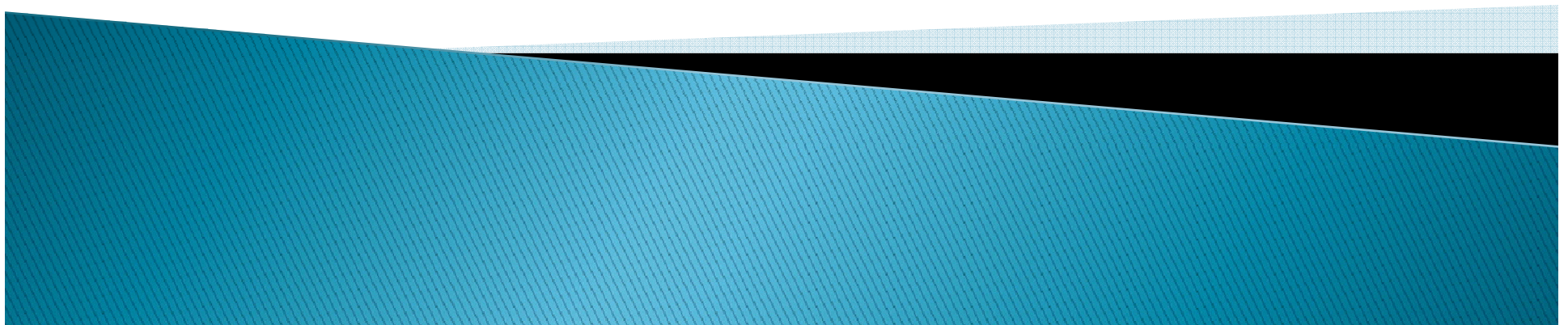


Opportunities & Challenges in offering Whole Life Fixed Rate Annuities

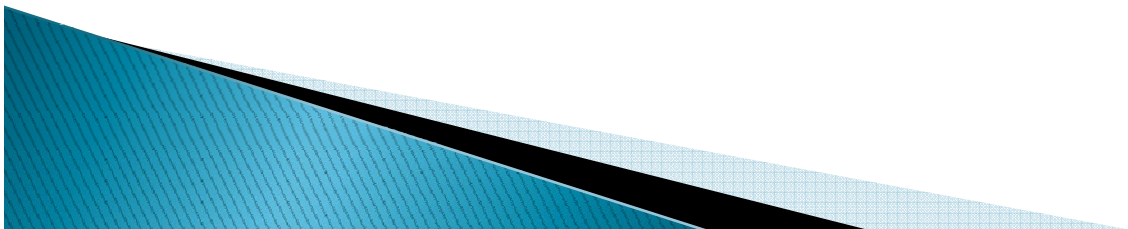
Patrick Curtin
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India Fellowship Seminar 13th June 2013



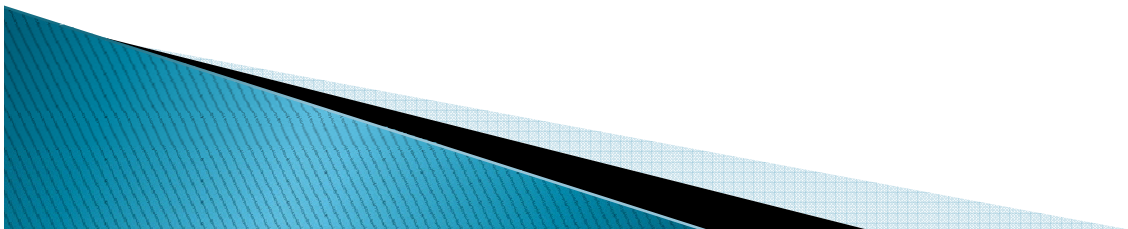
Agenda

- ▶ What are whole life fixed rate annuities?
- ▶ Various forms they come in
- ▶ Opportunities
- ▶ Challenges
- ▶ Discussion question
- ▶ Conclusion



