

INSTITUTE OF ACTUARIES OF INDIA

SA2-Life Insurance

November 2025 Examination

Indicative Solution

INDICATIVE SOLUTION

The indicative solution has been written by the Examiners with the aim of helping candidates. The solutions given are only indicative. It is realized that there could be other points as valid answers and examiner have given credit for any alternative approach or interpretation which they consider to be reasonable.

Solution 1:

i)

1. Ownership and Control:

Raising subordinated debt enables the company to access additional capital without any change in ownership structure or voting rights. In comparison, raising capital through equity may lead to dilution of existing shareholders' holdings **only if** new investors are brought in or existing shareholders do not participate proportionately. However, if the equity is subscribed entirely by existing shareholders in line with their current shareholding pattern, dilution does not occur, and ownership control remains unchanged.

2. Cost of Capital:

Subordinated debt generally entails a lower post-tax cost because the interest expense is tax-deductible, reducing the effective cost of funds. Equity is typically more expensive since dividends are paid from post-tax profits and are not tax-deductible. Also, the rate of interest on sub-debt are comparatively much lower than the return on equity expected by the equity shareholders.

3. Permanence of Capital:

Equity provides permanent capital with no repayment requirement, thereby strengthening the company's long-term solvency base. Subordinated debt, though long-term (minimum maturity of 10 years), eventually requires redemption or refinancing, creating future liquidity and refinancing risks.

4. Servicing and Profit Volatility:

Sub-debt introduces a fixed interest obligation, which must be serviced periodically and can strain profits or reduce solvency if earnings fall. Equity, by contrast, does not require mandatory payouts—dividends can be deferred in weaker years—offering greater financial flexibility.

5. Regulatory and Operational Flexibility:

Issuing sub-debt do not require prior approval for issuance. However, instruments must comply with strict features such as non-convertibility, subordination clauses, and minimum tenor. Equity issues require broader approvals from shareholders, IRDAI, and possibly FDI regulators, but have fewer ongoing covenants once issued.

6. Market and Rating Perception:

A well-rated insurer issuing sub-debt signals financial maturity and confidence in stable cash flows. However, excessive leverage could be viewed negatively by credit rating agencies. Equity infusion, on the other hand, is perceived as strengthening solvency and stability, particularly if the company is in a growth phase.

7. Suitability and Strategic Use:

Sub-debt is better suited when the insurer is profitable, solvent, and seeking to fund growth without ownership dilution. It provides flexibility for interim capital needs. Equity infusion is more appropriate when solvency needs are large or persistent, earnings are volatile, or when building a strong long-term capital foundation is the objective.

8. Regulatory cap

IRDAI restricts subordinated debt $\leq 50\%$ of paid-up capital and $\leq 50\%$ of net worth. Large insurers with limited equity base may find sub-debt quantum insufficient to meet capital plan. However, there are no such regulatory restrictions on the equity raise.

[Max 6 marks]

ii) As per the IRDAI (Registration, capital structure, transfer of shares and amalgamation of insurers) Regulations, 2024, following are the regulatory criteria and conditions of raising subordinated debt:

1. Subordinated Debt shall qualify as "Other Forms of Capital" provided all the following criteria are met:
 - a. The instruments must be issued and be fully paid-up in cash. The maturity period of the instruments issued by life insurer shall not be less than Ten Years
 - b. The seniority of the claims shall be governed by the following order, seriatim:
 - i. Claims of Policyholders
 - ii. Claims of Creditors
 - iii. Claims of Subordinated Debt holders
 - iv. Claims of Preference Shareholders
 - v. Claims of Equity Shareholders.
 - c. The instruments shall neither be secured nor covered by a guarantee of the insurer or other arrangements that legally enhance the seniority of the claims as specified in the regulations.
2. Issuance of "Subordinated Debt" is subject to the following conditions:
 - a. All instruments shall be non-convertible, fully paid up and unsecured.
 - b. If any portion of the debt is subscribed by foreign institutional investors, check FDI / FEMA rules.
 - c. No incentives shall be payable by the insurer to holders of Subordinated Debt for early redemption of instruments.
 - d. The rate of interest payable to the Subordinated Debt holders may be either a fixed rate or a floating rate. Such rate shall be with reference to a market determined rupee interest benchmark rate.
 - e. Interest on Subordinated Debt shall be charged to the Profit & Loss Account.
 - f. The solvency margin of the insurer shall remain above the Control Level of Solvency.
 - g. In the event of failure to service the Subordinated Debt, no restrictions shall be imposed on the insurer, except for distribution of dividend to equity shareholders.
 - h. Insurer shall ensure compliance with all regulatory requirements, including but not limited to corporate laws and all other stipulations as may be applicable.
 - i. The total quantum of the instruments under Other Forms of Capital taken together shall be lower of the following, at any point in time:
 - i. Fifty percent of the total paid-up equity share capital and securities premium of an insurer
 - ii. Fifty percent of the net worth of the insurer.
 - j. For issue of any Subordinated Debt, a resolution by the Board of Directors of the insurer shall be passed authorizing the issue of such Subordinated Debt

