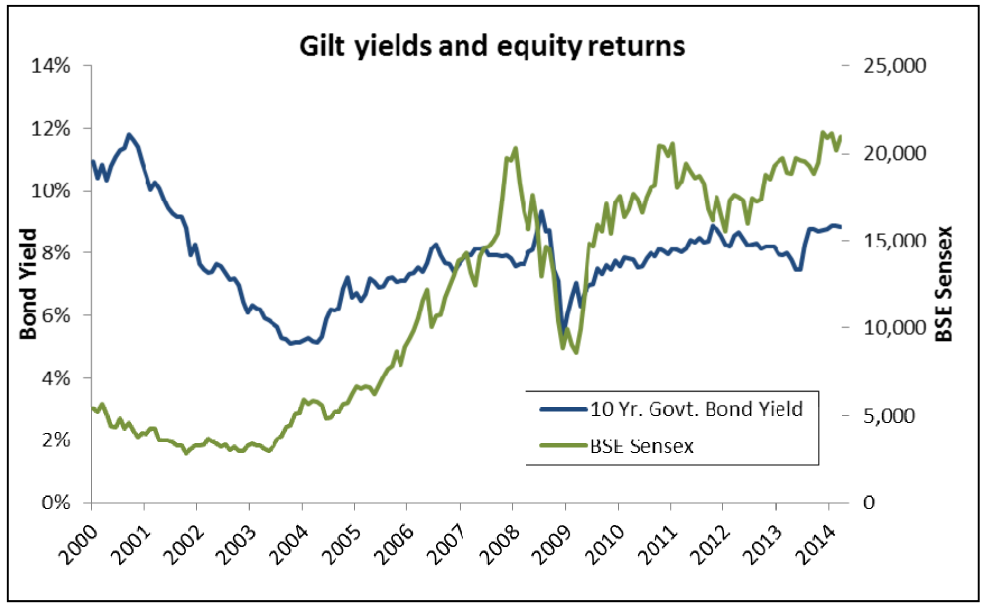
Participating business in India and Asia

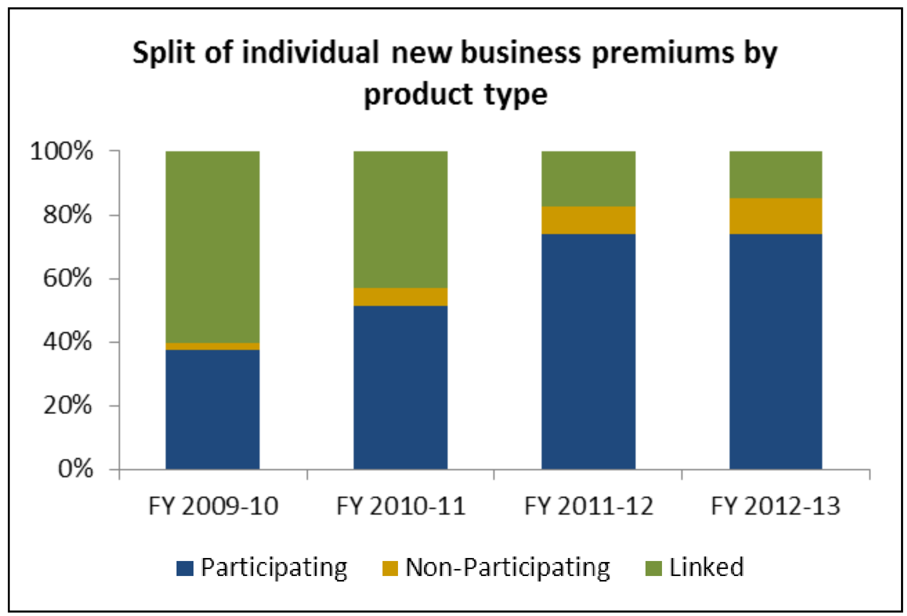
Introduction

- Indian life insurance market opened up to private sector in 2000
- Up to 2003-04 around 80% of new business sold was through par products
- In 2004-05 unit linked insurance products (ULIP) were introduced
- Rising stock markets aided strong sales of ULIP and market share of par business fell as a result
- Reductions in interest rates between 2000 and 2004 hurt existing providers of traditional business, also incentivising the move from par to ULIPs
- Public sector LIC also saw success that private sector firms had with ULIPs and it too started to promote ULIPs and by 2005-06 they made up c60% of its sales
- By 2010 more than 80% of new business from private sector companies was through ULIPs