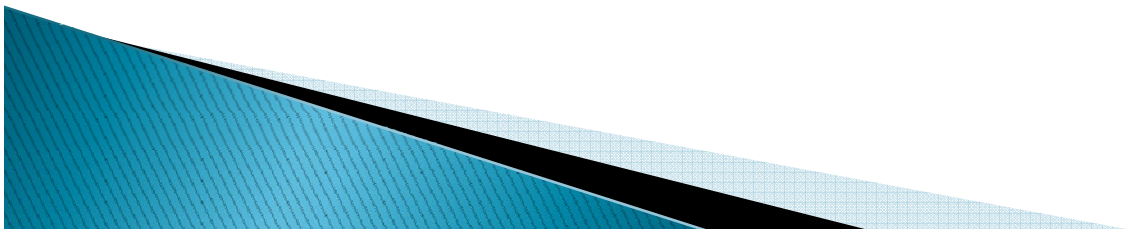
What are whole life fixed rate annuities?

- ▶ Single premium contracts
- ▶ Often known as pension annuities
 - Defined Benefit Schemes / Defined Contribution Schemes
- ▶ Policyholder exchanges a lump sum in exchange for guaranteed payments for life
 - Regular payments taxed as income
 - Can match known outgo only or provide full income cover
 - No surrender value
- ▶ Eliminates two big retirement risks:
 - that a market crash will decimate your savings
 - that you'll outlive your money



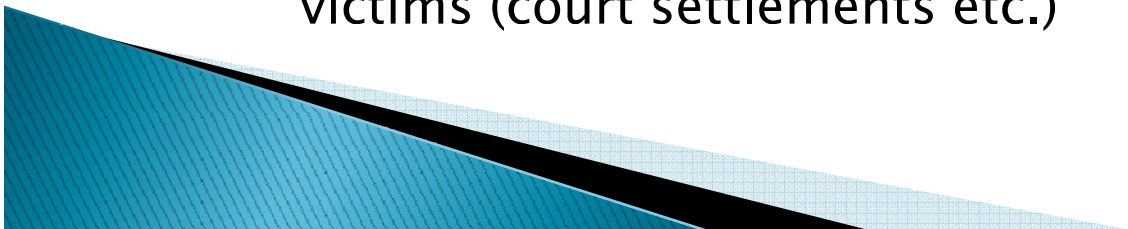
They come in many different forms...

- ▶ Immediate annuities
- ▶ Deferred annuities
 - Leavers from Defined benefit schemes prior to retirement
 - Accumulation phase + Immediate Annuity
 - Accumulation phase can be unit linked or with GMAB/GMMB
 - Annuity conversion rate at prevailing rates or g'anteed in advance
- ▶ Both typically come fixed or variable



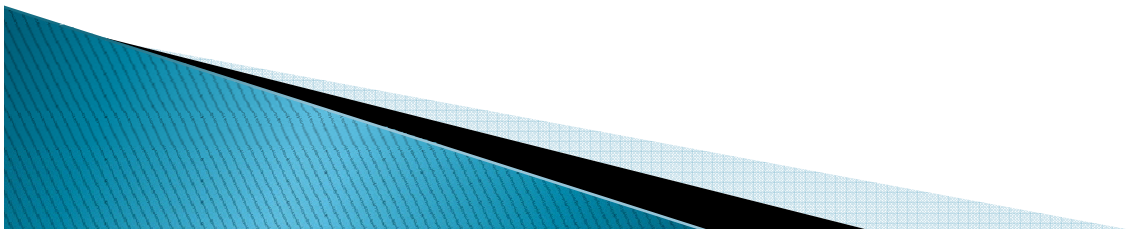
They come in many different forms...