[Max 8 marks]

iii) Following are the impacts of raising subordinated debt on:

Embedded Value

Immediate Impact

- Embedded Value represents the consolidated value of shareholders' interest in the life insurance business. When subordinated debt is raised, the company's assets increase by the debt amount, so do its liabilities—since the debt must eventually be repaid. Therefore, the direct immediate impact on EV should be broadly neutral.
- However, there are second-order effects in form of reduction in Frictional Cost of Capital for holding Required Capital. Hypothetically, if the whole Required Capital is backed by the subordinated debt, there is no Frictional Cost of Capital to the shareholder because Frictional Cost is only applicable on Required Capital which is funded by the shareholders.
- With raise of capital through subordinated debt, the company reduces reliance on shareholder capital to support the Required Capital and hence reduction in frictional cost, leading to a positive impact on the overall EV.

Impact over the subordinated debt tenor

- Going forward, as the EV unwind, the subordinated debt shall unwind at the rate of debt, and the backing assets shall unwind at the real-world yield on the backing assets. If the cost of raising debt i.e. debt yield is higher than the yield earned on the backing assets of subordinated debt, there will be net loss to the Company and hence, shall reduce the EV gradually.

Statutory Solvency of the Company

Immediate Impact

- Subordinated debt is eligible to be included in the insurer's Available Solvency Margin, subject to regulatory conditions.
- Since Subordinated debt ranks below the claims of policyholders and all other creditors, but above those of preference and equity shareholders, raising sub debt will increase the available solvency margin. There will be no impact on the statutory policyholder's liability. Thus, the solvency margin will increase.

Impact over the subordinated debt tenor

- The interest payable on subordinated debt is charged to the Profit & Loss (P&L) account as a financing cost. Simultaneously, any investment income generated from deploying the proceeds of the subordinated debt also contributes to the P&L.
- If the borrowing cost (i.e., the interest rate on the subordinated debt) exceeds the yield earned on the backing assets, the company will incur a net loss in the P&L each year, equivalent to the difference between the two rates. This will result in the reduction in the statutory profits and hence the reduction in available assets to back solvency margin.
- Further, for solvency margin computation, these instruments undergo a progressive straight-line haircut during the final five years prior to maturity. The inclusion percentage reduces annually as follows:

- 5 years or more to maturity: 100%
- 4 to <5 years: 80%
- 3 to <4 years: 60%
- 2 to <3 years: 40%
- 1 to <2 years: 20%
- Less than 1 year: 0%

[Max 8 marks]

iv) Alternative ways of raising the capital are as follows:

1. Raising equity from the existing shareholders:

One option is to request additional capital infusion from existing shareholders. This represents a permanent source of capital, enhancing market confidence and strengthening the company's financial base. Unlike debt, it does not require repayment within a fixed timeframe. However, shareholders may expect dividend payouts, which could create liquidity pressure depending on profitability and cash flow.

2. Raising capital from new shareholders (equity dilution):

If existing shareholders are unable or unwilling to contribute additional capital, the company may consider raising equity from new investors. This also provides a permanent capital base and can enhance market credibility. Since new shareholders may not expect immediate dividends, liquidity pressure is generally lower in the short term.

3. Issuance of Preference shares:

Under IRDAI's regulations, insurers are permitted to raise capital through preference shares, subject to prescribed conditions. Preference shareholders rank above equity holders in terms of dividend entitlement and claim priority. Dividends on preference shares are paid out of distributable profits.

