Increasing retention limit of Life Insurance companies and impact on Risks and Capital Management

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Why do life insurers reinsure?

Risk management

- Transfer mortality / morbidity risks
- Limit large / total claims
- Reduce claim volatility
- Reduce parameter risk
- Stabilize emergence of mortality experience

Capital management

- Lower reserves
- Lower solvency requirements
- Lower new business strain
- Increased liquidity

Technical assistance

- Knowledge transfer
- Expertise from other markets
- Product design / pricing
- Underwriting support

Agenda

Types of reinsurance arrangements

Individual Surplus

Excess of the original benefit over the ceding company's retention limit

To limit claims sizes and claims volatility

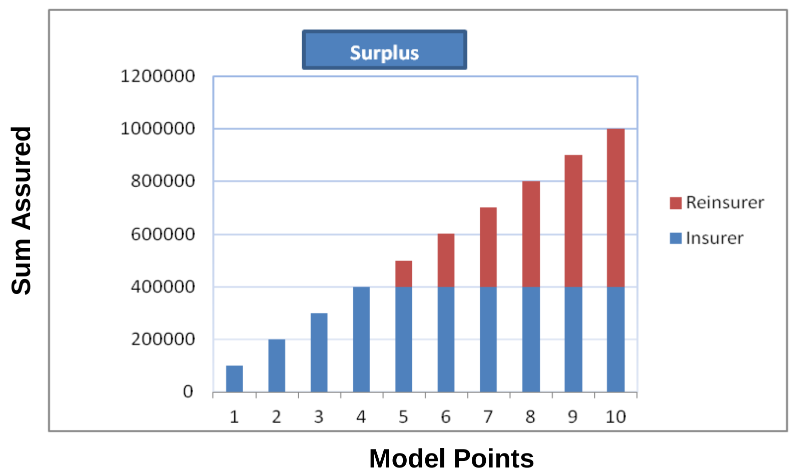
Individual life with higher sum assured (term, participating / non-participating savings)

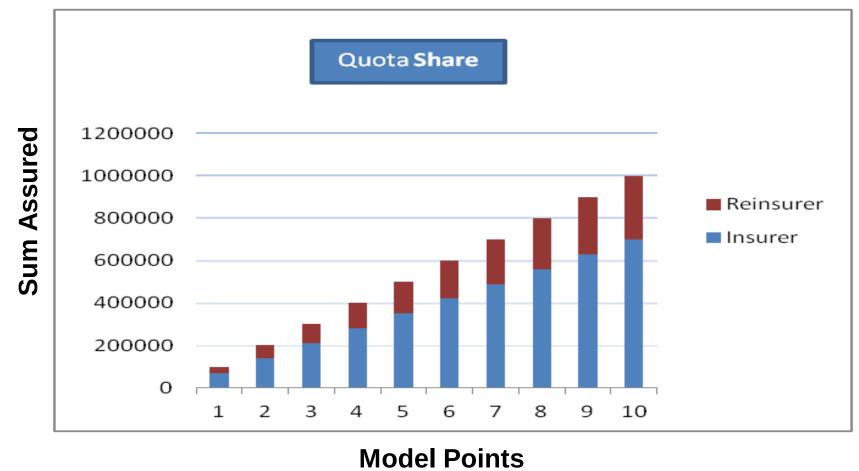
Quota Share

A specified percentage of each policy is reinsured

To reduce parameter risk

New risks, riders, group and health





Original terms reinsurance: not in India

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Reinsurance arrangements in India (1)

INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY

NOTIFICATION

Hyderabad, the 11th February, 2013

Insurance Regulatory and Development Authority (Life Insurance-Reinsurance) Regulations, 2013

- Individual surplus
  - The only reinsurance arrangement allowed for individual business (new regulations)

- Quota share
  - Group and Health (new regulations)
    - Initial two years of starting health / group operations
    - Initial two years of introducing a new risk / product

- Current scenario
  - Term business being offered at very competitive rates as it is being subsidized by low premiums charged by reinsurers

Reinsurance arrangements in India (2)

- New “benchmark limits”

Types of products or riders	Age of the insurer or year in which the risk is introduced				
	0-3 years both inclusive	4-7 years both inclusive	8-11 years both inclusive	12-15 years both inclusive	>15 years
Pure Protection	5 lacs	10 lacs	15 lacs	20 lacs	Will be prescribed by the Authority for all product types
Savings	10 lacs	20 lacs	30 lacs	30 lacs	
Group protection	5 lacs	10 lacs	15 lacs	20 lacs	
Health insurance	1 lac	3 lacs	3 lacs	4 lacs	

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Increasing retention limits – critical decision

Factors affecting level of retention:

- Risk appetite
- Risk limits / loss criteria
- Level of free assets
- Risk-return trade-off
- Effect on capital position
- Technical expertise

Higher retention → **Lower reinsurance premium** + **Potentially, higher claims**

Higher retention → **Higher risk** → **Higher capital requirements**

Increasing retention limits – insurer and regulator

- Why increase retention limits?

