

# 40th India Fellowship Seminar

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## Initial Public Offering (IPO) of a Life Insurer

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# Guide Introduction- Abhishek Chadha, FIA



- Abhishek is a Partner at Willis Towers Watson Actuarial Advisory LLP.
- He has experience of over 16 years providing advisory services to life insurance companies across the globe.
- Abhishek has been involved in several embedded value related projects, including those for the purpose of an IPO.
- He also has experience in several other areas such as statutory valuations, APS 4 peer review, risk-based capital assessment, IFRS 17 implementation etc.

# Case Study - IPO of a Life Insurer

## Background

- You are the Shareholder Reporting Actuary of a large Indian life insurance company that is considering a stock market listing through Initial Public Offering (IPO).
- The Company has been operating for many years and has a large participating business as well as a mid-size unit-linked business. Non-participating business (both savings and protection) is negligible. In recent years, the Company's Annualised Premium Equivalent (APE) growth has been around 10% p.a.
- The other listed insurers in the market have a more balanced portfolio including participating, unit-linked and non-participating (both savings and protection) businesses. Most of these listed insurers -
  - Have had their historical Annualised Premium Earnings (APE) growth at around 15% p.a.;
  - Have their recently disclosed new business margins (NBMs) at approximately 20% - 25% level; and
  - Are currently trading at roughly 2.5X - 3X their disclosed Indian Embedded Value (IEV).

# Case Study - IPO of a Life Insurer

## Questions

1. What are the key regulatory and professional requirements that need to be fulfilled by the Company for seeking an IPO? ➡
2. The Investment Bankers on the IPO have estimated that the likely range of valuation for your Company may be approximately 1.5X - 2X the IEV developed by you. Your senior management is surprised about the low expected valuation as compared to the range of traded IEV multiples in the market. Discuss the possible reasons for the low valuation multiple as compared to other listed insurers. ➡
3. How would you advise the management in order to be prepared for a 'post-listing' scenario in following areas - ➡
  - Internal 'cultural' changes
  - Systems
  - Regular disclosures and scrutiny by external investors

# Regulatory Requirements

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## Regulatory Requirement at different points

### Pre-IPO

- Various IRDAI regulations for regulatory requirements.
- Various APS applicable to the company.

### Additional regulation applicable during IPO

- IRDAI (Issuance of Capital for insurers transaction Life insurance business), 2015
- APS10 - Calculation of Embedded Value
- SEBI (Issue of Capital & Disclosure Requirements), 2018

### Additional regulation applicable Post-IPO

- IRDAI (Listed Indian Insurance Companies) Guidelines, 2016
- SEBI (Prohibition of Insider Trading) Regulations, 2015
- Securities Contract Act, 1956
- And more

# IRDAI (Issuance of Capital for insurers transacting Life Insurance Business), 2015

- Approval of IRDAI before applying under ICDR to SEBI
- Requirements & Considerations
  - Financial Position of the Company
  - Period of operation
  - History of Compliance
  - Maintenance of required solvency margin in preceding 6 quarters
  - Compliance with other rules & regulations like Indian owned, Corporate Governance Guidelines, Policyholder protection.
  - Embedded Value prepared by Independent Actuary as per APS10.
- If IRDAI is satisfied, approval is received, & may prescribe:
  - Extent of Promoters & Investors dilution
  - Lock-in period for promoters post issue
  - Additional Disclosures in the prospectus
  - Modification to AoA explicitly stating that no transfer beyond the limit as approved by authority shall be made

# IRDAI (Issuance of Capital for insurers transacting Life Insurance Business), 2015



## Additional disclosures required for DRHP

- Risk factors specific to the company
- Overview of the Insurance Industry
- Disclosure of Financial Statements
- Glossary of Terms used in the insurance sector
- Particulars of the issue
- Particulars about the issuer
- Legal & Other information

# APS10 - Determination of Embedded Value

## Various considerations as part of APS10

- Prepared by an Independent Actuary and Peer Reviewed by another Independent Actuary
- Various considerations for the Independent Actuary
- Source of data and various considerations
- Assumptions for calculation of IEV
- Methodology to be used for IEV calculation (Free Surplus + Required Capital + VIF)
- Market consistent Valuation
- Written report to the BoD from the Actuary
- Disclosures as per APS10