4. Other sources:

Insurers may also consider ad hoc strategies to optimize capital from existing operations, such as:

- a. Releasing excess prudence from reserves, where actuarially justified.
- b. Realising mark-to-market (MTM) gains on equity or debt instruments held in the shareholders' fund, which can boost the capital base without increasing liabilities.
- c. Raising capital through Financial Reinsurance.

[Max 4 marks]

v) Possible alterations in the business plan if raising additional capital is not possible:

1. Control the Volume of New Business

Reducing the volume of future expected new business can help manage strain on required capital to support the growth. New business often requires upfront capital in form of new business strain. This new business strain varies at line of business, products, channels etc. level. This action may slow growth and reduce market share temporarily.

2. Expense Management

Building operational effectiveness would help streamlining operational expenses and hence reduce capital pressure. Reduction in maintenance expenses would reduce the reserves and hence increase the capital base of the company.

3. Distributor Payout Optimization

Reducing distributor commissions can also reduce capital pressure. This could be achieved by renegotiating contracts, shifting to digital channels etc. This will enhance profitability and frees up capital, though may affect distributor motivation.

4. Deferring or Suspending Dividend Payments

Temporarily halting dividend payouts conserves capital that would otherwise be distributed to shareholders. This may affect investor sentiment and shareholder expectations.

5. Reinsurance Arrangements

Explore opportunities of reinsuring the existing book if it is not already reinsured. Depending upon the mortality assumptions used by the Company compared to the reinsurance rates applicable by the reinsurer, the company might release some reserves and hence increase the capital base.

Further, there is reinsurance credit allowed in the required capital assessment which should reduce the capital requirement from the existing book.

For future new business as well, explore and exploit the reinsurance arrangements in case they look profitable and capital supportive.

6. ALM Optimization

Explore opportunities of optimizing the existing ALM techniques for the existing business as well as for the future new business. Improving the investment strategy by having better matching, exploiting interest rate hedge options etc. would help to enhance returns and reduce volatility. Better ALM matching can help in a stable valuation rate of interest and hence, may reduce the statutory reserves for guaranteed business.

7. Product Structure Optimization

Revising product designs to reduce new business strain and improve cash flow matching. For examples, reduced initial benefits like early incomes etc. Having deferral of the commissions through lower acquisition commissions and higher renewal commissions.

8. Repricing

Repricing of the new business to add more buffers could help in supporting the capital requirement. This could reduce the new business strain by reducing the reserves requirement at inception of the contract. However, this might make the product less competitive and might lose market share.

9. Business Mix Realignment

The new business strain varies by products, variant of product, channels, profile of customers, line of business etc. Adjusting the mix of business would help to optimize capital usage. Revisit

all lines of business wherever the new business reserves + initial commission + expenses are higher than the first year premium. Similarly revisit businesses which require higher solvency capital. Some of the examples are as follows:

- a. Shift between retail and group business.
- b. Avoid pure term or group term products as they have high capital requirements given 0.1% of SAR
- c. Avoid group super annuation products given RSM is 3% of fund value
- d. Revisit the mix of unit linked business as the reserves under unit linked is same as fund value and if expenses and commission plus fund value are higher than first year premium
- e. Use cost-effective channels like digital or direct sales

[Max 12 marks]

[38 Marks]

Solutions 2:

i)

a) Participating business:

1. Policyholders' Returns

- The composition of the liabilities determines the extent of the impact on the policyholders:
 - Guaranteed benefits are safe and do not change with market performance.
 - Discretionary benefits (like terminal bonuses or even reversionary bonus) can be affected by equity market ups and downs.
 - If the participating fund has mostly guaranteed liabilities, the impact is limited to the smaller discretionary portion.
- The extent of impact on discretionary benefits depends upon a few factors as follows:
 - Bonus philosophy of the company
 - Market recovery time
- Company's Bonus Philosophy
 - If bonuses are based on book yield (excluding unrealised gains/losses), market changes won't affect bonuses unless losses are realized.
 - If based on market yield (including unrealised gains/losses), bonuses may be reduced during market downturns.
- Market Recovery Time: A longer recovery period means:
 - Policyholders exiting during the downturn may receive lower bonuses, especially under market yield. This is also applicable where bonuses are paid regularly, such as cash bonus.
 - Under book yield, the company may eventually realise losses to meet cash needs, which could then affect bonuses – again for the exiting policyholders.

