Model Office Projections

Case Study

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Agenda

I. Background on current situation

II. Analysis of rationale behind proposed changes

III. Checks to validate market research

IV. Model projections with implementation of changes

V. Calculation of impact on profitability in model office

VI. Discussion of considerations with AFH / AA

VII. Alternative Strategies

VIII. Conclusion

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Background – The Company

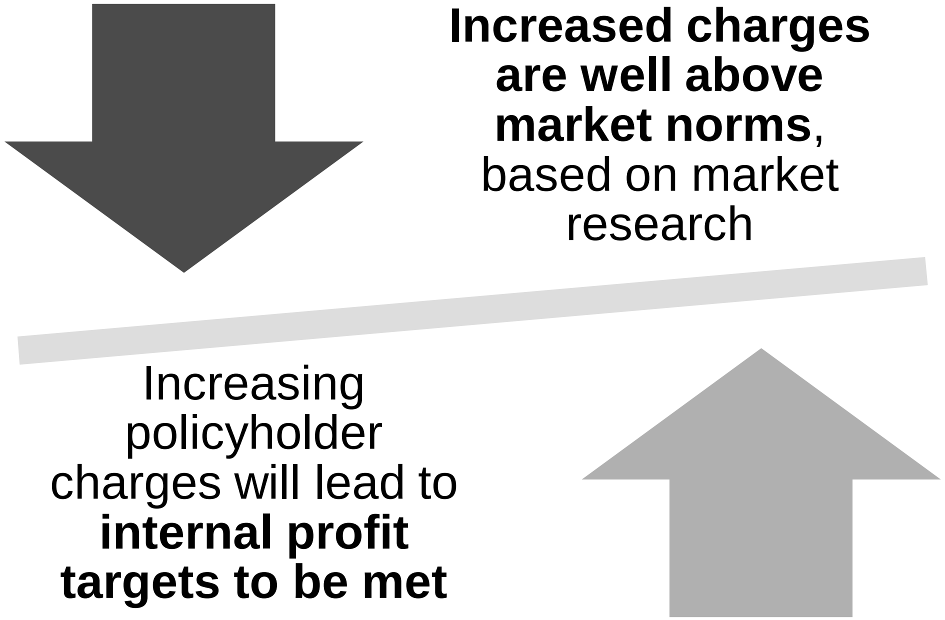
Main stakeholders – life insurance company and policyholders

Current policyholder charges – assumed to be in line with market norm

Company’s internal profit targets not achieved

Background – Current Proposal

Current proposal is to increase charges to policyholders



Background – Assessment

Assessment needs to be done from two perspectives

1. Forecasting actuary

Direct responsibility is to provide forecasts but can provide opinion on suitability of changes based on investigations

2. Actuarial Function Holder / Appointed Actuary

Direct responsibility for assessing the changes

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Analysis of rationale behind the proposed changes

Situation: The company is not meeting internal profit targets

?

What could be the potential reasons for not meeting profit targets?

Current charges lower than market

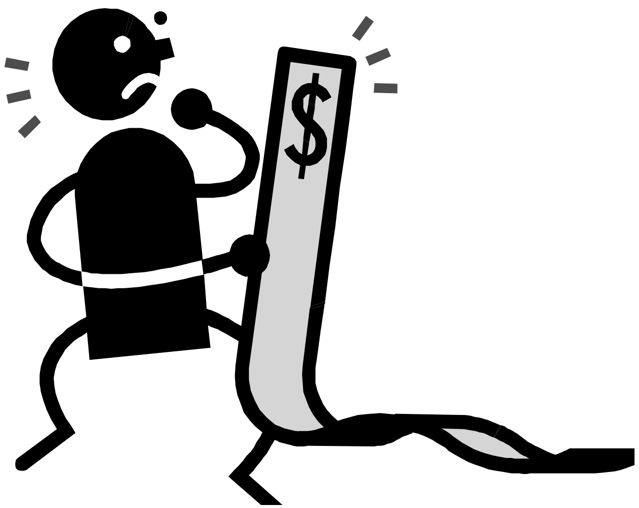
Riskier business and hence higher capital

Assumptions excessively prudent

Higher expense base

Internal profit target too ambitious

Models & model points not representative of business



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Research to validate market situation

Research suggests: Increased charges are well above market norms

!

