Life Insurance Product Regulation

Perspective & Reality

A presentation to the 8th CILA, IAI
Mumbai

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29-30 November 2012

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Agenda

- Historical Perspective -General
  - Product
  - Regulation
  - Drivers of Change
- Historical Perspective - India
  - The Pre-Liberalisation Period (Upto 2000)
  - The Post-Liberalisation Period (from 2000)
- Exposure Draft (ED) on Linked & Non-Linked Insurance Products Regulations, 2012
- IAI Submission to IRDA
- What next?

Agenda 1 : Historical Perspective - General

- Product
- Regulation
- Drivers of Change

- Life Insurance has a long two century old history – many old life insurance companies of the world still exist. They survived war, depression, technology revolution, great social changes, rise and fall of socialism and varied economic & financial conditions of high & low interest rates & inflation.
- Considering Product Regulations in isolation is not sufficient, most other regulations have impact on Products and Product Development.

Agenda 1 (a) : Products

Till 1970, Life Insurance companies throughout the world had a limited range of fairly standard Products (bundled Products)

- Pure Protection Products – Term Insurance
- Savings cum Protection against death
  - Endowment
    - Fixed Premium, Fixed Sum Assured, Fixed Term
    - With Profit (Participating)
    - Non-Profit (Non-Participating)
  - Whole of Life
    - Fixed Premium, Fixed Sum Assured
    - With-Profit
    - Non-Profit
- Savings um Protection against longevity (Pension)
  - Immediate Annuity
  - Deferred Annuity

Agenda 1 (a) Products

- Unit-Links Products arrived in early 1970s; but With Profit Endowment dominated till mid 1980s.
- Most companies were mutuals; but there were a few large shareholder companies too
- Risk sharing amongst Policyholders was the central assumption.
- Insurance is sold and not bought – forced savings propagated by Insurance Agents, mostly tied to a company
- No Bancassurance, No Direct Marketing, Not many Independent Insurance Brokers in many countries
- Limited alterative forms of savings – no Mutual Fund, access to bank was limited, Stock Market out of bounds for most savers.

Agenda 1 (b) : Regulations

- Central focus of Insurance Regulation was the Prudential Regulations: aim was to ensure that the companies can meet long-term promises made to policyholders.
- Hardly any specific Market Conduct Regulations – though general laws of the land was considered sufficient.
- Reliance was on competition: Freedom with Publicity
- And competition was on premium rates, bonus rates, quality of post sale service and of course personal touch of the insurance salesman.
- Regulators did not try to address many well-known defects of Traditional Endowment Products (like poor S. V.) by Product Regulations.
- Policyholders Reasonable Expectation (PRE) introduced in 1970s is a major milestone.

Agenda 1 (c): Drivers of Change

- Gradual Decline of Welfare State – more private provision
- Arrival of Mutual Fund and Unit-Linked (Unbundled) Life Insurance Products
- Computer Revolution
- Rise of individualism
- Wider access to many alternative savings vehicles
- Withering of Trusts on Professionals
- Economically more active Governments; Financial Services Act 1986 (UK)
- Decline of Mutual Insurance Companies
- Mis-selling and other high-profile failure of the industry : Newly designed products sold in large numbers were not suitable for the customer – Pension and Endowment Mis-selling in the UK; Equitable life collapse etc.
- Treating Customer Fairly

Agenda 2: Historical Perspective (India)

- The Pre-Liberalisation Period (1938-2000)
- The Post-Liberalisation Period (from 2000)

Agenda 2 (a) Historical Perspective : India (1938-2000)

- India has a fairly long history of life insurance industry, possibly beginning with a company founded in Bombay in 1823. An Indian Life based industry was firmly in place by the last quarter of the Nineteen century.
- The Insurance Act of 1938 is a major landmark. It consolidated, codified and modernised Insurance law and Regulations in India
- The 1938 Act was amended many times since 1938.
- Demand for nationalisation of Insurance business was first made in 1944. There was serious debates on merits and demerits till 19 January 1956 when CD Deshmukh, the Finance Minister rather unexpectedly made the announcement of the nationalisation of Life Insurance Industry. LIC came into existence as an Autonomous Corporation, answerable to the Parliament of India, and a state monopoly. LIC Bill was passed on 19 June 1956 and its first Board Meeting was held on 1 September 1956.