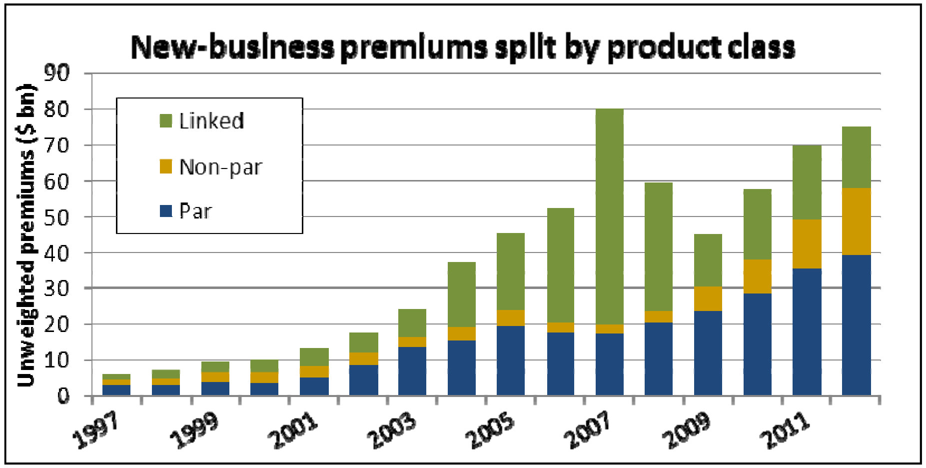
Recent sales trends

- New restrictions on benefit structures and charges were introduced by IRDA in September 2010
- These made it difficult for insurers to offer attractive distributor compensation on ULIPs compared to traditional products, giving a competitive advantage to par business
- Stock market falls during the global financial crisis (GFC) in 2008 also had a negative impact on consumer demand for policies linked to investment markets.
- ULIPs have also suffered from bad publicity linked to various mis-selling reports
- All of this has led to a large drop in the market share of sales from ULIP products since 2010, with a corresponding increase for par, which accounted for more than 70% of 2013 new business premiums
- The revival of stock markets in recent years, however, seems to have led to a revival of focus on ULIPs from some private sector companies.