Forecasting Actuary to validate that the research on market level of charges is reasonable

- ü **Mode of research**
- ü **Source of data**
- ü **Credibility of analysts**
- ü **Reliance on past trends, any assumptions made**
- ü **Soundness of adjustments made to make the assumptions more company specific**

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Methodology of implementing the proposal

Proposal: To increase policyholder charges (possible in various ways)

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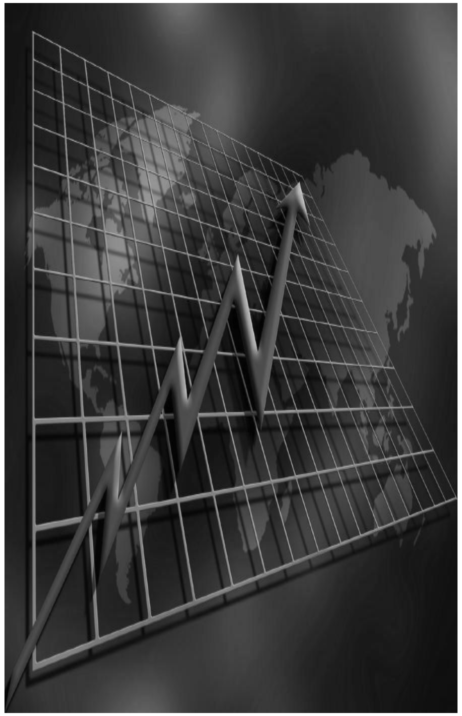
How are the charges being increased in the proposal?



- Higher profit margins in premiums/charges for new products
- Higher future premiums/charges for existing products
- Higher future discretionary charges
- Higher surrender penalties
- Higher expense charges
- Higher FMC/ bid offer spread (UL)

Methodology of implementing the proposal

Where do these changes flow into the model?

Which Product?

Which Cash flow?

Increased premiums or charges

- Higher profit margins in pricing
- Higher expense charges in pricing
- Higher charges for cost of benefit
- Higher FMC / bid offer spread (unit linked)

Lower payouts and reserve

- Higher discretionary charges
- Charge higher for discontinuance
- For UL, overall benefit is lower as result of charges (for unchanged premiums)

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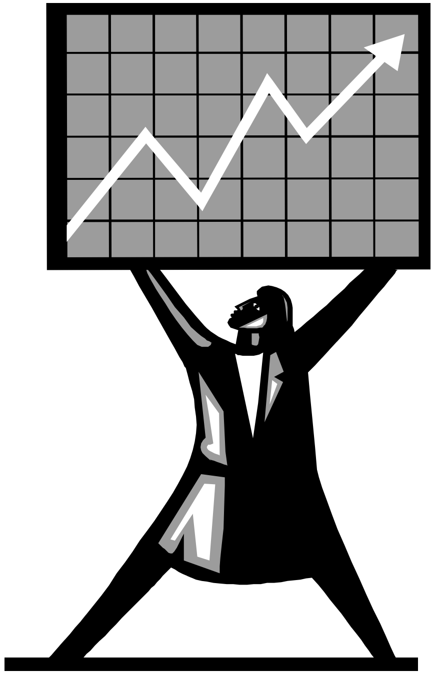
Impact on model profitability by implementing proposed changes

- Ø Calculation of **impact on cash flows** leading up to profits
- Ø Any **future management actions** included in model?
- Ø Compare profits on new charges to **internal targets**
- Ø Use **sensitivities** or derive results in scenarios
- Ø **EV basis** – TEV/EEV/MCEV? **IFRS profits** considered?
- Ø Assumed a change in **future persistency** in the model?
- Ø Any other **second order impact**