Agenda 2 (a) : Historical Perspective : India (1938 – 2000)

- A. Rajagopalan, the Controller of Insurance (1955) Govt. of India and a Legendary Actuary wrote a comprehensive note to the Govt. of India making the case of Nationalisation. The note highlighted many failures of a rapidly growing industry.
- To appreciate the current turmoil of Life Insurance Industry from a historical perspective, I recommend members to read this note {ref: Thresholds in Indian Insurance – Dharmendra Kumar, MacMillan (2011)}
- An interesting observation made by Mr Rajagopalan: The 1938 Act was based on the recognition that the principle of "Freedom and Publicity" had failed in India. Even after 9 subsequent amendments of the 1938 Act mal-practices continue.

Agenda 2 (a) : LIC Monopoly Period (1956-200)

- LIC is a remarkably successful organisation
- It was subjected to close scrutiny by the Govt. of India, Parliamentary Committees and Expert Committees
- But there was not much Regulation – product or otherwise – that hindered or helped LIC
- The picture changed with the entry of new Private players. LIC is now subject to IRDA Regulation
- After a decade of liberalisation LIC is still, depending on the measure, 75-80% of the Life Insurance Industry in India (2011).

Agenda 2 (a): Is LIC a special Case?

- In some respects, YES and it may remain so in foreseeable future.
- Govt. of India owns LIC. It’s interest as owner is different from the interest of the Regulator (IRDA) who too is answerable to the Govt.
- Govt. needs LIC to generate new savings, retain existing funds, deliver good outcome to policyholders and make profit/surplus.
- LIC is very influential in Indian Stock Market ; Govt. uses such influence for its own goal
- Solvency is not an issue for LIC in India
- LIC has a massive legacy Endowment Business – mostly With Profit
- LIC is almost the sole provider of immediate annuity business and is exposed to longevity and Asset-Liability mis-match risks.
- Govt. will react – sooner or later – if IRDA or other Regulations hurt LIC badly
- Till 1999 LIC was mostly run by Actuaries, now LIC has no Actuary left at Top Management level
- As on today, LIC is poorly represented in the leadership of IAI and in its various technical committees.

Agenda 2 (b) : Historical Perspective India (2000 onwards)

- Mission Statement of IRDA
  - To protect the interest of and secure fair treatment to policyholders
  - To bring about speedy and orderly growth of the insurance industry (including annuity and superannuation payments) for the benefit of the common man, and to provide long term funds for accelerating growth of the economy

And

Five other missions focused on high standards of integrity, financial soundness, speedy claim settlement, fraud prevention, orderly conduct of financial markets, reliable management system, optimum amount of self regulations and action to enforce standards.

Agenda 2 (b) : Historical Perspective India (2000 onwards)

- First Authority set up to regulate the Post liberalization Industry was called Insurance Regulatory Authority (IRA).
- After considerable deliberation, the name and nature of the Authority was changed to the current Insurance Regulatory and Development Authority (IRDA).
- The change was done with a purpose – to put the dual responsibilities of Regulations and Development on the same authority, so that one is not sacrificed for the sake of the other.
- The first two missions of IRDA state these twin objectives.
- The life Insurance Industry will not grow if it is not allowed to design and sell products that are profitable to the company and its stakeholders.
- Fair Treatment to policyholders must be balanced by the requirement of speedy and orderly growth, and generation of long term funds.