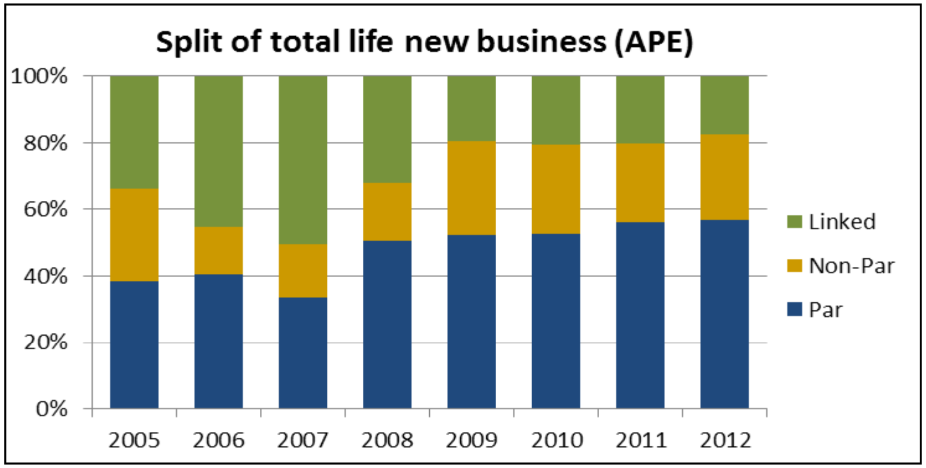


Volumes in other Asian markets

Hong Kong

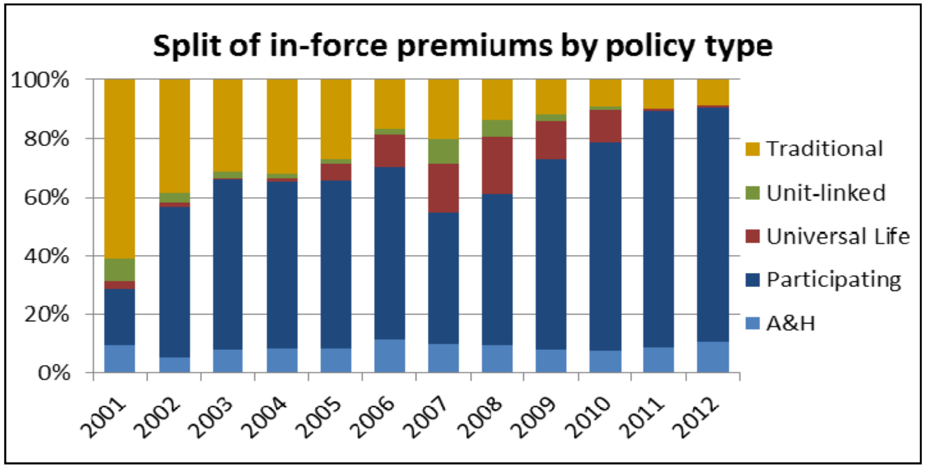


Singapore



- Par sales (very) significant in these markets
- Same pattern observed in all three, of growing sales of linked business up to 2007, followed by decline and a shift back to par
- Effects of GFC have highlighted the value of guarantees and reduced volatility offered by par business

China



Product styles

Reversionary Bonuses	Cash Dividends
• Basic sum assured is increased annually through reversionary bonuses that increase the guaranteed benefits • Additional discretionary terminal bonuses can apply on claim	• Basic sum assured remains the same • Surplus distributed annually via cash payment to policyholder • Dividends can be held on deposit with the insurance company earning variable, non-guaranteed interest

- The **reversionary bonus** style is more common in India, as is also the case in Singapore and Malaysia
- In Hong Kong and China, the **cash dividend** style is currently more common
- Endowments are typically the most common product style, but are certainly not the only type of products sold as par.
- Par products are predominantly conventional in nature, but there has been some very limited sales of unitised with-profits (UWP) products in India and China.

Regulations

Shareholder profit sharing

- India, Singapore, and Malaysia all have a 90:10 gate
- In China the split is 70:30
- Hong Kong has no explicit restriction

Solvency Requirements

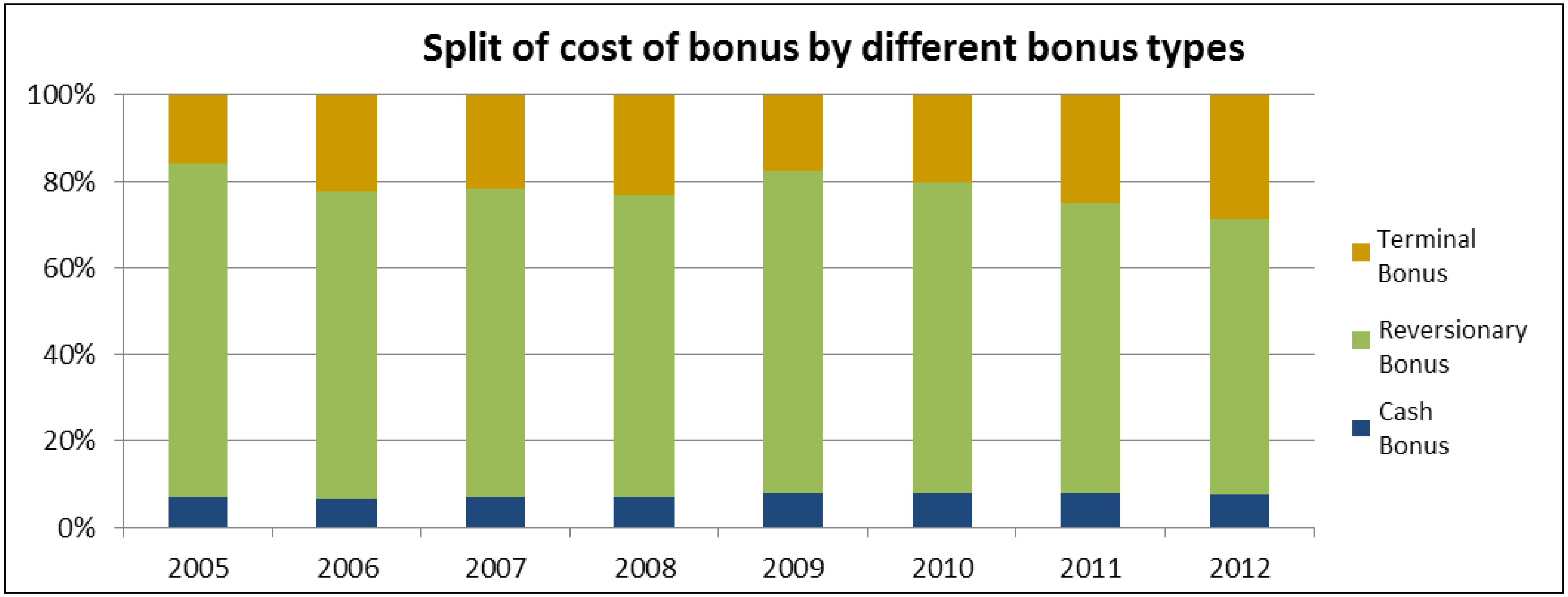
- A general factor based approach (X% reserves + Y% sum-at-risk) is used in India
- Singapore and Malaysia have an RBC approach is more specific to the risks of each individual company
- The approaches in China and Hong Kong are currently similar to that in India, but they are both now in the process of developing RBC type regimes.