Insurer	Regulator
• Increased risk appetite • Ability / desire to retain mortality / morbidity risks • Reduced claims volatility • Offering products with little mortality / morbidity risk • Increased confidence in assumptions / variability • Higher cost of reinsurance • Improved capital position • Regulations!!!	• Avoid fronting of business • Encourage development of robust in-house risk management capabilities • Minimize counterparty risk • Minimize reinsurance cost • Retain life insurance premium within the country?

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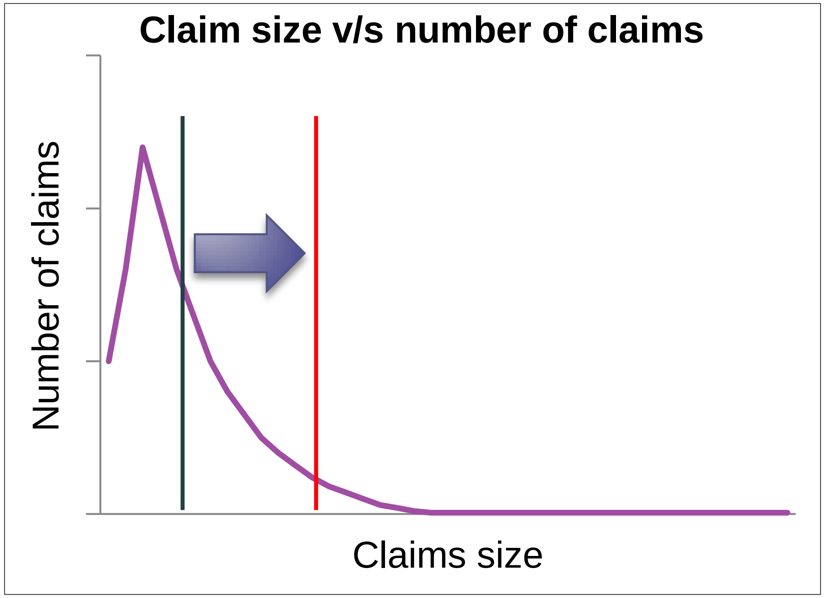
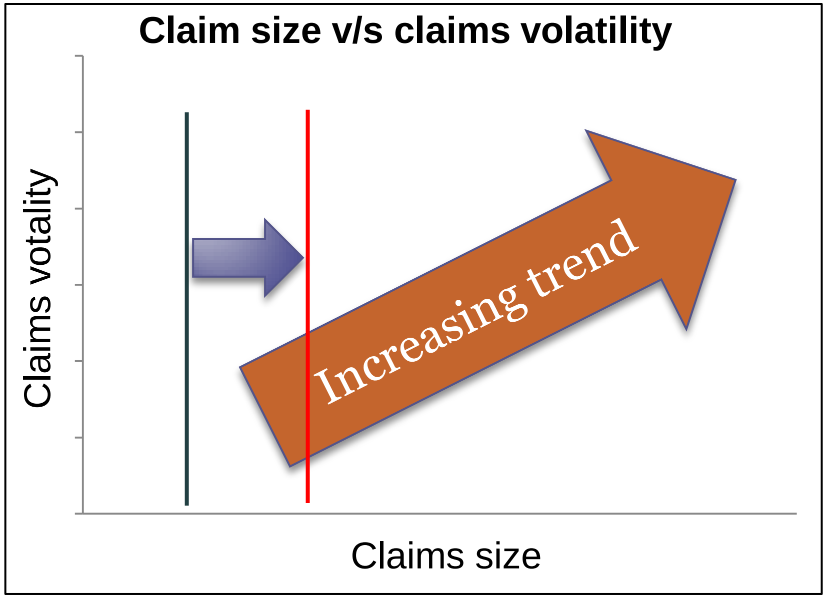
Impact of increasing retention limits – micro (1)





Number of claims v/s claims size --> no. claims reduce as claims size increases

Claims volatility v/s claim size --> volatility increases as claims size increases