2. Shareholder Perspective

- Impact on Embedded Value (EV):
 - If discretionary liabilities are less than the equity exposure (e.g., 30% invested in equity), the guarantees are partly backed by equity.

- In such cases, if the fall in equity is higher than the total discretionary liabilities, shareholders may bear more than 10% of the equity loss, increasing the impact on EV.
- If discretionary liabilities match or exceed equity exposure, the impact on EV remains limited to 10% of the equity fall subject to PRE and TCF.
- Further, there might be an increase in the TVFOG.
- Impact on Solvency:
 - If the Fair Value Change Account (FVCA) remains positive (due to past unrealised gains), solvency is not affected.
 - If FVCA turns negative, it reduces the Available Solvency Margin (ASM), leading to a drop in solvency.
 - To manage solvency, the company may realise losses, which could also reduce book value of asset share and hence policyholder reserves through lower bonuses.

[Max 6 marks]

b) Unit-Linked business:

1. Policyholder Perspective

- In unit-linked business, the investment related risk is completely owned by the policyholder and hence the sudden fall in equity market will reduce the fund of the policyholder.
- However, in case there are minimum investment guarantees offered in the unit fund, in that case, the impact will be restricted to the tune of the guarantees offered in the fund.

2. Shareholder Perspective

- Impact on EV
 - Lower Fund Size → Lower FMC → Lower EV: In unit-linked products, future profits come mainly from Fund Management Charges (FMC). If equity markets fall, fund values drop, leading to lower FMCs and a reduction in EV.
 - Persistency Risk: Poor market performance may lead to higher policy discontinuance, further reducing EV.
 - Fund Switching: Policyholders may switch to less equity-heavy funds. If these funds have lower FMCs, it can reduce future profits and EV.
 - Investment Guarantees: If the product offers guarantees, the EV impact could be significantly higher during market downturns. Equity Exposure in Non-Unit Portion: If the company has invested in equity to back non-unit liabilities, any fall in equity directly reduces EV.
- Impact on Solvency:
 - Unit Fund Impact: A fall in unit fund assets is matched by a fall in unit-linked liabilities, so reserves remain unaffected—unless guarantees are involved. There are second order positive impact on solvency as lower fund value means lower RSM as % of unit reserves.
 - Non-Unit Liabilities: These may increase slightly due to lower FMCs and higher persistency, but the impact is limited because unit-linked reserves are often floored at zero.

- Equity Exposure in Non-Unit Portion: If equity backs non-unit liabilities, a market fall can reduce asset values without a matching liability reduction, negatively affecting solvency.

[Max 5 marks]

ii) Key Strategies for Managing Equity Investment Risk in a Life Insurance Risk Framework are as follows:

1. Strategic Asset Allocation and Exposure Limits

The first line of defence is setting clear limits on equity exposure across different product lines. These limits should be aligned with the company's overall risk appetite and the nature of the liabilities they support.

- For guaranteed liabilities (e.g., non-par annuities), equity exposure should be conservative, as market downturns directly affect shareholder value.
- For participating products, where policyholders share in investment performance, equity exposure can be higher but must be managed to ensure stability in bonus declarations.
- For unit-linked products, while investment risk is borne by policyholders, the company must still monitor exposure to manage reputational risk and persistency.

2. Stress Testing and Scenario Analysis

Regular stress testing is essential to understand how equity market shocks affect key financial metrics:

- Embedded Value (EV): Assess the impact of equity stresses on EV of the Company.
- Solvency: Evaluate how equity losses affect the Fair Value Change Account (FVCA) and Available Solvency Margin (ASM).
- Bonus Sustainability: Model the ability to maintain discretionary bonuses (both reversionary and terminal bonuses) under various market conditions.

3. Hedging and Risk Transfer Mechanisms

To mitigate downside risk, the company can use financial instruments such as Equity derivatives to hedge against market falls.