Par fund governance

- The recent introduction of new governance requirements for par business in India suggest it is more advanced in this area than other Asian markets
- These have included requirements for with-profits committees and asset share frameworks
- The regulator in Malaysia has recently issued a concept paper that also sets out clearer governance and management requirements for par business
- Management of par funds in Singapore, Hong Kong, and China is less transparent

Issues in other countries

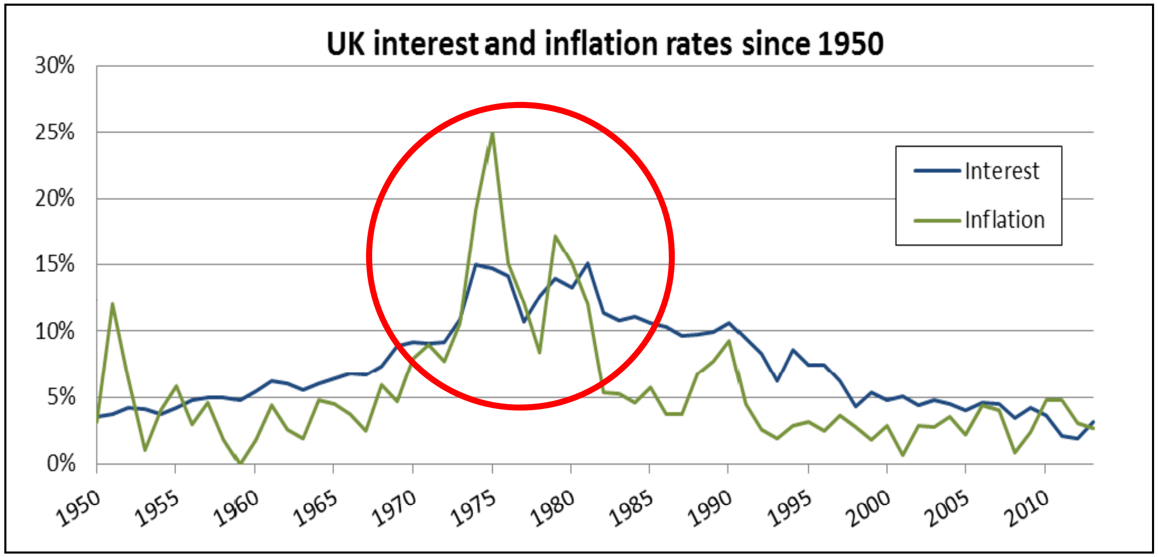
- Recent low interest rate environment has made guarantees more expensive (increase in liabilities)
- Following chart shows cost of bonuses declared in Singapore has been shifting towards a greater distribution via (non guaranteed) terminal bonuses
- A reaction to the lower interest rate environment?