Agenda 2 (b) : Historical Perspective : Early Days of Liberalization (2000-2009)

- Large scale expansion by private Insurers
- Massive recruitment of New Agents
- Strong emphasis on Unit Linked Products
  - That too on single Premium products with very little life Cover.
- Unhealthily competition for business and market share; churning of business by lapsation; lapse surplus at the cost of investor; Return of Pre-1956 era?
- Mis-selling ! Mis-selling !! Mis-selling !!!
- Distant Thunder ignored. Did the actuarial profession fail in its public interest obligation?
- Financial Crisis (2008 onwards) and decline of Stock market inflicted large losses to policyholders with Unit linked investments, particularly Single Premium Policies
- Tidal wave of complaints. The industry failed to react
- Stung by criticism, IRDA acts

Agenda 2 (b) : Historical Perspective India : Developments in the recent Past (2009 onwards)

- Newton's third law: Actions will be followed by Reactions
- The focus for the Regulator no longer lies in growth but in punishment and retribution of past sins
- First set of major change to December 2005 UL guidelines were made in 2009, when IRDA mandated a Cap on charges on ULIPs. A massive industry-wide repricing and Cost Control followed
- An outcome of dispute with SEBI was IRDA's revised UL guidelines of 1 September 2010 (the '910' ULIP guidelines)
- New business declined very sharply immediately after '910' ULIP guideline
- The biggest casualty was the individual life UL Pension business. The requirement of providing guarantees led to complete withdrawal of these products
- To re-start the individual pension market IRDA issued a separate guideline governing Pension products, which came with effect from 1 December 2011. But any positive impact of some relaxation on guarantee was neutralized by other new requirements that were very onerous – for example the requirement of compulsory annuity provision on retirement
- Additional guidelines were issued in 2011 on tightening of norms for all forms of insurance intermediation, including agents, corporate agents, referral arrangements and distant marketing . These contributed to a sharp fall in the number of insurance salesmen, causing further decline of New Business

Agenda 3: ED on Product Regulations, 2012

- A list of Topics covered by
  - IRDA ((Linked Insurance Products) Regulations, 2012
  - IRDA (Non-linked Insurance Products), Regulations, 2012

  - **Important**: A set of Revised Exposure Draft was issued by IRDA on 22nd November 2012.
  - This presentation was written before the Revised Draft was issued. Hence some of the comments made may be out-of-date.

Agenda (3a): ED on linked Products:

- 18 Chapters in the ED are listed below to give a general flair of the issues covered.
- Chapter I : Preliminary : includes definitions
- Chapter II : Linked Insurance Products : Section 3
- Chapter III : Benefits payable on Death, Benefits payable under Health cover and Guarantees: Sections 4-5
- Chapter IV : Policy Term, Premium Paying Term and Commission : Sections 6-8
- Chapter V : Discontinuance Terms : Sections 9-19
- Chapter VI : Free Look Period, Surrender Value, Top-up Premium, Partial Withdrawals and Settlement options : Sections 20-24
- Chapter VII : Pension Products : Sections 25-32
- Chapter VIII : Charges and Reduction in Yield : Sections 33-39
- Chapter IX : Group Linked Products : Sections 40-41

Agenda (3a): ED on linked Products:…..Contd

- Chapter X : Computation of Net Asset Value (NAV) for Unit Linked Products : Sections 42-44
- Chapter XI : Administration of Linked Insurance Products : Section 45
- Chapter XII : Miscellaneous Provisions : Sections 46-54
- Chapter XIII : Market Conduct : Sections 55-57
- Chapter XIV : Disclosure Norms : Section 58
- Chapter XV : Advertisement : Section 59
- Chapter XVI : Furnishing of Information : Section 60
- Chapter XVII : Rating of Unit linked Funds : Section 61
- Chapter XVIII : Procedure for implementation and other Provisions : Sections 62-65

Agenda (3b) : ED on Non-Linked Products

14 Chapters in the ED are listed below to give a general flair of the issues covered

- Chapter I: Short title and Commencement: including definition.
- Chapter II : Product Structure : Sections 3-6
- Chapter III : Minimum Death Benefits : Section 7
- Chapter IV : Non-Linked Variable Insurance Products : Section s8-16
- Chapter V : Administration of Insurance Products : Section 17
- Chapter : VI : Policy Term, Premium Paying Term & Commission : Sections 18-20
- Chapter VII : Group Products : Sections 21-25
- Chapter VIII : Surrender Value : Section 26
- Chapter IX : Miscellaneous Provisions : Sections 27-31
- Chapter X : Benefits Disclosure : Section 32
- Chapter XI : ------------------
- Chapter XII : With Profit Fund Management : Sections 33-34
- Chapter XIII : Market Value adjustment : Section 35
- Chapter XIV : Procedure for Implementations and other Provisions