4. Dynamic Bonus and Policyholder behaviors

- For participating products, managing equity risk involves adjusting discretionary benefits:
 - Implement bonus smoothing to avoid sharp changes in payouts due to market volatility.
 - Maintain estate to absorb short-term equity losses and support stable bonus declarations.
 - Clearly communicate bonus philosophy (book yield vs. market yield) to policyholders to manage expectations.
 - Have buffers in form of unrealised gains in FVCA balance to act as a cushion in equity fall scenarios.
- For linked business: Equity market downturns can influence policyholder actions:

- Monitor fund switching trends—policyholders may move to low-equity or low-FMC funds, affecting profitability.
- Track persistency—higher lapses or surrenders during downturns can reduce future income and increase strain on reserves.
- Use behavioral analytics to anticipate and respond to shifts in policyholder behavior.

5. Governance and Regulatory Compliance

- Strong governance ensures that equity risk is actively managed and integrated into decision-making:
 - Establish clear roles and responsibilities for equity risk management across risk, investment, and actuarial teams.
 - Regularly review equity exposure and risk metrics through Risk and Investment Committees.
 - Ensure Board-level oversight and approval for strategic decisions involving equity investments.
- Ensure all equity risk management practices comply with IRDAI regulations:
 - Adhere to investment norms regarding equity limits and diversification.
 - Maintain documentation and audit trails for all equity-related decisions.
 - Report stress test results, solvency impacts, and risk mitigation actions to regulators as required.

[Max 10 marks]

[21 Marks]

Solution 3:

i) Following are the conditions for the Variable annuity pay-out option:

1. Annuity pay outs shall vary with a publicly available benchmark as per the formula as specified in the product filing document.
2. The annuity amount may vary based on specific formula linking to benchmark value on quarterly or less frequent basis.
3. This option is available only with:
 - a. Individual Life annuity with Return of 100% of Purchase Price on death of annuitant
 - b. Joint Life annuity with a provision of 100%, 50% or such other percentages of annuity to Secondary Annuitant on death of the Primary Annuitant and Return of 100% Purchase Price on death of Last Survivor.
4. The minimum guaranteed annuity rate throughout the currency of the policy shall not be less than 60% of the annuity rate at inception of the policy under fully guaranteed life annuity with ROP or fully guaranteed joint life annuity with ROP.
For example, if the annuity rate at inception of the policy for annuitant with age at entry of 60 years is 7% per annum under fully guaranteed life annuity with ROP variant, the minimum guaranteed annuity rate for variable life annuity with ROP shall not be less than 4.2% per annum throughout the currency of policy.
5. Variation of annuity pay-outs in relation to the publicly available benchmark shall be explicitly stated in all the filing documents in a clear and unambiguous manner for easy understanding of the customer or policyholders and for enabling them to take an informed decision.
6. The projected variable annuity pay-outs shown in the Benefit illustration shall be realistic and be based on expected movement of the benchmark. The expected movement shall reflect the inherent volatility and risk of adverse movements of the benchmark.

7. Benefit illustration shall explicitly mention that the investment risk is partially borne by the policyholders or annuitants in case of variable annuity pay-out option.

[Max 7 marks]

ii)

1. Asset-Liability Mismatch (ALM) Risk

The product guarantees 70% of the annuity rate, while the remaining 30% is linked to an index. The introduction of caps and floors to the variable portion makes the ALM even more complicated. Additionally, benefits such as surrender (if any) and mortality payouts are fully guaranteed. This dual structure increases the complexity of ALM.

Mitigation Approach:

- For the guaranteed portion, apply standard ALM practices used for traditional annuity products.
- For the variable portion, invest in instruments that closely replicate the benchmark and monitor performance regularly to ensure alignment.
- Maintain a segregated investment strategy for each component to avoid cross-contamination of risks.

2. Index Tracking Error

The insurer must match the variable annuity payouts with the predefined benchmark. Any deviation in investment performance from the index (tracking error) can result in a mismatch between expected and actual payouts.

Mitigation Approach:

- Establish quarterly or more frequent rebalancing protocols to align with payout schedules.
- Monitor and report tracking performance to internal risk committees.
- Allow one/two-day lag for return benchmark to allow for calculation of returns and processing of annuity payout

3. Investment Guarantee Risk

The insurer is obligated to honour the minimum guaranteed annuity rate (70% of inception rate), even if the benchmark performs poorly. Additionally, there is minimum guarantee on the variable portion wherein the index returns are floored to minimum 2%.