Lessons from the UK with-profits market

Background history

- 1762 – Equitable Life established (first mutual insurance company in UK), with first bonuses declared in 1781
- Initially all bonuses declared were reversionary. Prudent approach led to the building up of estates.
- First terminal bonuses declared in 1956 (Prudential) and over the 1950s and 1960s reversionary bonuses went from simple, to compound, and then super-compound in attempt to improve balance of profit distribution.
- Inflation and interest rates both rose well above 10% during 1970s
- 1970s also saw the introduction of low-cost endowments to back property loans and significant sales of deferred annuity pensions



Birth of unitised with-profits in the 1980s

- The unitised with-profits concept was introduced during the 1980s, with several factors influencing its development and later popularity:

Popularity of investment linked products

Decrease in interest rates

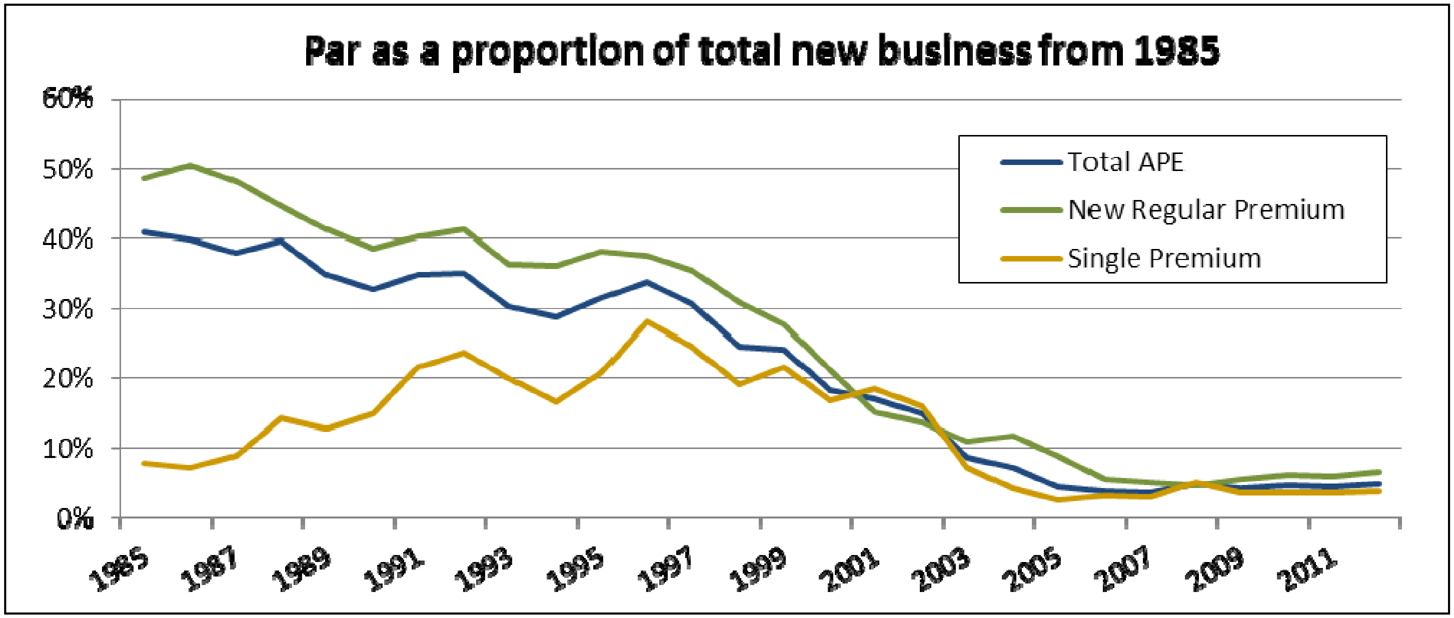
Competition over bonus rates

Sales opportunity from pensions business

Pressure on available capital

The decline of UK par business

- Proportion of new life insurance business in the UK that is participating has dropped-off significantly since the late 1990s.