- ▶ Fixed annuities (traditional annuities in UK)
 - Flat amount every month/quarter/year etc.
 - Payments fixed or linked to inflation index to protect purchasing power
 - Minimum guaranteed periods (5 years, 10 years)
 - Reversionary annuity for spouse/children on death
- ▶ A further variant
 - Impaired annuities / life settlements (UK, US)
 - Annuities providing higher regular payments to reflect an impaired life
 - Life annuities providing replacement income for accident victims (court settlements etc.)



They come in many different forms...

- ▶ Variable annuities (Japan, US, UK, Canada)
 - Similar to fixed annuities
 - Guaranteed minimum income stream for life
 - Policyholders can still manage their fund and benefit from long term capital appreciation
 - income is a % of Guaranteed Fund
 - Ratchet features allow Guaranteed Fund to increase with capital appreciation at certain times (e.g. policy anniversary) thereby giving upside exposure
 - Accumulation phase common before retirement
 - Various features exist: GMAB, GMMB, GMIB, GMWB, ...
 - Remaining fund can be part of inheritance estate



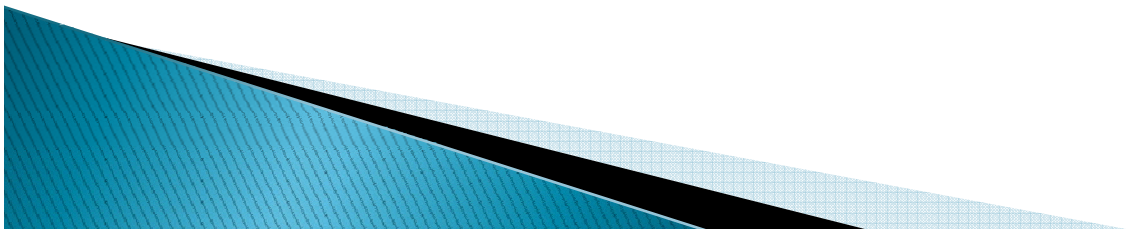
Opportunities

▶ Clear customer need

- People living longer
- Lack of social support in India
- Nuclear family structure becoming more common
- Desire for financial certainty

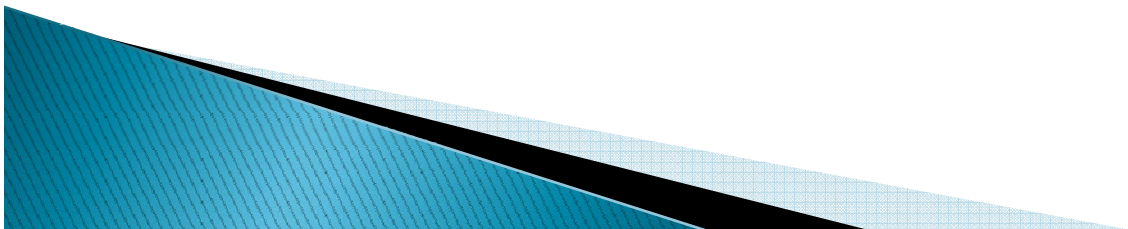
▶ Indian market

- National Pension Scheme requires annuity purchase
- Current pension regulations require annuity purchase post accumulation phase (from same company)
- Young population – average age mid 20's
- Not many providers



Opportunities (contd.)

- ▶ Diversification benefits
 - Longevity risk a natural hedge against mortality
- ▶ Lots of history and ideas/structures in other countries
 - Can learn what worked and what did not
 - Guaranteed Annuity Options
 - High financial guarantees
 - Hedging capabilities
 - Understanding policyholder behaviour in market shocks