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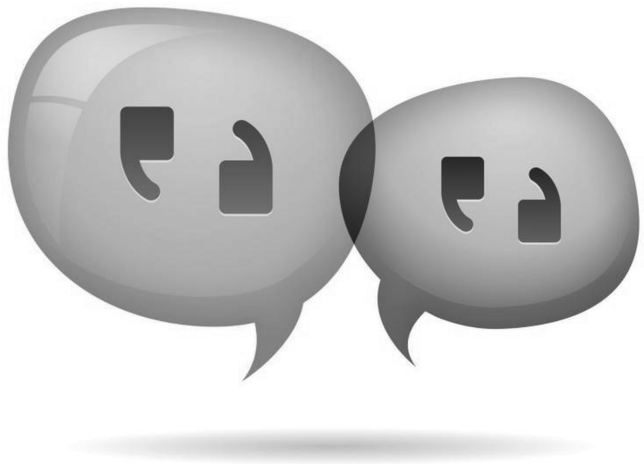
Critical assessment of impact

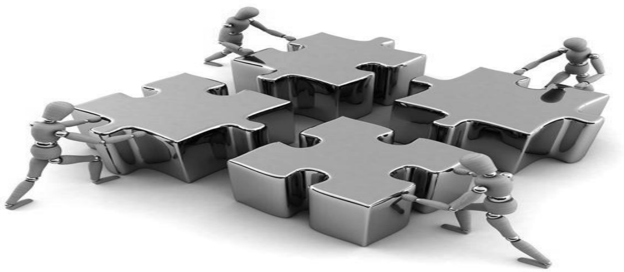
The Forecasting Actuary and Actuarial Function Holder / Appointed Actuary need to consider a variety of issues for comprehensively assessing the situation and estimated impact to arrive at a conclusion.



Critical assessment of impact

Factors to Consider

Policyholders' Interests	Regulatory	Legal and Compliance	Financial/ Business issues	Competitors



Critical assessment of impact – Policyholders interests

The following principles of TCF are particularly relevant

Principle 6: Customers' interests	Principle 7: Communications with clients	Principle 9: Customers: relationships of trust
• *A firm must pay due regard to the interests of its customers and treat them fairly.*	• *A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.*	• *A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.*

While considering increasing charges, the company needs to:

- ü Ensure interests of policyholders' are considered to a sufficient degree
- ü Ensure proper communication to policyholders of the changes
- ü Consider past communication/disclosures/illustrations and resulting policyholder expectations

Critical assessment of impact – Regulatory (1/3)

Relevant regulations to consider in Indian context

IRDA

I. **IRDA (Appointed Actuary) Regulations 2000** – in particular, duties of AA such as complying with section 40-B of the Act in regard to the bases of premium, and also ensuring solvency and overall advice to management

II. **IRDA (Protection of Policyholders' Interests) Regulations 2002** – mainly around disclosure of changes and communication with policyholders

III. **IRDA (Distribution of Surplus) Regulations 2002** – if bonuses are reduced

IV. **IRDA (Treatment of Discontinued Linked Insurance policies)** Regulations 2010 – for changes to surrender charges for linked policies

V. **IRDA Circulars on ULIP products** – if changes are made to charges for UL products

Critical assessment of impact – Regulatory (2/3)

Relevant regulations to consider in Indian context

Actuarial Practice Standards

I. **APS 1** – Accounting for increased charges appropriately in valuation of liabilities, and consideration of threat to solvency (if charges not increased)

II. **APS 2** – Impact on actuarial valuation method/assumptions? Impact on solvency margin/capital required?

III. **APS 3** – Since the work was originally for preparing the FCR, all investigations/conclusions must be in line with APS3

IV. **APS 4** - Investigation/ market research and conclusions will have to be peer reviewed, subject to APS4

V. **APS 5** - Changes related to policy illustrations, subject to APS5

VI. **APS10** – if EV is used as the main profit measure, and IAI guidelines on MCEV if MCEV is used

Critical assessment of impact – Regulatory (3/3)

Relevant regulations to consider in Indian context

Insurance Act 1938

I. **Section 13** (Actuarial report and abstract)

II. **Sections 40A & 40B** (portions related to assumptions in premium bases)

III. **Section 49** (Restriction on dividends and bonus)

IV. **Section 64VA** (Sufficiency of assets)

V. **Section 112** (Declaration of interim bonuses)

VI. **Section 113** (Acquisition of surrender values by policy)

Insurance Rules, 1939

I. Provisions of the Insurance Rules, 1939 (such as **Section 11** - policy prospectus, **Section 17C** – bases of premiums)

Critical assessment of impact – Legal & Compliance

Internal policy and compliance issues to consider

ü **Discuss the changes with legal advisers** for possible adverse outcomes

ü Check that **proposed action complies with company policy and equivalent of PPFM** (special considerations for participating business)

ü Check against **policy literature** for changes made to existing policy portfolio

ü The changes and future outcome has to be **communicated to the Board**

ü How and with whom will the changes be communicated/ discussed internally **before sign off**?