Agenda 4: IAI Submission to IRDA

- A conceptual Note on Product Regulation
- Comments on Linked Products
- Comments on Non-Linked Products

Agenda 4 (a): A Conceptual Note of Product Regulation

The Note is meant to address at a conceptual level, certain issues raised by the draft regulations. In particular;

- The arbitrage between conventional and other forms of savings contract, and how this may be managed.
- The possibility of writing non-participating non-linked conventional endowment assurances;
- The Structure of participating Variable Insurance Plans (VIPs), and in particular, how they may be constructed to optimize both policyholder protection and shareholder returns; and
- Whether a cost-benefit analysis should be conducted to assess the utility of regulatory changes.

Agenda 4 (a) Conventional Endowment Assurances and other Savings Products

- Elimination of lapse surplus due to early lapsation is good for both UL and NL products
- Danger of mis-selling exists for conventional Endowment Products too. If an Annual Premium policy lapses after first Premium, the company may benefit at the cost of the policyholder.
- ED proposes higher guaranteed surrender value after two years. This does not address the mis-selling problem and may be onerous for companies
- In With-Profit (Par) Fund, any lapse surplus remains in the Fund and may be a part of PRE of existing policyholders.
- Asset share as special S. V. is OK for Par fund. But who bears the cost if the guaranteed S. V. is more than the Asset share?
- Should there be a cap on expenses allocated to asset shares to a similar extent to those of UL business?
- The concept of a proxy asset share for Non-Par has been insufficiently defined.

Agenda 4 (a) Non-Par Non-Linked Conventional Endowment

- Non-Par Endowments, that benchmark their benefits to an index, could be considered as both linked and Non-linked – a paradox that needs clarification.
- The concept of a proxy asset share does not fit into the structure of traditional Non-Par products in market.
- Two ways of dealing with poor persistency – Regulations of the quality of the Sale and Regulations of Products – have not been used consistently between UL and Traditional Non-Linked Products.

Agenda 4 (a): Non-Linked Participating VIPs

- ED proposes to allow companies to write participating VIPs (known as Accumulating with profit in the UK)
- We suggest that these contracts be allowed to be written in a Non-Par Fund; which will benefit both the policyholders and the Company

Agenda 4 (a) : Cost –benefit Analysis (CBA)

- Frequent changes of Regulations, including Product Regulations, costs the industry considerable amount of money and resources to implement.
- IRDA should provide cost – benefit analysis with every change of Regulation.
- Any benefit should be demonstratively commensurate with the cost.
- This is done by FSA in the UK

Agenda 4 (b) : Comments on Linked Product

- 38 Comments were made on different Sections of the ED on Linked Products. The major ones are highlighted
- Chapter II Section 3 (a) (i) on Minimum Death Benefit of SA **plus** FV should be replaced by SA **or** FV
- Section 3 (d) : 4 comments seeking clarity on VIPs.
- Chapter III Section 4 (h) on Death Benefit underpin of 105% of Premiums : IAI recommended withdrawal of this underpin from at least Pension and Health Products
- Section 5 (b) : Guarantee charge on VIP : Companies should be allowed to levy a guarantee charge
- Chapter IV Section 8 (a) on Commission Cap : Should be removed, as there is already a Cap on Reduction in Yield (RIY)
- Section 8 (d) : Direct Marketing : The requirement of Commission Savings to be passed on to the policyholder by a premium discount should be removed, to avoid channel conflict
- Chapter V Section 12 (a) (vi) on Discontinuance charges : Absolute Rupee Amount Caps should be removed
- Section 18 (b) Minimum interest rate on Discontinued Polices: the proposal to credit in force policyholders any excess returns earned over 2% on the discontinued Policy fund should be withdrawn.