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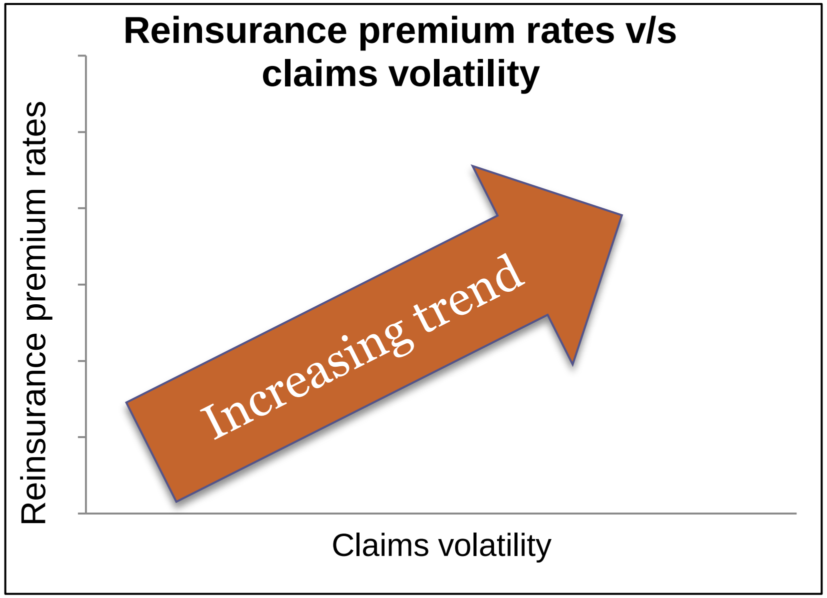
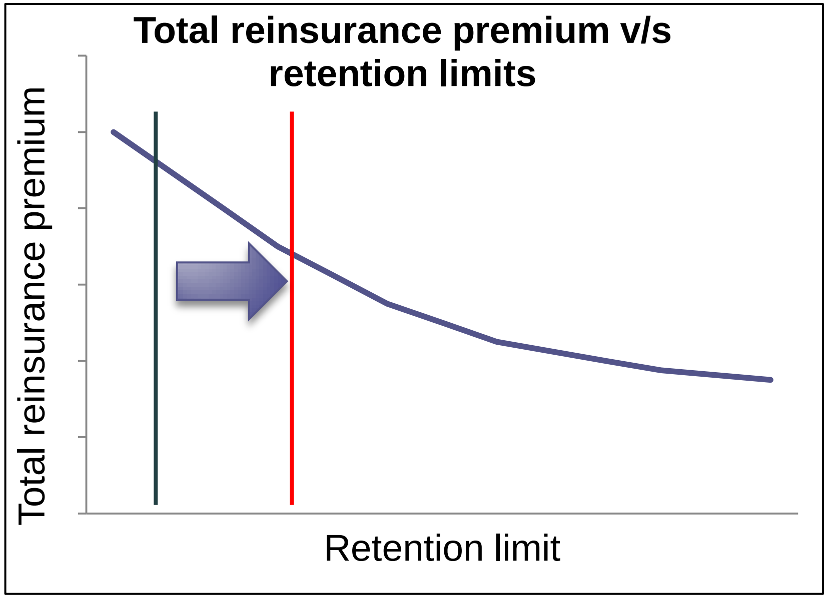
Original retention limits

New retention limits

Impact of increasing retention limits – micro (2)





Reinsurance premium v/s claims volatility --> reinsurance premium increases with claims volatility

Reinsurance premium v/s retention limits --> increasing retention limits should reduce reinsurance premium, but the reduction in reinsurance premiums might slow down due to increased volatility

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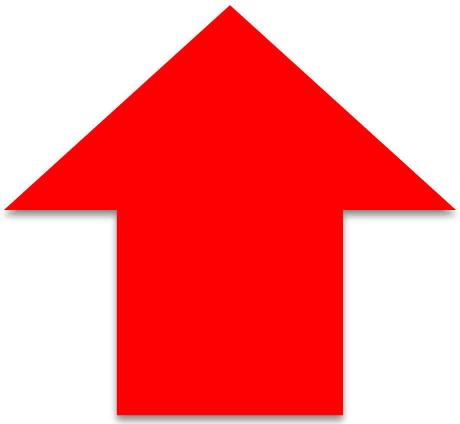
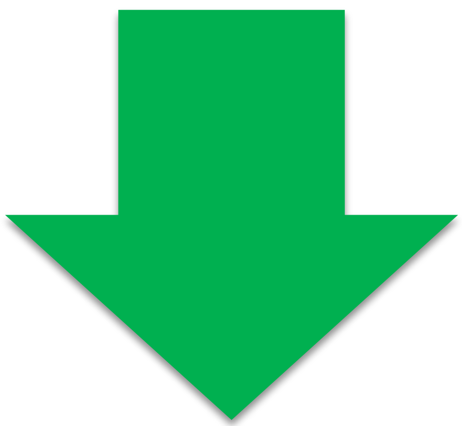
Original retention limits
New retention limits

