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Life Professional Case Study
Credit Life Repricing

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Agenda

- Case Study - Background
- Review of Pricing
- Duties, Responsibilities & Professional Requirements for Appointed Actuary
- Governance framework
- Conclusion

Case Study - Background

Case Study – Background (1/2)

- You joined as Appointed Actuary at Jeevan Beema Co Ltd in India.
- You have been asked to reprice/refile the credit life product with the Product Management Committee ("PMC") since reinsurance rates have gone up by 50%.
- You found that claims are pretty low and stands less than 60% of the revised reinsurer rates. The historical claim cost as % of current premium rates stand @10% of the single premium.
- On further enquiry, you found out that commission paid on this product is as high as 75-85 % of single premium depending on various other factors.
- You raised the principle of "treating customer fairly" with the CRO/CFO and CEO. You were told that business is done this way only and everyone else is doing the same.

Case Study – Background (2/2)

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- If you do not support then this business which is 20% of your top line would be lost to competitors. The company can not afford to lose this business as it supports significant part of fixed expenses.
- You have been given the previous File & Use where claims cost of 70% has been justified and been asked to use the same principle.
- You also came to know that previous AA resigned because she did not want to follow the company's directive.
- What should you be doing?

Review of Pricing

Regulatory Guidance on Assumptions

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- Clause 20.3 of Use & File circular requires that
  - ✓ premium rates/charges, benefit structure, terms and conditions are workable and sound
  - ✓ premium rates/charges are fair and appropriately reflect benefits and terms & conditions of the product
  - ✓ the underlying assumptions are reasonable
- Clause 20.6 states that pricing basis should be line with the insurer's own experience, to the extent applicable
- Clause 20.10 - Financially viable at the portfolio level
- Clause 20.11 - Reasonable profit margin

Considerations for Claims Costs

- Assumptions to be set in view of actual claims experience as well as the expected future claims experience
- Given:
  - ✓ historical claims experience is 10% of current single premium.
  - ✓ claims cost considered while pricing the product is 70%, we have assumed this to be % of single premium
  - ✓ Assumed that the basis for computing 10% and 70% are the same
- Evaluate the reasons for the difference in pricing and actual
  - ✓ Difference in actual and expected business mix, target market, UW practices
  - ✓ claims experience is still emerging or it has completely emerged
  - ✓ should also incorporate recent trends, IBNR claims pattern
  - ✓ Check if justification of 70% claim cost comply with latest regulations
- If current experience is expected to continue in future, then the current mortality assumption is not reasonable and should be brought down

Considerations for Expenses

- Given:
  - ✓ commission paid is as high as 75%-85% of single premium
  - ✓ assumed that commission includes remuneration in line with IRDAI (Payment of Commission) Regulations, 2023
  - ✓ no mention of other overheads incurred
- Company should evaluate:
  - ✓ what % of business written falls within such high commission range
  - ✓ check if such high commissions are a market norm; whether competitors are also paying such high commissions to their distribution partners
  - ✓ commission should be in accordance with board approved commission policy
- Actual average commission including overheads should be considered for pricing provided it is as per Board approved policy and compliant to EOM regulations
- Evaluate cost reduction strategies (For e.g. Use of technology, increase in business sourced from captive agents)

Consideration for Reinsurance Rates (1/2)

- Given:
  - ✓ reinsurance rates have gone up by 50%
  - ✓ Claim experience is 60% of revised reinsurance rates
- Evaluate reasons why reinsurer has increased rates
  - ✓ claims experience do not meet the expenses/profit margins of the reinsurer
  - ✓ retention limits might be lower so reinsurer wants to align experience with the retention limits
  - ✓ claims experience of major master policyholder is poor so worsening the experience of entire portfolio
  - ✓ poor experience of past and expectation of future experience
  - ✓ overall experience of the reinsurer and the market outlook of the product has changed so need to increase rates

Consideration for Reinsurance Rates (2/2)

- Negotiate with Reinsurer
  - ✓ To decrease rates
  - ✓ Risk management practices – address issues in the practices identified by reinsurer and make changes in the new product
  - ✓ Market outlook – make changes in the product basis reinsurer's outlook
  - ✓ Use of technology – use of AI/ Predictive analysis tools, digital processes to help assess risk better and faster; thus improve experience and hence reduce rates
- Others
  - ✓ Get quote from another reinsurer
  - ✓ Consider sharing of risk with two reinsurer / facultative arrangement
  - ✓ Relook at reinsurance arrangement after considering risk appetite, capital and solvency requirements.

Alternatives to Increase Profitability

- Introduce options which are attractive to the policyholders
  - ✓ critical illness cover,
  - ✓ offering moratorium period benefits, etc.

