PAR AND NON-PAR PRODUCTS - WHICH WOULD BE THE PREFERRED WAY FORWARD

IMPACT OF GUARANTEED SURRENDER VALUES

Guided by – Bharat Venkataramani

Presented by –
Pradeep Kumar Anand
Ramakant Malpani
Saddam Hossain

Agenda

- A Glance at Evolution of Regulations
- Impact of 2013 Regulations on
  - Participating (PAR) products
  - Non- Participating (Non- PAR) products
  - GSV
- Advantages and Challenges for different product categories
- Way Forward

A Glance at Evolution of Regulations

1938: Insurance Act was enacted

1999: IRDA was constituted as an autonomous body

2000: IRDA incorporated as an statutory body

2005

Guidelines on Unit Linked Products

2009: ULIP Regulations

2013: Non-Linked, Linked & Reinsurance Regulation

Major Stakeholders impacted by Regulations

- Customer/Policyholder (PH)
  - Protection and Savings needs are met through insurance products
- Shareholder (SH) / Insurer
  - Designs products to meet the customer needs
  - Look for profit and return on capital
- Distributor
  - Help customer through product recommendations
  - ..and help Insurer by distributing the products
  - Rewarded by commission.

2013 Regulations- Key Points

- Clearly defined product categories
- Change in scope of product design and innovation
- Index linked products categorized as VIP
- Death benefit
- Benefit disclosure
- Better With Profit (PAR) governance
- Guaranteed Surrender Values (GSV)
- Provisions for pension and group products
- Commission structure based on PPT

Clearly Defined Product Categories

- PAR products
  - Non – linked platform
    - Variable Non-Linked Insurance products
    - Other than Variable Linked Insurance products
- Non- PAR products
  - Linked platform
    - Variable Linked Insurance products
    - Unit Linked Insurance products (ULIP)
  - Non-linked platform
    - Variable Linked Insurance products
    - Other than Variable Linked Insurance products

Change in Scope for Product Design

PAR

- Mostly identical products
- Lower Saleability due to discretion in bonus declaration
- Level of bonus will be a key factor -
  - Investment Performance
  - Expense Management
  - Smoothening philosophy
- Demonstrating as savings product – non negative return restricts design structure

Non- PAR

- Differentiated products possible
- Customer usually prefers guarantee
- Lower return than earlier; balancing between -
  - SH Profit
  - Distributor Remuneration
  - Customer Return
- Possible increase in market share in short term

Index Linked Products Categorized as VIP

Earlier

- Linked to external index
- Many companies were selling this product
- Lower reinvestment risk

Now

- Considered under VIP
- Companies may be reluctant to sell
- Separate and stringent regulations
- Higher guarantee risk

Capital Requirement

PAR

- Reserve increases gradually as bonus vests gradually
- Capital gets locked for long term
- Distribution of Surplus in 90:10 ratio - *IRDA (Distribution of Surplus) Regulations, 2002*
- Self sustainable when sufficient estate built-up
- Low risk- sharing of risk

Non- PAR

- Higher initial reserve – higher capital strain
- Capital intensive product may not be preferable by SH
- High investment risk
- Extensive ALM required
- 100% of profit released to SH

Death Benefit

PAR

- Mortality surplus/ loss distributed to PH/SH
- Competitive pricing through aggressive assumption
- Parity can be achieved through bonuses
- 105% condition – lower SAR (credit of VB)
- Enhanced Return

Non-PAR

- Higher death benefit (DB) – higher mortality risk
- Conservative assumption leading higher premiums
- Reinsurance regulation – more retention with insurer- higher claim volatility
- Change in risk management

Death Benefit (contd..)