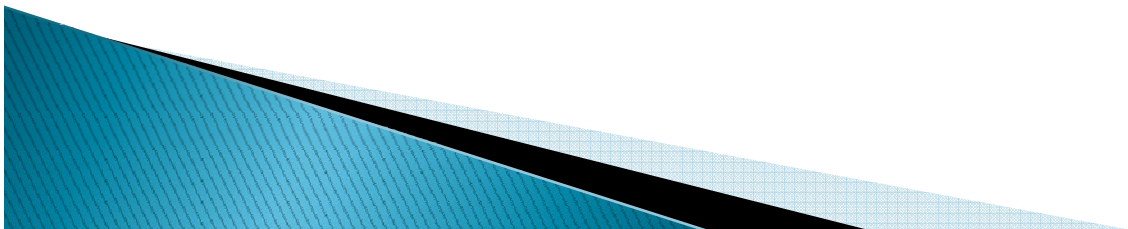
Challenges

▶ Education

- Need for pensions amongst general population
- Importance of pension saving from a young age
- Comparisons with other products
 - E.g. bank deposits offering higher rates

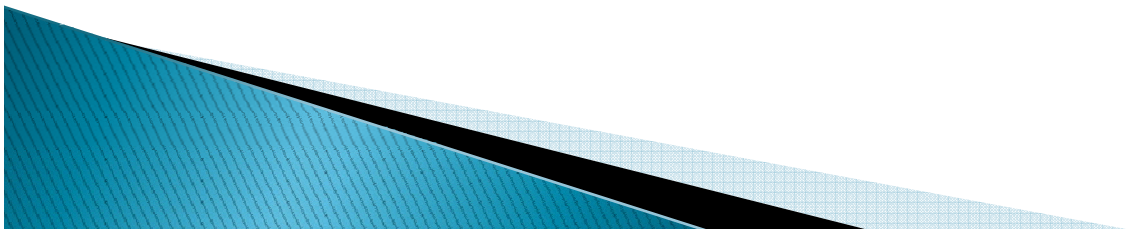
▶ No specific tax incentives for pension accumulation

- Max 1 Lakh tax relief on contributions to insurance
- Other countries have age related tax relief on income to encourage pension saving
 - Ireland: Under 30yrs – 15%, 30 to 39yrs – 20%, 40 to 49yrs – 25%, 50 to 54yrs – 30%, 55 to 59yrs – 35%, 60 or over – 40%



Challenges (contd.)

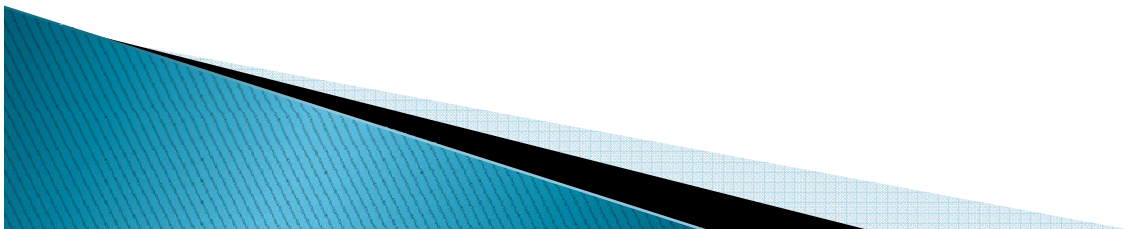
- ▶ Current regulations
 - Non-zero g'tee required in accumulation phase
 - Value for customer v risk to company
 - Protecting purchasing power of accumulated fund close to retirement
 - Ability to hedge market risks currently restricted
 - Interest rate risk only but even then benefit is restricted
 - High capital strain
 - Restrictive reinsurance regulations
- ▶ Competitive pressures
 - Annuities considered commodity-like products
 - Could result in unsustainable/low profit margins
 - Pricing credit spread into products to increase competitiveness (UK)



Challenges (contd.)