ü Who will **sign off on the final changes**?

ü Any potential **conflicts of interest?**

ü Who will be responsible for **executing the changes** finally proposed in the FCR? Who will **monitor the impact**?

Critical assessment of impact – Financial/ Business issues (1/4)

Base Case Situation	Current Policyholders	Future Business	Risk Profile & Solvency	Other practical issues

Forecasting Actuary to discuss key findings summary with AA:

- Level of profit targets set by company, and main reasons for not meeting these in the base scenario
- Impact of increasing charges on profitability
- Current solvency level relative to minimum level

Critical assessment of impact – Financial/ Business issues (2/4)

Base Case Situation	**Current Policyholders**	**Future Business**	Risk Profile & Solvency	Other practical issues

Impact on Current Policyholders:

- Potential for lapses due to increased charges, leading to further profitability drop
- Current policyholders may shift to competitors with lower charges

Impact on Future Business:

- Future Sales volumes may drop
- Product mix may not turn out as intended

Critical assessment of impact – Financial/ Business issues (3/4)

Base Case Situation | Current Policyholders | Future Business | **Risk Profile & Solvency** | Other practical issues

Potential impact on Company's Risk Profile & Solvency:

- Risk profile of the company may change as it may attract poorer/substandard quality lives after making this change, having a feedback effect on margins
- Potential impact on projected unit expense. Will the loadings in the new premium rates/charges recover the same?
- Potential threats to solvency from impact on lapses/new business sales

Critical assessment of impact – Financial/ Business issues (4/4)

Base Case Situation	Current Policyholders	Future Business	Risk Profile & Solvency	**Other practical issues**

Potential impact on Company's Risk Profile & Solvency:

- Any major systems cost/ issues for implementing changes?
- Training required explaining changes for employees / agents?

Critical assessment of impact – Competitors

How far from major competitors' pricing/charging structure do the suggestions go?

Is product mix for competitors substantially different, with a lower risk profile?

Are competitors using any innovative techniques to increase charges?

Is there a strategy followed by competitors to achieve higher cost efficiency?

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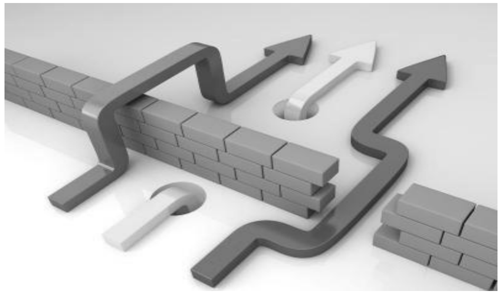
Alternative Strategies



To **increase profitability**, the company can also consider **other strategies** as an alternative to increasing policyholder charges

1 Reduction of expenses	2 Focusing sales strategy on higher margin products	3 Selling less risky business (with lower capital requirement)	4 Introducing cross subsidies	5 Revised investment strategy (higher returns, subject to risk)
6 Increasing risk mitigation to lower capital requirement	7 Revisit target market and review underwriting procedures	8 Change sales channel mix	9 Utilise expertise of reinsurers	10 Improve capital efficiency and returns in various departments

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Conclusion - Recommendation Options

1 Full increase

Raise charges to proposed level

2 Partial increase

Increase charges to a lower level than originally anticipated

3 No increase

Keep charges unchanged, with alternative strategy to meet targets

Conclusion – Immediate Considerations

ü Comprehensive Assessment

Consider all discussion items for each option

+

ü Risks arising

Introduce risk mitigation measures for changes made

+

ü Shortfall

If full implementation is not made, the shortfall must be covered through alternative strategies

Conclusion - Further steps

Review results

Peer review (internal / external)	Frequent monitoring of impact and implications

Separate strategies

Short term changes	Long term plan

Future changes

Revert changes on adverse impact	Further increase charges if required, subject to constraints

Thank You

Questions?