Further, the annuity rates are changing every quarter and hence the index tracking is happening at quarterly basis. Any negative movement in the index over the quarter doesn't impact the policyholder payouts.

Mitigation Approach:

- Define the benchmark such that there is prudence into the product formula, such as applying a haircut or buffer to the index return before passing it to the policyholder.
- Use scenario testing and stress analysis during product design to assess guarantee cost under adverse conditions.
- Keep a separate guarantee reserve to manage returns of 2%

4. Regulatory Risk

Unlike unit-linked products, this product type lacks a clearly defined framework for charge structures. Designing the formula for the benchmark may require multiple iterations with the regulator, increasing compliance risk.

Mitigation Approach:

- Engage in early and transparent dialogue with IRDAI during product development.
- Ensure clear documentation of the benchmark definition in the product filing.
- Maintain a compliance checklist aligned with IRDAI's product regulations and circulars.

5. Operational Risk

The product's complexity—due to its dual payout structure and benchmark-linked variability—requires robust systems and operational controls. Errors in calculation or data feeds can lead to mis payments and reputational damage.

Mitigation Approach:

- Implement automated systems for benchmark tracking and payout computation.
- Conduct rigorous UAT (User Acceptance Testing) and system validations before launch.
- Establish strong governance and audit trails for payout processing.

6. Mis-selling and Customer Dissatisfaction Risk

Customers may not fully understand the benchmark-linked payout structure, leading to unrealistic expectations or dissatisfaction. Mis-selling risk is high if advisors fail to explain variability and guarantees clearly. Further, if the real yield on the backing index is lower or negative (i.e. inflation being higher than index performance), the ultimate objective of such feature will be defeated causing more dissatisfaction among the policyholders.

Also, the cap of 20% on the Nifty 50 index returns could raise dissatisfaction among the policyholders in periods when the returns are consistently higher than 20% and the policyholders are getting only 20%.

Mitigation Approach:

- Provide clear, illustrative disclosures in sales material and policy documents.
- Train distributors and advisors on product mechanics and risk communication.
- Include scenario-based benefit illustrations to show potential variability.

7. Mortality Risk

The product is offered only under Return of Purchase Price (ROP) variants, which exposes the insurer to mortality risk. In case of death, the insurer must return the full purchase price, regardless of investment performance. This poses a risk in case of realized value in benchmark index falls below the invested value. This risk can be higher given higher ages of annuitants and death rate is higher

Mitigation Approach:

- The cost of such guarantees should be priced and reserved appropriately.
- Re-assess the 1% charge deducted from Nifty returns to cover such guarantee costs due to mortality
- Consider reinsurance solutions for mortality guarantees.

8. Surrender / Discontinuity Risk

Generally, annuity with ROP offers the guaranteed surrender value to the policyholders, which exposes the insurer to surrender risk. In case of surrender, the insurer must return the guaranteed surrender value, regardless of investment performance. This poses a risk in case of realized value in benchmark index falls below the invested value.

Mitigation Approach:

- The cost of such guarantees should be priced and reserved appropriately.
- Allow MTM loss adjustment in case of surrenders

[Max 14 marks]

iii) Key features of benchmark linked products are:

1. Structure: A life insurance product where returns are linked to a predefined benchmark index (e.g., Nifty 50, G-Sec yields), with no active fund management.
2. Return Mechanism: Returns are linked to a **pre-defined benchmark**, which may be a blend of indices or asset classes. The formula is disclosed upfront. For example, the regulator allows 60% of the annuity rate to be guaranteed, with remaining 40% being linked to a predefined benchmark.
3. Transparency: Moderate to high – depends on how clearly the benchmark composition and its calculation is disclosed in benefit illustrations and policy documents.
4. Surplus Sharing: Policyholders do not participate in any surplus or deficit arising from other sources such as mortality, persistency, or expense experience. Investment risk is **partially transferred** to policyholders via benchmark linkage. Their benefit is strictly tied to the benchmark defined.