Impact of increasing retention limits – micro (3)

- Factors impacting reinsurance premiums



- Claims volatility
- Fixed costs (reduced business)

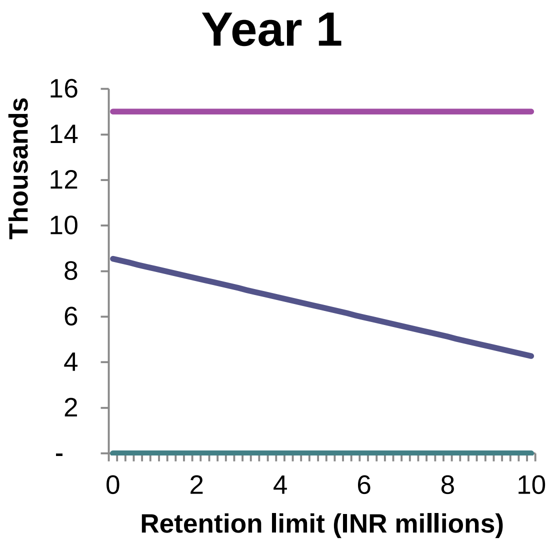


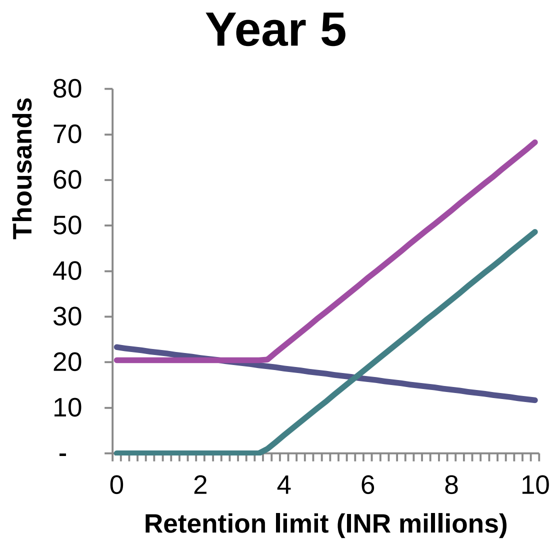
- Improved selection
- Increased competition

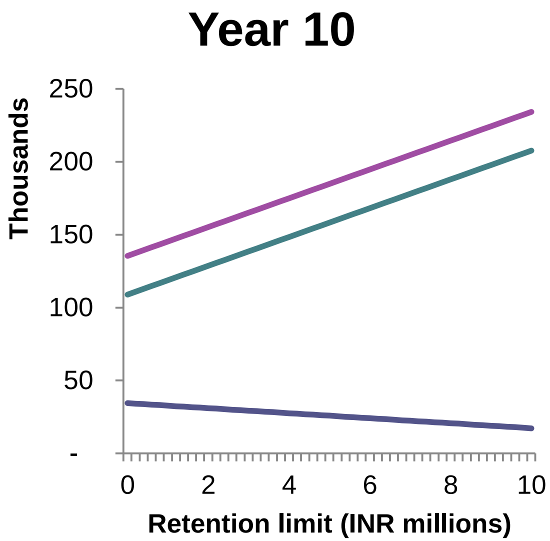
- The exact impact on reinsurance premiums would vary depending upon the circumstances of each reinsurer.