- Benefits of introducing options:
  - ✓ increase in premium due to different options
  - ✓ Company can then negotiate lower commission rates such that overall commission paid remains same on absolute basis
  - ✓ This will increase the profit margin of the product

Miscellaneous Considerations

Other important factors to be considered for product design/pricing –

- Premium and Commission Rates Offered by the Competitors
- Customer Needs and Demand
- Impact on Financing/Capital Requirements
- Sensitivity Analysis of Assumptions
- Current and Expected Business Mix
- Company's Overall Short-Term & Long-Term Business Strategy
- Can make arrangements to recover commission/remuneration when experience is poor

Duties, Responsibilities & Professional Requirements for Appointed Actuary

APS 1 (1/3)

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- Clause 2: Nature of responsibility of Appointed Actuary (AA)
  - ✓ monitor solvency, profitability of the product (Sub-Clause 2.1)
  - ✓ premium rates to be fair and reasonable taking into account PRE (Sub-Clause 2.2)

- Extract from APS 1:
  - ✓ Sub-Clause 2.1: Central to the financial soundness of the insurer
  - ✓ Sub-Clause 2.2: Ensure (within his/her authority) that insurer's business is conducted on sound financial lines and that he/she has regard to Policyholders' Reasonable Expectations (PRE)
  - ✓ Sub-Clause 2.3: Maintain the highest professional standards envisaged by the IAI and seek help and advice from IAI when doubtful as to the proper course to adopt in relation to a potentially significant matter

APS 1 (2/3)

- Clause 4.2: The Appointed Actuary has a continuing responsibility to look after the reasonable expectations of the company's policyholders, having regard to;

  i. the broad nature of the company, and

  ii. its approach to the treatment of policyholders both individual and as a group vis-à vis shareholders.

- If a significant change is likely, the Appointed Actuary must make sure that the company appreciates the implications of this on its policyholders reasonable expectations.

APS 1 (3/3)

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- Clause 4.3: The Appointed Actuary must take all reasonable steps to ensure that new policyholders are not misled with regard to their expectations.
- Clause 4.4: The Appointed Actuary must ensure that his or her conduct and reach and depth of his or her functionalities enable him or her to discharge his or her duties and obligations in letter and sprit in accordance with regulation (8) of AA Regulations.
- Regulation (8) of AA Regulations specifies the duties & obligations of the AA.

Appointed Actuary Regulations

- Regulation 8: Duties & Obligations of AA

  ✓ Clause (ii): Actuarial advice to the management in the areas such as product design & pricing and reinsurance

  ✓ Clause (xii c): Actuarial advice in respect of expenses of management

  ✓ Clause (xii d): Ensuring that the premium rates of the insurance products are fair

  ✓ Clause (xii g): Actuarial advice in the interests of the insurance industry and the policyholders

Fairness of Premium Rates

The relevant requirements for assessing the fairness of premium rates:

- Premium rates should appropriately reflect benefits and terms & conditions of the product with reasonable underlying assumptions. (Clause 20.3 of U&F Circular)

- Premium rates should be equitable between policies sold through different distribution channels. (Clause 20.8 of U&F Circular)

- Product should be financially viable at portfolio level and insurer's profit margin should be reasonable. (Clause 20.10 & 20.11 of U&F Circular)

Professional Conduct Standards (Ver 4.0) (1/2)

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- Clause 1.3: A member who has any doubt about the interpretation or application of any professional guidance should –
  - ✓ First seek advice from actuary who has relevant experience in the matter, and
  - ✓ If this approach is inappropriate or if member still has any residual doubts about the course of action to be taken, he/she must seek guidance from the professional body.
- Clause 1.4: A member must avoid arrangements which inhibit the members ability to conform to the standards of behavior, integrity, competence, and professional judgement which other members or the public might reasonably expect of a member (including but not limited to the requirements of professional guidance).
- Clause 2.1: An actuary has an obligation to serve the public interest by–
  - ✓ Informed contribution to debate on matters of public interest, and
  - ✓ Influencing those with power to protect and enhance the public interest.

Professional Conduct Standards (Ver 4.0) (2/2)

- Clause 4.1: An actuary is expected to use best judgement in formulating advice and must have proper regard to any relevant professional guidance or other guidance.
  - ✓ The AA should ensure compliance with relevant regulations (Product regulations, U&F circular, APS etc.).
  - ✓ The AA should use best judgement in providing his advice regarding the pricing of the product.