- Image of with-profits was (irreversibly?) damaged by three issues:
  - Failure of Equitable Life
  - Endowment backed mortgages
  - Market Value Reductions

The aftermath – reviews and reports

- Several reviews and reports have been launched following the near failure of the Equitable Life
- The main points highlighted have been concerns over:
  - the **lack of transparency** with par business and the level of discretion that providers have;
  - areas of **governance**, in particular conflicts of interest; and
  - policyholder **communications**
- Some of the outcomes of the reviews have been:
  - New rules and guidance on **treating customers fairly** (TCF);
  - Introduction of **PPFM documents**;
  - Spitting of statutory Appointed Actuary role into separate Actuarial Function Holder (AFH) and With-Profits Actuary (WPA) roles;
  - Introduction of **with-profits committees**

So, what can we learn from the UK?

Policyholders' perspective

- Smoothing and guarantees are valuable benefits
- Good communication is essential
- Discretionary nature makes par very opaque – greater transparency is required

Shareholders' perspective

- Reputation and regulatory risks are very significant
- PRE has a very significant effect on the management of par business
- Working capital/inherited estates play an important role in fund management
- Need to manage relationship between assets held and guarantees provided and/or expected under PRE

Final Remarks

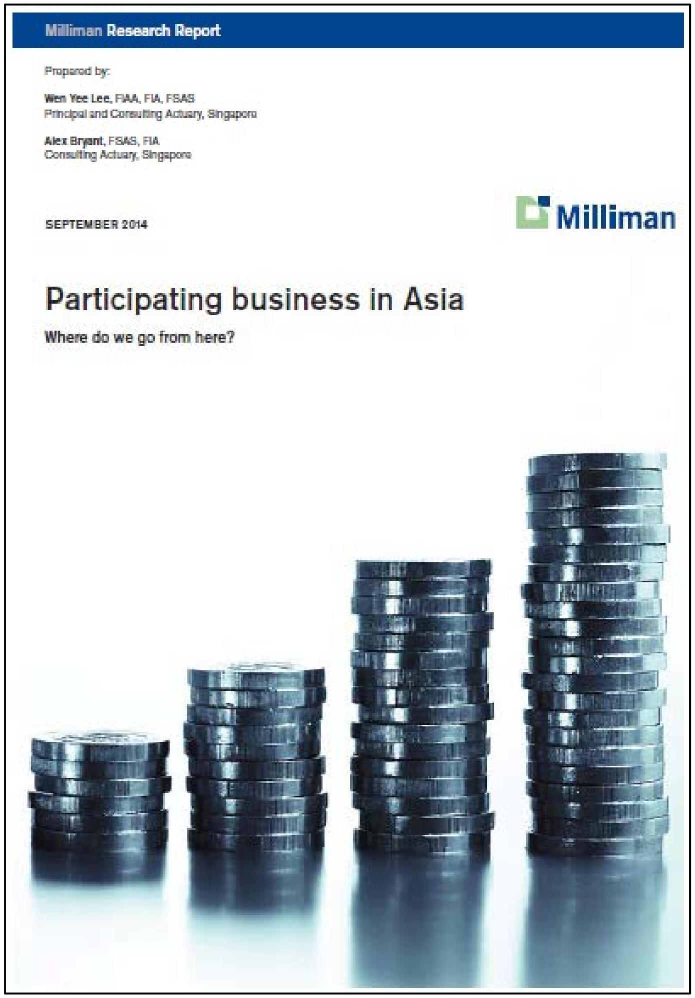
Overall Conclusions

- Par business is a significant element of life insurance market in India and other of the more developed markets in Asia, despite restrictions on the transfer of profits to shareholders (i.e. the 90:10 gate)
- Regulatory changes in India have made par a more attractive proposition for distributors to sell, but could this change in the future?
- Effects of the GFC seem to have led customers to put more value on guarantees (and smoothing?) offered by par
- The management of PRE and issues with transparency of how par business is run are key for the long-term viability of par business

Participating business in Asia research

- This presentation has been based on elements from our recent research report into participating business in Asia.
- This report looks at the current status of par business in four Asian markets: Hong Kong; Singapore; India; and China; and also how par business evolved in the UK.
- It also includes a spotlight on unitised with profits and a focus on how it might work in the example market of Singapore
- The report can be found on our internet site:

http://us.milliman.com/insight/Periodicals/asia-ealert/Participating-business-in-Asia/



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