Agenda 4 (b) : Comments on Linked Product…….Contd

- Chapter VI : Section 22 on Top-up Premium : 22 (e) disallowing top-up in the last five years of the contract should be removed ; 22 (f) Caps on Top-up Premium should be removed
- Chapter VII: Section 25 © on Cap on Riders : 15 % cap should be increased.
- Section 27 (c) on Age Restrictions on Pension Product should be removed
- Section 31 (a) on Assured Benefits for DB Scheme clause should be removed
- Chapter VIII Section 37 on RIY at Maturity : Should be removed
- Chapter XII Section 53 on UL Health Insurance Products : Surrender value requirement when applied to Health insurance may compromise Tax treatment for the policy.
- Chapter XVIII Section 62 (a) on implementation date: Recommend deferment to 30 Sept 2013 instead of 31st March 2013.
- Section 62 (d) on Group Products : New members should be allowed to be added on to an existing Scheme

4 (c) : Comments on Non-Linked Products

36 Comments were made on different Sections of Non –Linked Product ED. The major ones are highlighted below.

- A couple of comments on definitions in Chapter I
- Chapter II Section 5 (a): Prohibiting benefits linked to any index under Non-par structure should be removed.
- Chapter III Section 7 : Minimum Death Benefit : Minimum Benefit SA of 105% of all Premium as on date of death will make policies more expensive and cause other difficulties for Life and Health Products
- Chapter IV: Sections 8-16 Non-Linked Variable Insurance Product (VIPs) : A few clarifications were sought on ED proposals. IAI recommends that companies be allowed to write a participating VIP under Non-Par Fund. To allow flexibility of declaring bonus in arrears or in advance. Hypothecation of assets and NAV for each product separately is unnecessarily cumbersome with no benefits to the policyholders
- Chapter V Section 17: Administration of Insurance Products: Responsibilities for certifying systems readiness should reside with the CEO instead of Board of the delegated Risk Committee. Requirement of development of <u>all</u> the system <u>at the outset</u> is not the optimal way to manage the IT system

4 (c) : Comments on Non-Linked Products…..Contd

- Chapter VI: Policy Term, Premium Paying Terms & Commission (Sections18-20). The Section 20 (f) requiring the AA to demonstrate the premium rate for each distribution channel arrived at independently and together should be removed. The Company should be allowed the flexibility to provide cross-subsidy among channels.
- Chapter VII: Group Product: Sections 21-25 : 9 comments / suggestions were made for these Products.
- Chanpter VIII: Surrender Value : Section 26: The guaranteed S.V. will be onerous to the company, can compromise investment strategy which will be harmful to continuing policyholder and does not provide much protection against mis-selling. The concept of proxy asset share is not adequately defined and developed.
- Chapter X: Benefit disclosure Section 32 (d): RIY for Non-Linked Product should be done using gross 10% as in Linked Products. RIY can be a nebulous concept for Par business.
- Chapter XII on With Profit Fund Management: This is a large Topic in itself and should be covered by its own dedicated Regulation
- Chapter XIV on Implementations: Same comments on implementation date and allowing new member to an existing group Scheme as in Linked Products Regulation.
- Section 40: Review of the guidelines: The basis of any review of the guidelines should not solely be Protection of Policy-holders; it should be extended to concern about the shareholders interest too.
- For a healthy insurance industry, the shareholders should be able to generate an appropriate profit on Capital invested, on a risk adjusted basis.

Agenda 5: What Next ?

A few comments and reactions:

A few comments, most of which are from senior members of the profession:

- In the last 2/3 years these (the discontinued fund and other) Regulations have changed at least 3 times. The time and cost involved in implementing these changes is huge for an organization like LIC where policy bonds and stationery are printed in bulk, costing crores of rupees and the change makes existing stocks useless. And the IT also finds it difficult to make such frequent changes.
- The option of extending term for Non-Linked Pension Products – specially after age 55 – will be difficult to implement, particularly because IRDA regulation says that during the extended term policy should continue paying the same premium.
- Expense Caps in money amount and without inflation protection is not appropriate
- We have not paid enough attention to the broader issue of the cost and business disruption burden of quick, often piecemeal and successive wave of regulatory changes being brought in by IRDA and the implications of these changes vis-a-vis the benefit to the policyholder.
- The term products may get affected by the proposed regulations on Re-Insurance.
- These regulations (including Reinsurance regulations) do not provide any encouragement for annuity product development.