[Max 3 marks]

Benchmark linked product vs. Traditional Participating product

1. Structure: A life insurance product that provides guaranteed benefits and shares in the insurer's profits through declared bonuses, based on actual experience (investment, mortality, expenses).
2. Return Mechanism: Returns above the guaranteed rate are discretionary, declared by the insurer based on the fund's performance. Typically, the 90:10 rule applies—90% of surplus is allocated to policyholders and 10% to shareholders. However, policyholders do not have visibility into the underlying asset performance or allocation.
3. Transparency: Bonus declarations are made at the insurer's discretion and are not directly linked to disclosed fund performance. Policyholders do not choose or see the asset allocation.
4. Surplus Sharing: Policyholders share in the overall surplus or deficit of the participating fund, which includes not only investment returns but also gains or losses from mortality, persistency, and expense variances.

[Max 3 marks]

Benchmark linked product vs. Unit Linked Product

1. Structure: A life insurance product where premiums are invested in market-linked funds (equity, debt, hybrid), and returns depend on fund performance. The investment risk is borne by the policyholder. The value of the policy depends on the performance of the chosen investment funds.
2. Return Mechanism: Returns are based on the performance of selected funds. Policyholders can choose and switch between funds. Returns depend on the performance of chosen investment funds, which are actively managed.
3. Transparency: High transparency. Fund performance, charges, and NAVs are disclosed regularly. Fund performance is disclosed but subject to fund manager strategy.
4. Surplus Sharing: No surplus sharing from sources other than the investment surplus. Investment returns are purely market-driven.

[Max 3 marks]

Benchmark linked product vs. Index Linked Product

1. Structure: A life insurance product where returns are linked to the performance of a specific market index (e.g., Sensex, Nifty), often through structured instruments.
2. Return Mechanism: Returns are derived from index performance.
3. Transparency: High transparency. Fund performance, charges, and NAVs are disclosed regularly. Fund performance is disclosed but subject to fund manager strategy.
4. Surplus Sharing: No surplus sharing from sources other than the investment surplus. Investment returns are purely market-driven.

[max 3 marks]

[12]

[33 Marks]

Solution 4:

a) Shareholders

- Loss of Input Tax Credit (ITC): Insurers will no longer be able to claim ITC on GST paid for operational expenses (e.g., distributor commissions, rent, marketing). This may increase operating costs, potentially impacting margins.
- Pressure on Profitability: While premiums become more affordable, insurers may need to absorb higher net costs, especially in the short term, leading to margin compression.
- Growth Opportunity: Lower premiums may drive higher policy sales, improving long-term profitability and market share.
- Strategic Adjustments: Shareholders may push for cost optimization, digital distribution, and product redesign to maintain profitability.

[Max 2 marks]

b) Distributors (Agents, Brokers, Bancassurance)

- Higher Sales Potential: Lower premiums make insurance more attractive, especially to first-time buyers, potentially boosting sales volumes.

- Commission Structure Review: With insurers facing margin pressure due to loss of ITC, commission payouts may be restructured or rationalized.
- Training Needs: Distributors must be equipped to communicate pricing/design changes and value propositions effectively to customers.
- Digital Enablement: Insurers may shift towards low-cost digital channels, impacting traditional distributor roles.

[Max 2 marks]

c) Policyholders

- Lower Premiums: Removal of 18% GST directly reduces the cost of insurance, making it more affordable across product types (term, ULIP, health, annuity).
- Greater Coverage Accessibility: Lower cost may encourage higher coverage levels and broader adoption, especially among middle-income and rural segments.
- Simplified Pricing: Premiums now reflect the actual payable amount, improving transparency and customer trust.
- No Change in Tax Benefits: Deductions under Section 80C and Section 10(10D) remain intact, offering dual tax advantages up to specified limits.

[Max 2 marks]

d) Regulator / Government

- Revenue Loss to the government: Annual revenue loss due to GST exemption.
- Policy Alignment: Supports the “Insurance for All by 2047” vision, promoting financial inclusion and health security.
- Monitoring Compliance: IRDAI and GST authorities must ensure insurers pass on benefits to consumers and do not inflate base premiums.
- Market Expansion: The move is expected to increase insurance penetration, especially in underserved segments.

[Max 2 marks]

[8 Marks]