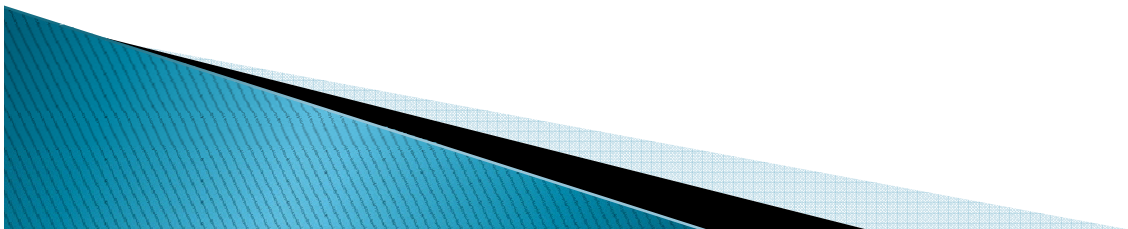
- ▶ Managing/measuring longevity risk
 - What will the rate of longevity improvement be like?
 - Urban India v Rural India
 - Medical advances
 - Diet improvement
 - Health awareness
 - Increasing wealth
 - Data available?
 - LIC / reinsurers / university studies / Government statistics office / similar developing countries / look back at progression over time in developed countries

- ▶ Ability to mitigate
 - Reinsurance
 - Longevity swaps (index / indemnity based)



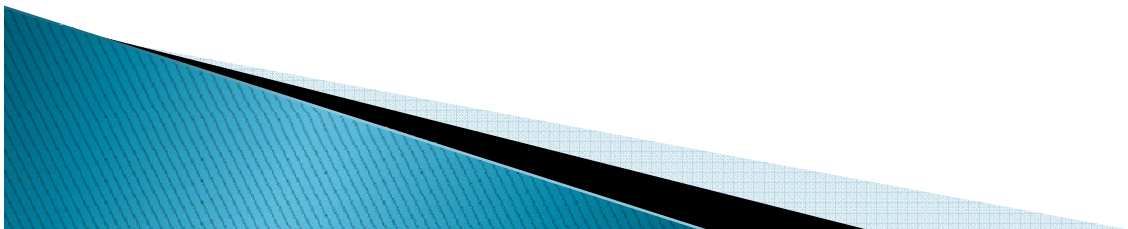
Challenges (contd.)

- ▶ Asset liability management
 - Availability of long terms bonds
 - Availability of inflation linked bonds
 - With 'inflation' measure relevant for consumer
- ▶ Hedging – VAs providers in other countries use futures, swaps, options, variance swaps etc.
 - Sound risk management requires hedging of the Greeks
 - Availability of instruments even if regulations were 'hedge friendly'
 - In countries like Japan with low interest rates, foreign currency annuities being offered
 - Need for currency swaps



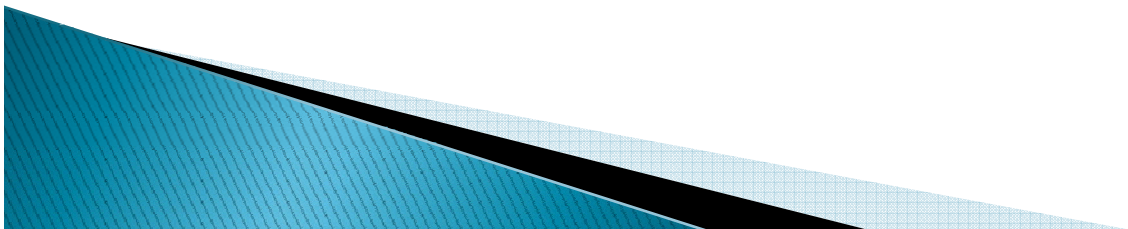
Question for you!

- ▶ How do we deal with the misalignment of interest between the policyholder and the company?
 - In a term policy, both the company and the policyholder want the policyholder to live
 - In a health policy, both the company and the policyholder want the policyholder to be healthy



Conclusion

- ▶ Huge opportunity and need in India
- ▶ Tax authorities, Regulators and Insurance Companies need to work together
 - Create awareness
 - Tax incentives to drive pension savings behaviour
 - Regulation amendments
 - Financial guarantees (optional or enforced) without ability to hedge will create significant future industry problems or poor value for policyholder
 - Learn from other countries
 - Let's not repeat the mistakes...



Q&A