Agenda 5: What Next ? (Contd..)

- On the traditional policies, while a regulation around the surrender values has some merit, the question is whether we need to revamp the entire with-profit portfolio just because the life cover is say 9.5. times the annual premium instead of 10 that the IRDA sees as the minimum or because life cover falls just short of 105% of the total Premium paid in the last two years of a 20 year term.
- (If we fail to influence IRDA, there would be) a turbulence period when companies would hardly have any product to sell for an extended period, given IRDA's recent track record of product approval.
- Participting Endowment products are popular because they are well established in Indian market and are simple to understand. A policyholder will get a promised sum Assured and the upside of declared bonus if he/she continues. The proposed change in death benefit structure and other changes will make the product difficult to understand and damage the attractions of the product.
- Guaranteed and Special Surrender values are to be considered together. Asset share as special S. V. is fine for Par Products. But if the actual S. V. paid (if guarantee bites) is more than the Asset Share, who will bear the Cost?
- The proxy asset shares concept for Non-Par policies cannot be supported. For Non-Par Products, the insurer take all risks and so should take all profits.

Agenda 5: What Next ? (Contd..)

- Unable to understand how illustration or RIY can be done for Par Products. The regulation talks about illustration at 10% and 6%. But interest rate is not the only factor. There are mortality, expenses and lapse profit. How to allow for these? And surplus distribution is discretionary and the company in future may pay anything between 0% to 100% of the surplus to the policyholder (subject to 90: 10 rule)
- Very prescriptive micro-level product regulation is not the way to deal with mis-selling. Market Conduct Regulations and better implementations of existing Regulations are the way forward.
- Any commission related regulation does not recognize the reality of "rebating" practice. Rebates though illegal, are still fairly widespread.

A few Important Questions:

- Are the actuaries working/advising IRDA in a position to share with the profession the actuarial investigations and modelling they do in support of their advice to IRDA?
- Should there be more formal and informal interactions with IRDA and IAI at the drafting stage of such regulations?

Agenda 5 : What next ?
The country needs FDI:

A. Lesson from Telecom Sector (Source : Times of India 15 Nov 2012)

- Spectrum Auction flops. Kapil Sibal, Telecom Minister blames Telecom Regulatory Authority.
- "Consumer has not benefited at all because the nature and the kind of investments that ought to have gone with the Sector have stopped and the Sector has been in debt" – Kapil Sibal
- "We are looking forward to a more predictable and Stable Regulatory Environment" – Jon Fredrik Baksaas (Telenor Group President and CEO)

B. Similar seems to be the story even in unregulated Aviation Sector. Other stakeholders make profit while Airlines shareholders bleed.

C. Life Insurance Sector in India is one of least profitable markets amongst the Asia Pacific Countries.

Agenda 5 : What next ?
The country needs FDI: continued….

- Will it be able to attract new capital - foreign or domestic, if shareholder sentiment remain depressed? Will IPO succeed with current state of pessimism?
- It is now time to reassure the shareholders too.

Agenda 5 : What next ? How to Change the Tide ?
A few ideas to consider:

- The industry and the profession should own up past errors and set their house in order. Public and the media are still very sore about widespread mis-selling of unit linked investment products.
- Introduce industry wide high quality Self-regulation in exchange of less prescriptive IRDA regulation.
- Treating Customer Fairly should be at the heart of industry practice.
- Define Target market for every product, based on risks and risk tolerance and monitor whether products are reaching wrong market. Take preventive actions proactively.
- Highlight IRDA's Mission Statement 2. The shareholders of Private Insurers are disillusioned, the Life Industry needs fresh Capital injunction. Growth must come back, for the sake of India's long term Investment requirements.
- We need more predictable and stable Regulatory Environment.

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Questions