Impact of increasing retention limits – micro (3)

Level term insurance product (SA = INR2 Crores)

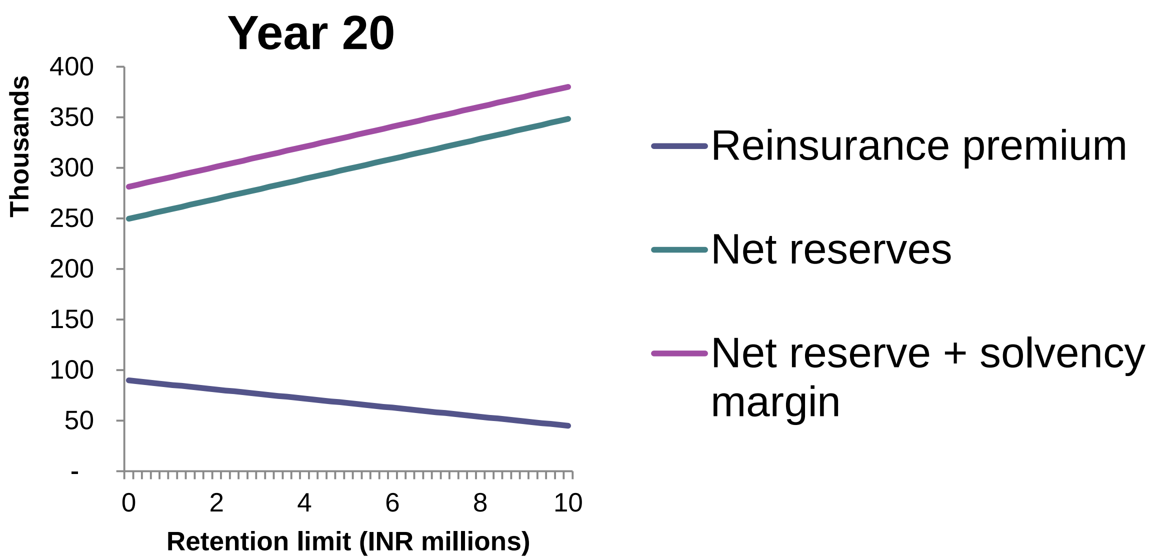






Model point details

- Age = 36
- Gender = Male
- Policy term = 25
- Premium term = 25
- Sum assured = INR2 Crores
- Premium = INR53,800



Impact of increasing retention limits – micro (4)

- Impact on revenue account and balance sheet for different product types:

Protection

- Increased premium levels due to lower subsidy from reinsurers
- Higher claims volatility
- Increased reserves / solvency capital requirements

Unit linked

- Higher mortality charges?
- Small impact on reserves / solvency capital requirements

Participating/ non-participating

- Small increase in premium levels
- Small impact on reserves / solvency capital requirements

- Note that in other countries who have implemented economic capital, capital requirements might have increased significantly for protection business due to increased volatility.

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II	Types of reinsurance arrangements
III	Reinsurance arrangements in India
IV	Increasing retention limits
V	Impact of increasing retention limits – Micro
VI	Impact of increasing retention limits – Macro

Impact of increasing retention limits – macro (1)

Impact on risks

- Increased parameter risk
- Increased claim size risk
- Increased claims volatility
- Increase in risk tolerances / limits
- Lower mortality / morbidity risk mitigation options
- Operational risk – administrative / reporting errors
- Marketing risk - increase premium levels
- Liquidity risk?
- Reduced counterparty risk
  - retention of larger percentage of gross premium within the company
  - retention of larger percentage of gross premium within the country

Impact of increasing retention limits – macro (2)

Impact on products

- Re-pricing
- Different retention assumptions for different product category
- Change in cost of reinsurance
- Higher premiums for protection oriented products
- Pricing assumptions: lower support from reinsurers
- Reduced innovation?
- Valuation assumptions: increased MADs
- Terms and conditions – more exclusions?
- Underwriting: more stringent at inception and claims stage
- More realistic price of risk charged to customer

Impact of increasing retention limits – macro (3)

Impact on capital management

- Increase in reserves
- Increase in solvency capital requirement – especially for protection oriented business
- Reduced solvency ratio – impact should be minor for larger companies, higher for smaller protection oriented companies
- Possible modifications to risk appetite / limits / reallocation of economic capital
- Increased cost of capital
- Fluctuation in dividends to shareholders
- Capital infusion

Impact on business strategy

- Limit the market for pure protection product
- Change in distribution channel strategy (e.g. online selling)
- Limit entering new market with no prior experience
- Limit development of product with little or no knowledge

Impact of increasing retention limits – macro (4)

Reinsurer

- Reduced total reinsurance premiums
- Need to change reinsurance premium rates
- Diseconomies of scale
- Lower interest – hence reduced technical support
  - Pricing
  - Underwriting
  - Market research data for innovative products
- Possible exit of reinsurance companies from India
- Increased monopoly if fewer reinsurers
- Deterrent for entry of new reinsurer

Disclaimer

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Questions and answers

Thank you!