- Effect on some popular product structure

Child Plan

- Typically higher DB because of inbuilt waiver
- New regulation further increases cover
- Less return to customer

Moneyback Plan

- DB does not consider *survival benefits paid already paid*
- Higher SAR compared to regular plans
- Less return to customer
- Possible design structure
  - Payouts weighted towards later part of the policy
  - Limited pay option – lower mortality cost

Benefit Disclosure

PAR

- Illustration @4.0% & @8.0%
- G. Sec yields are usually much higher than 4.0%
- Low/nil bonus under 4.0% scenario – negative view
- Short bonus history – illustration sets PRE

Non-PAR

- Benefits are guaranteed for Non-linked plans
- No interest rate scenario is required for illustration
- Look attractive to customer

Taxation

PAR

- Tax is payable on total surplus (both PH and SH portion)
- Possible change in future tax method
  - After DTC – Tax on SH part only with a higher tax rate
  - Overall higher return to PH

Non-PAR

- Tax is payable on SH profit
- After DTC
  - Higher tax outgo
  - Lower return to PH (if after tax SH profit unaltered)

With Profit (PAR) Governance

- Constitute With Profit Committee – one independent Director of the Board, the CEO, the AA and an independent Actuary
- With Profit Fund Management
  - Reinsurance Arrangement
  - Expense Allocation – reducing cross subsidy
  - Calculating per policy asset share
  - Disclosure in Annual Reports
  - Review by Independent Actuary

With Profit (PAR) Governance (contd…)

- Forming PRE
  - Bonus Philosophy
  - PPFM – currently not mandatory
  - Parity between PH generation
  - Better engagement with PH – gives confidence, security, lower lapses
- Following *GN- 6 'Management of PAR life insurance business with reference to distribution of surplus'*

With Profit (PAR) Governance (contd…)

- Advantages
  - Better understanding among all stake holders
  - Better management
  - Increased confidence in PH and distributor
  - Expected higher take up rate
  - No regulatory compulsion for public disclosure

With Profit (PAR) Governance (contd…)

- Challenges
  - Asset Share calculation – in accordance to *GN 6*
    - Level of expense charge
    - Investment return allocation
    - Treatment of miscellaneous profit
    - Tax on estate
    - Treatment of cost of guarantee calculation
  - Higher internal and regulatory disclosure
  - No past experience
  - System requirement
  - Expertise required
  - Company may not venture in PAR to avoid hassle

GSV – Current v/s Previous

- Comparison of earlier and current GSV

Policy Year	Earlier	Now #		
		Regular Pay		Single Pay
		Policy Term ≥ 10	Policy Term < 10	All Policy Terms
2^{nd}	NA	NIL	30%	70%
3^{rd}	For Regular Pay : 30% of total premiums paid excluding first year premium	30%	30%	70%
4^{th}		50%	50%	70%
5^{th}		50%	50%	90%
6^{th}		50%	50%*	Based on Asset Share; converging to maturity value
7^{th}		50%	50%*	
8^{th} onwards		Based on Asset Share; converging to maturity value	Based on Asset Share; converging to maturity value	

as % of total premium paid less any survival benefit already paid

* 90% for policy term less than 7 years

GSV

Positives

- Attractive selling point
- Higher liquidity to PH
- Overall sell may increase

Negatives

- Continuing PH may suffer - higher cross subsidy
- Lower return for matured policies
- Unviable for short term policies
- Higher overall capital strain

GSV – Impact on Product

PAR

- Lesser impact compared to Non-par
- Lapse surplus distributed among PH/SH through bonus
- GSV increases guarantee
  - At higher ages bonus supportability is low (@4%)
  - Capping of maximum age/ maturity age
- GSV – linking with Asset Share
  - Forced to liquidate assets in unfavorable market conditions
  - Less flexibility in investment

Non- PAR

- Earlier lower GSV
  - ..so higher surrender profit
  - Less emphasis on renewing policies
- Now less surrender profit
- Unviable for lapse supported product (except for Protection plans)
- Link with proxy asset share
  - On maturity, SV may not converge to maturity value
  - Past experience passed on – goes against 'Non-PAR' concept

GSV - Challenges

- Setting up assumptions for
  - Withdrawals
  - Maintenance Expenses
- Uncertain PH behaviour under new surrender regulation
  - Guarantee in the money
    - Possibility of higher surrender
    - Adverse effect on financials

GSV – Challenges (contd…)

- Lower Equity Exposure
  - Lower return to customer
  - Change of bonus strategy
- Matching Asset Liability Strategy
  - Higher surrender - duration will reduce
  - Investment in lower duration assets – lower return
- SSV – might be close or even lower than GSV

Pension and Group products

Pension

- Restriction of purchasing annuity from the same insurer
- Guaranteeing non negative return
- Higher disclosure requirements

Group

- Only fund based product under ULIP
- Non-linked products – Both EE & non-EE
- Savings VIP offered to only non-EE homogeneous groups
- Cap on surrender charges for fund based products
- Cap on Commission