# APS10 - Determination of Embedded Value



## Example of Minimum Disclosures

- Components of EV
- Analysis of Movements of IEV
- Assumptions
- Methodology adopted
- Sensitivities

## IEV AOM structure

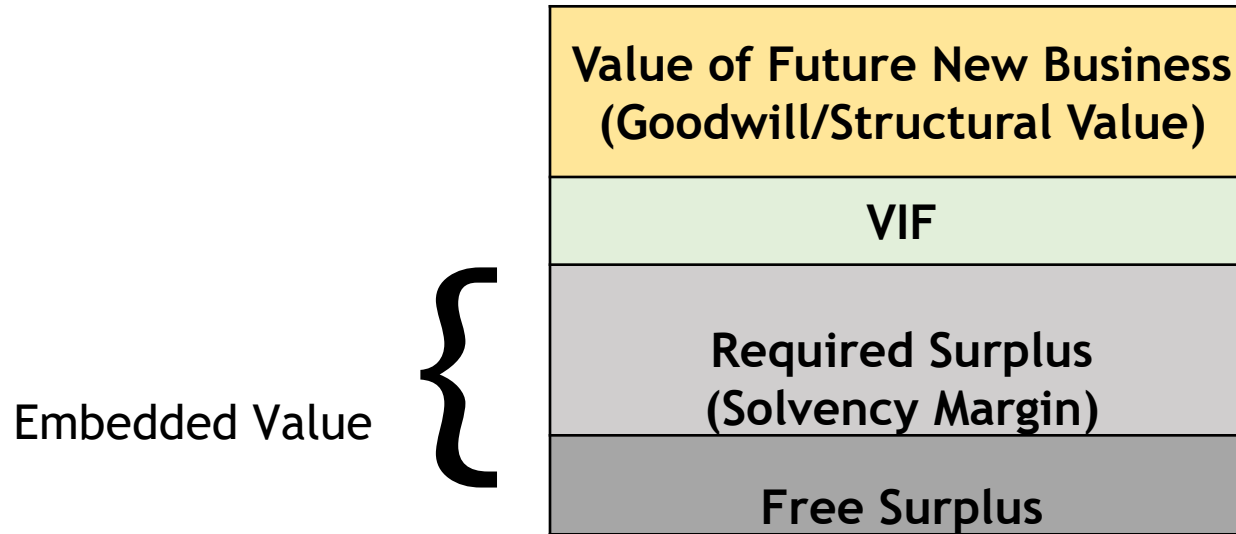
|  | Free Surplus | Required Capital (RC) | Value of In-Force (VIF) | Embedded Value |
|--|--------------|-----------------------|-------------------------|----------------|
| <b>Opening EV</b>  |              |                       |                         |                |
| Opening Adjustments  |              |                       |                         |                |
| <b>Adjusted opening EV</b>   |              |                       |                         |                |
| Value added by new business during the period  |              |                       |                         |                |
| Expected return on existing business   |              |                       |                         |                |
| Transfers from VIF and RC to Free Surplus  |              |                       |                         |                |
| Variance in operating experience split by major components including mortality / morbidity, policy persistency, etc. |              |                       |                         |                |
| Change in operating assumptions  |              |                       |                         |                |
| Other operating variance   |              |                       |                         |                |
| <b>EV operating earnings</b>   |              |                       |                         |                |
| Economic variances   |              |                       |                         |                |
| Other non operating variances  |              |                       |                         |                |
| <b>Total EV earnings</b>   |              |                       |                         |                |
| Capital contributions / dividend payouts   |              |                       |                         |                |
| Closing adjustments  |              |                       |                         |                |
| <b>Closing EV</b>  |              |                       |                         |                |

# SEBI (Issue of Capital & Disclosure Requirements), 2018

- Various types of securities covered
- Comprehensive disclosures requirements
- Various listing obligations
- Minimum promoter contribution and lock-in requirements
- Guidelines for Issue Process & Pricing
- Regulation of Intermediaries
- Redressal mechanism and Investor Protection

# Valuation of a Life Insurance Company

Value of a life insurance company can be assumed to consist of the following main components:



- Value of future new business is usually determined based on the value of one year's new business with the application of a capitalization factor.
- However, it can also be directly derived by projecting several years' future new business.