- Communication with previous Appointed Actuary
  - ✓ As per clause 7.2, while accepting the role of an AA, the actuary should communicate with the previous AA to ask if she is aware of any professional reasons to be considered in accepting the appointment.
  - ✓ In the given case, we have assumed that there has been communication with the previous AA to understand the rationale for previous pricing assumptions

Governance Framework

Payment of Commission Regulations

- Clause 4 of IRDAI (Payment of Commission) Regulations, 2023: Board Approved Policy for Payment of Commission
- Policy should consider -
  - ✓ Interest of the policyholders;
  - ✓ Interest of the Insurance agent, Intermediary or Insurance intermediary;
  - ✓ Enhances the performance of the Insurance agent, Intermediary or Insurance intermediary;
  - ✓ Increases insurance penetration and density in the country;
  - ✓ Commensurate with its business strategy;
  - ✓ Brings cost efficiencies in the conduct of business and simplification of the administration;
  - ✓ Nature and tenure of the insurance policy;

Expenses of Management Regulations (1/2)

- Clause 16 states that
  - ✓ in case of Non-participating (including Linked) policies, the Insurers shall ensure that their expenses of management are within the allowable limits on an overall basis.
  - ✓ Where an insurer has exceeded the limits of expenses of management on overall basis for Non-participating (including Linked) policies, the excess of such expenses shall be charged to Profit & Loss Account
- Hence, it should be ensured that expenses for non-participating portfolio is within EOM limits
- We are given that this product contributes to 20% of the Company’s topline.

Expenses of Management Regulations (2/2)

- In case of breach of prescribed EOM limits, the insurer may be subject to following restrictions put in place by the Authority –
  - ✓ Excess of actual expenses over EOM limits charged to P&L A/c (i.e. borne by the shareholders)
  - ✓ Restriction on performance incentives to MD/CEO/Whole-Time Director (WTD) and Key Management Persons (KMPs)
  - ✓ Removal of Managerial Personnel and/ or appointment of Administrator
  - ✓ Restrictions on underwriting new business in one or more segments
  - ✓ Restrictions on opening of new places of business
  - ✓ Cause a valuation of the insurer to evaluate its financial soundness
  - ✓ Administer a warning to the insurer
  - ✓ Penal action under section 102 of the Act.

Use & File Circular (1/3)

- Clause 5.1 - Every Life Insurer shall have a Board Approved Product Management & Pricing Policy (BAPMPP)
- Clause 5.2 - The Board of insurer shall constitute a Product Management Committee (PMC), which shall have AA, CRO, CMO/CDO, CTO and CCO of the insurer as members
- Clause 6 - The PMC shall review and approve the products/riders in line with BAPMPP before filing with the Authority under Use & File procedure
- Clause 8 - The CEO of the insurer shall have an overall responsibility for ensuring that a robust due diligence process is in place to mitigate risks arising from the products
- The AA should ensure that the product pricing confirms with the BAPMPP
- Above clauses put the responsibility on various KMPs constituting the PMC to review and approve the products and ensure compliance with BAPMPP

Use & File Circular (2/3)

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- Clause 7: The PMC shall carry out a due diligence process and record its concurrence/sign off on various product related risks (such as risks related to capital requirements, profitability, underwriting, reinsurance etc.) to ensure
  - ✓ proper product design,
  - ✓ appropriate pricing, and
  - ✓ filing with the Authority with complete compliance of regulatory requirements.
- Certification I - Compliance relating to various provisions of the circular pertaining to pricing and other elements – Signed off by AA & CEO
- Certification II – Compliance to U&F circular – Signed off by Chairperson of PMC, AA and CEO

Use & File Circular (3/3)

- Clause 22.2: Regulatory Actions. The Authority may
  - ✓ at any time, examine any documents filed by an insurer and/or the products/riders it offers for sale in the market
  - ✓ initiate action against the signatories of the certificate, the members of the PMC, and the insurer, jointly and/or severally, under the applicable provisions of the Insurance Act, 1938 or any other applicable legal / regulatory provision if any violation of extant norms is noted
- Clause 22.3: Regulatory Actions
  - ✓ The Authority may also:
    - ➢ Direct the insurer to withdraw the product / rider
    - ➢ Withdraw the Use & File facility for products / riders for such period as may be determined

Conclusion

Our Approach as AA

- Communicate with Senior Management
  - ✓ Pricing approach - Assumptions to be in line with experience
  - ✓ Mortality assumption should be brought in line with current and expected future experience
  - ✓ Commission to be aligned with actuals, fairness and reasonability to be ensured along with compliance with board policy and EOM regulations
  - ✓ Negotiate with reinsurer for reduction in rates
  - ✓ Company may also increase target profit margin to have buffer in case of future adverse mortality experience. However, it should be reasonable
  - ✓ Pricing to be revised based on the updated assumptions and taking into account the revised reinsurer rates

Our Approach as AA

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- Communicate with Senior Management
  - ✓ Responsibilities of overall management – Compliance with various regulations like Use & File circular, EOM and payment of commission regulations and respective Board approved policies
  - ✓ Implications – In case of non compliance, regulatory implications like closure of product, withdrawal of U&F facility, no performance pay and in extreme cases removal of managerial personnel. There could also be reputational issues that can impact brand value of the company
  - ✓ Alternatives
    - ➢ Include new features like CI to increase price and absorb higher cost
    - ➢ Implement overall cost reduction strategies

Questions

Thank You

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