PAR- Advantages and Challenges

Advantages

- Benefits to PH
  - Smoothed return – lower risk of volatility
  - Overall higher & stable return
- Bonus – flexibility to split between RB & TB
  - Innovation through differentiated bonus structure
- Investment flexibility
  - Higher TB will give higher flexibility – higher estate
  - Possibility to have higher equity exposure
- Higher long term interest rate is favorable

PAR- Advantages and Challenges

Challenges

- Discretion in bonus declaration
  - PH confidence will be lower
  - Lower RB strategy – effect product marketability
- Higher GSV
  - Restriction on product design
  - Capping of max age/maturity age
- Non existence of adequate bonus history – mainly for new entrants
- Less potential for Group business
- Higher With Profit Governance
  - Asset Share Calculation, PRE - Bonus philosophy, communication to PH
  - System development

PAR- Advantages and Challenges (contd…)

Challenges (contd…)

- Risk of failure of governance leading to insolvency
  - Loss of PH confidence
  - Loss of company reputation

Target Markets

- Customers looking for wealth creation along with protection in early years
- Customers looking for upside income with lower volatility

Non-PAR (Protection) - Advantages and Challenges

Advantages

- Good product to start a relationship with a customer
- Simple administration
- Aid in increasing insurance penetration
- Growing level of income – higher protection required – higher sell expected
- Expected quick approval by the regulator
- Surrender regulation does not impact this category
  - Some lapse supported product will still be there
- Attractive for Group business

Non-PAR (Protection) - Advantages and Challenges

Challenges

- Increased retention limit – pushing for retaining higher cover
  - Treaty – quota share to surplus arrangement
- Competitive reinsurance rates – price war under protection business
- Difficult to gain market share for new entrants
- Generally strain is there – so capital intensive

Target Markets

- Suitable for protection and mortgage planning
- Young customers with potential growth in earning in future

Non-PAR (other than VIP) - Advantages and Challenges

Advantages

- Supportable commission level is higher (compared to ULIP)
  - More incentive to sell
- Higher profit margins - compared to ULIP & PAR
  - Along with higher risks
- Innovation is still possible
  - Selling pitch
  - ..but system challenges

Non-PAR (other than VIP) - Advantages and Challenges (contd...)

Challenges

- Capital intensive product
- High death cover and higher liquidity – lower return to PH
- Following *GN 22 - 'Reserving for guarantees in Life Assurance Business'*
  - Preferable by risk averse PH

Target Markets

- Meet various PH needs
  - Guaranteed return, higher cover
  - Preferable by risk averse PH

Non-PAR (VIP) Advantages and Challenges

Advantages

- Preferred by customers
  - Guaranteed return - Minimum guarantee
  - Non negative claw back additions

Challenges

- Interest declaration in advance
- High guarantee – ALM required
- System Challenges

Target Markets

- Customers looking for guaranteed return
- Group savings scheme

Non-PAR (ULIP) Advantages and Challenges

Advantages

- Higher marketability
  - Attractive product structure after the new regulation
  - Pitch can be made by showing RIY
  - Preferred by customers
- Risk is very low – PH bears most of the risk

Challenges

- Lower level of commission supported – lower sale
- Lower surrender penalty
  - Lower level of profit for SH
  - Higher lapse – initial expense might not be recovered

Non-PAR (ULIP) Advantages and Challenges (contd...)

Challenges (contd...)

- Loss of market segment
  - Highest NAV product stopped
  - Series of funds are not allowed anymore
- ULIP charge restrictions – documentation for guarantee charges