# Key Issues for Investors in determining the Structural Value

What growth rate of future new business to be assumed?

What is the expected profitability of the new business?

Key Issues for Investors in determining the Structural Value

Which is the “typical” year of new business to be considered?

What capitalization factor should be used?

# Participating & Unit Linked Business



## Reasons for lower Profitability:

### Participating Business:

- 90:10 gate limits the profitability of participating products
  - Investment surplus is shared in that proportion
  - Surrender profits belong to the fund and shared in the same ratio
  - Similarly for mortality and expense surpluses
- However, 100% of the deficit is to be made good by shareholders and repatriation from future surplus is not permitted

### Unit-Linked Business:

- Commissions and distribution expenses are largely front-loaded
- Regulations require the charges during the lock-in period to be spread out in an even manner, such that the difference between minimum and maximum charge during the first five years is not more than 50%.
- Limit on surrender charges is rather stringent
- Poor persistency experience, attributable to a variety of reasons - distribution mis-selling in the previous equity bull market, short term outlook of the customers

# Non-Participating Savings & Protection Business



## Reasons for higher Profitability:

- Premiums and benefits (death, surrender and maturity) are guaranteed at the outset. There are no discretionary benefits.
- 100% of the surplus belongs to Shareholders in Non-Par Fund:  
Investment Surplus, Surrender values are generally lower than asset shares,  
Mortality Surplus & Expense gains
- Companies might be pricing the products at higher margin due to higher risk and in-built guarantees.
- Derivatives like FRA may help limit interest-rate risk and may lead to higher MCVNB.
- Protection products are priced Lapse-supportive, higher margins since no surrender value is payable
- Favourable Reinsurance rates may lead to higher margins as well
- Higher loading for Profits due to higher risk involved

# Reasons for Low Valuation



| Internal Factors                            | External Factors                    |
|---|-------------------------------------|
| Insurer's business plan and premium targets | Expected GDP growth                 |
| New Business Margins                        | Insurance Penetration levels        |
| Proportion of VNB by IEV                    | Timing of IPO                       |
| Maintenance of Single/Segregated Fund       | Change in IRDA Regulations          |
| Distribution channels                       | Change in Taxation norms            |
| Level of Persistency & Expenses             | Financial condition of Promoter co. |
| Past Experience & Assumptions used          | Government intervention             |
| AUM   |                                     |
| Investment Performance                      |                                     |
| Level of Guarantees offered in the products |                                     |
| Profits from the Insurer's back book        |                                     |
| Economic Value of the company               |                                     |

# Advice on Post Listing Scenario



## What Changes?

- Additional Regulator - SEBI
- Reporting structure and timeline
- Exponentially higher disclosures for exchange
- Investor/analyst calls
- Media scrutiny
- Market, investor, and analyst expectations



# Advice on Post Listing Scenario



## Systems

- What matters
  - Efficiency
  - Agility

## Impact on

- Financial Reporting Systems
- Investor Relations Committee
- Grievance Redressal Mechanism
- Vigil Mechanism
- Compliance and Governance Systems
- Internal Controls and Auditing
- Related party transactions policy
- Employee Training and Insider Trading
- Dividend Distribution
- Public Relations Systems
- Website

# Advice on Post Listing Scenario

## Regular disclosures and scrutiny by external investors

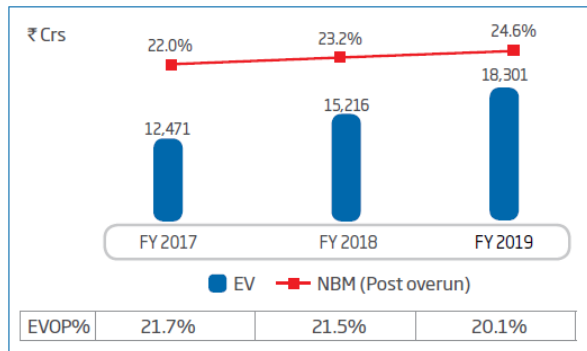
- Some of the important regulations and guidelines applicable Post-IPO
  - IRDAI (Listed Indian Insurance Companies) Guidelines, 2016
  - SEBI (Prohibition of Insider Trading) Regulations, 2015
  - Securities Contract Act, 1956
  - SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
- Exponentially higher disclosures for exchanges
- Investor Relations Team
- More detailed Annual reports plus Quarterly Reporting
- Investor/analyst calls - Quarterly
- Media scrutiny/communication