Target Markets

- Those who look for market linked returns

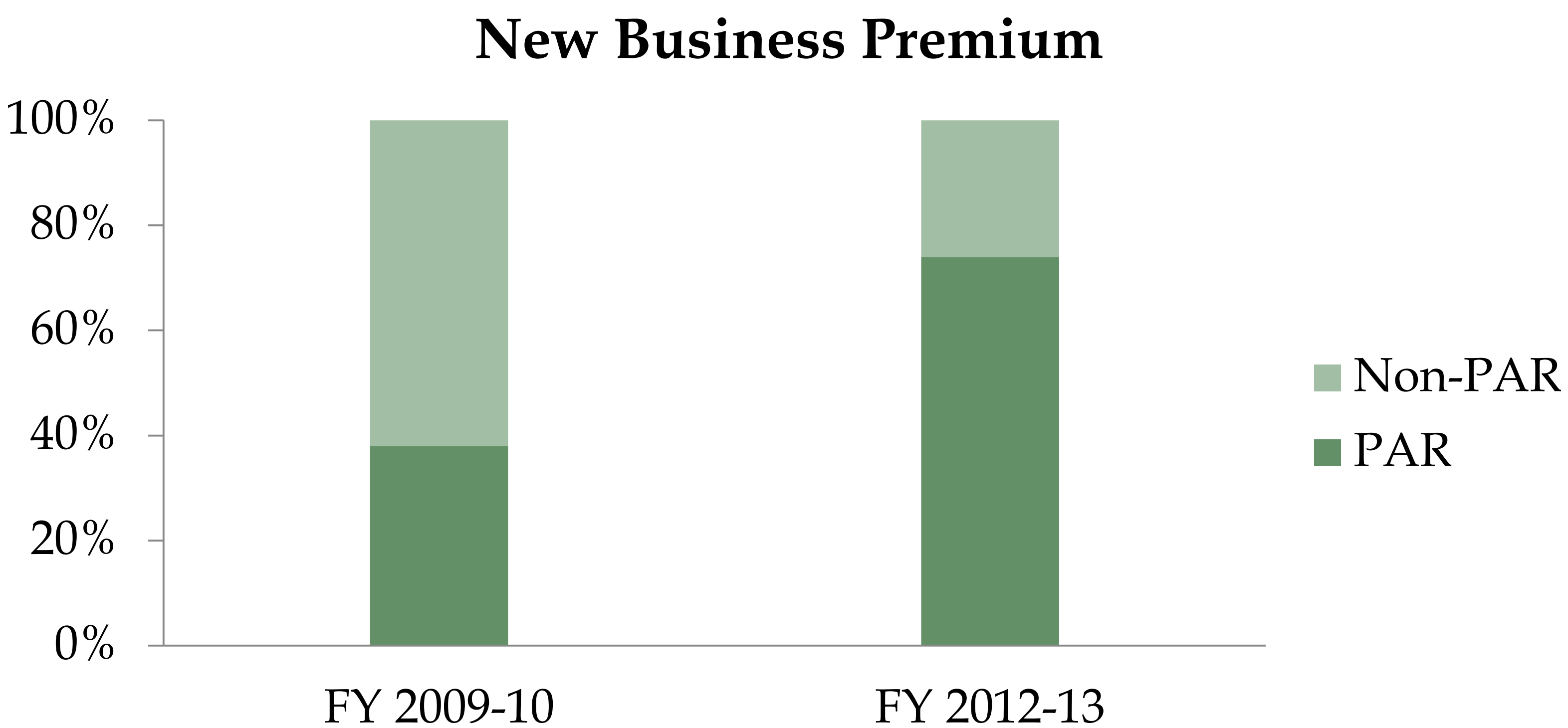
Forces impacting Company's strategy - Internal Factors

- Target segment/ sector – geographical & financial
- Strength and reach of distribution channel
- Brand perception
- Capital position and cost of capital
- Expansion plan
- Years of operation - vintage
- Budgeted break-even target
- Expense management – expense over run
- Risk management strategy – risk appetite
- Level of profit for existing product category
- Balancing interests of PH, SH and distributor
- Level of system sophistication

Forces impacting Company's strategy - External Factors

- Growth in GDP and level of insurance penetration
- Regulatory developments
- Financial sophistication of target market
- Customer awareness
  - Level of education
  - Internet sophistication
- Tax incentive and impact of DTC
- FDI hike

Product Mix



Source- IRDA monthly journals, The Actuary India Magazine October 2013
*Non – PAR includes ULIP

Way forward

- It is too early to judge between Par and Non Par
  - Good mix of Par and Non-Par may be preferred
  - ULIP – out of favour for now – may pick up in future
  - Mix may depend on each company's strategy
- Company Strategy will depend on
  - Capital Support
  - Risk Appetite
  - Existing expertise
  - Comfort of distribution channel – existing culture
- Increased FDI might impact the strategy

Questions??..

Thank You!!