# Advice on Post Listing Scenario

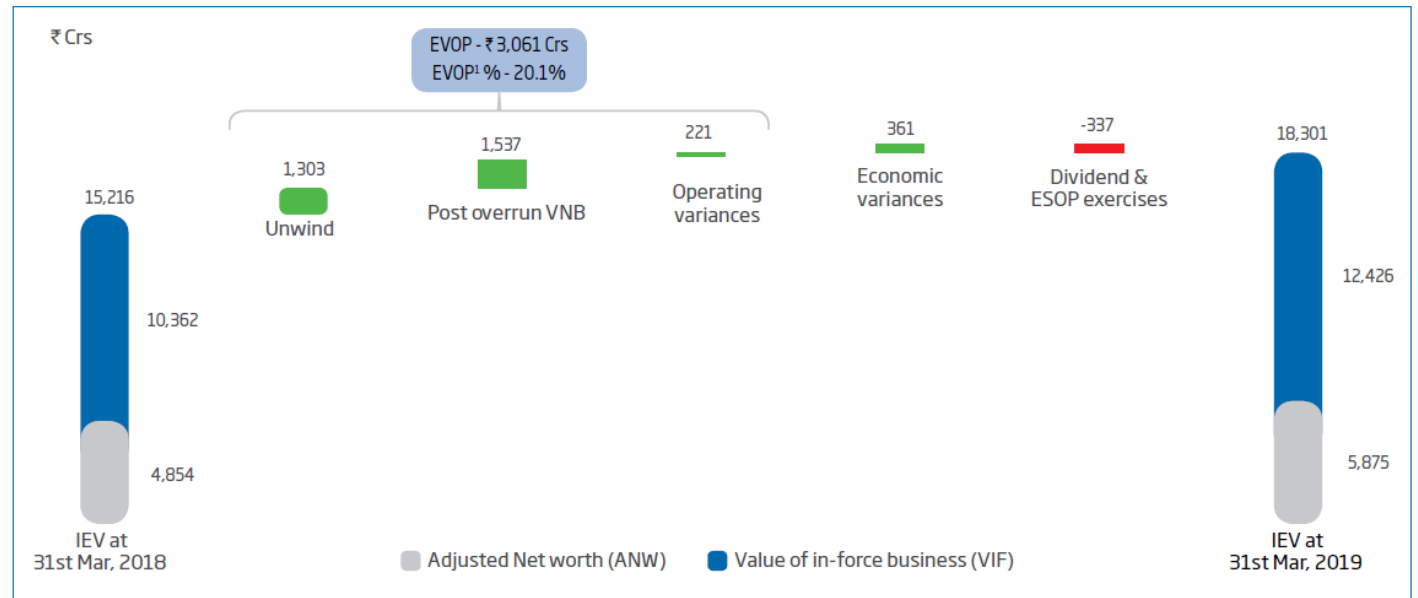
## Actuarial Perspective during investor calls

- KPIs
- How it all adds up/ties up
- Competition
- Markets trends/Macros

- Analysis of change in EV



Note: Operating return on EV is calculated as EVOP (Embedded Value Operating Profit) to Opening EV



Source - [www.hdfclife.com](http://www.hdfclife.com)

# Advice on Post Listing Scenario

## Internal Cultural Changes

- Impact on company's strategy
  - Share price
  - Investor confidence
  - Competition
- Proactiveness
- Speed of communication
- Timelines
- Confidentiality
- Conduct by employees
- Collaboration between teams/department
- Attitude towards ESG

**Thank you!**

