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India

Institute of Actuaries of India

Session 5
Evolving regulatory landscape and implications for insurers

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Waves of Reforms…Oceans of Opportunities

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Macroeconomic overview

- India has averaged real GDP growth rate of 7.86% over the last 5 years
- Though GDP growth in FY13 is expected to slow down to 5.5-6.0%, it is expected to be 6.5-7.5% over the next decade
- Inflation and interest rate expected to start moderating in first half of FY14 and is expected to be approximately 6-6.5% over the next 10 yrs
- Robust foreign capital inflows of USD 36.5 billion for FY12, registering a growth rate of 88% over the previous year
- Widening fiscal and current account deficits are a major concern for the economy in the short run, FY13 fiscal deficit expected to be 5.7%, higher than government's target of 5.1%, while current account deficit is expected to be 4.2%
- Gross domestic savings averaged 33.7% over the last 5 years and is expected to remain steady at approximately 30% over the next decade
- Insurance funds and Provident & Pension funds account for approximately 23% and 13% share respectively of financial savings

Growth outlook

Growth rate (%)	FY10	FY11	FY12E*	FY13P†
GDP (at factor cost)	8.4	8.4	6.5	6.0
- Agriculture and allied activities	1.0	7.0	2.8	1.3
- Industry	8.4	7.2	3.4	4.0
- Services	10.5	9.3	8.9	8.1
Private final consumption expenditure	7.1	8.1	5.5	5.8
Government final consumption expenditure	14.3	7.9	5.1	10.1
Gross fixed capital formation	6.8	7.5	5.5	3.5
Wholesale price index	3.8	9.6	8.9	7.9
Index of industrial production	5.3	8.2	2.9	3.3
Exports	(2.6)	40.7	21.3	(5.2)
Imports	(3.9)	28.5	32.4	(3.3)
Corporate PAT	28.4	9.6	(0.4)	17.7

Source: CMIE Monthly Review of Indian Economy (2012 – November)

*CMIE estimates

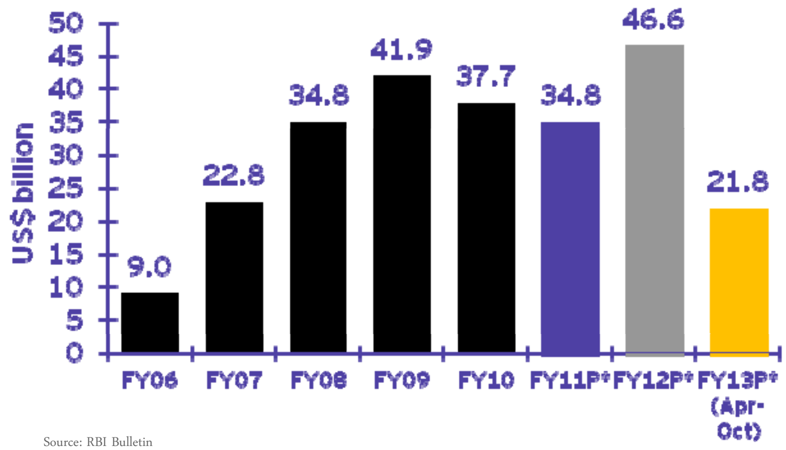
†CMIE projections

- GDP at factor cost is estimated to have grown at 6.5% in FY12. Economic growth slipped in FY12 mainly due to poor performance of manufacturing and agriculture sector, and declining output of the mining industry. The GDP is forecasted to grow by 6% in FY13.
- High fuel and commodity prices kept WPI levels on a rise in FY11 and FY12. Depreciation of the rupee is expected to add to inflationary pressures with inflation projected to reach 7.9% in FY13.
- Private and government final consumption expenditure continue to contribute to India's growth trajectory.
- Industrial output is expected to grow by 4% in FY13 driven by an acceleration in production growth of large industries like electricity, crude oil, steel, fertilizers and automobiles.
- In FY11 and FY12, petroleum products, transport equipment, gems and jewellery, agri-products, machinery and instruments witnessed an increase in exports. The government targets to double the merchandise exports by FY14 taking it to US$500 billion.

FDI inflows – India the third most attractive FDI destination in the world

- **Top global destination for FDI:** According to UNCTAD's 'World Investment Prospects Survey '2012-2014', India is the third most attractive destination for FDI (after China and US) in the world.
- **Decline in FDI inflow during FY11:** FDI in India decreased during FY10 witnessing a y-o-y decline of 10%. In FY11, it witnessed a fall of 7.7%.
  - **Key causes:** The decline in FDI can be attributed to delay in government approvals for projects, land acquisition issues and macroeconomic factors such as interest rates and inflation.
- **Renewed momentum in FDI in FY12:** During FY12, the direct investment into India has witnessed a significant comeback growing by 33.9% y-o-y. In January 2012, the government liberalised its policy for FDI in single brand retail by increasing the FDI cap to 100% from 51%, thereby promoting retail FDI.

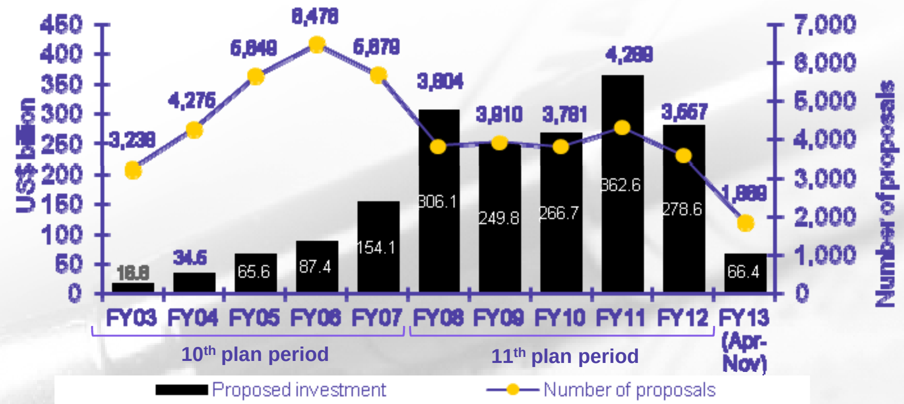
FDI in India (US$ billion)



Source: RBI Bulletin
FDI includes credit portion of direct investment in equity, reinvested earnings and inter company debt transactions
*Provisional

- **Investment momentum:** During the period FY03-FY12, the value of investment proposals into India increased at a CAGR of approximately 36.6%.
- **Investment scenario in FY12:** During FY12, India received 3,557 investment proposals amounting to US$278.6 billion.
- **Procedural reforms:** The Government has allowed Foreign Investment Promotion Board (FIPB) to clear FDI proposals up to a limit of INR12 billion. Earlier investments above INR6 billion were put before Cabinet Committee of Economic Affairs (CCEA) for approval.

Number of proposed investments and their value



Source: Department of Industrial Policy & Promotion, Government of India
*Includes Industrial Entrepreneur Memoranda, Letters of Intent and Direct Industrial Licenses

*Values in INR have been converted to US$ using the average exchange rate for each financial year (FY03: 1 INR = 0.02066 US$; FY04: 1 INR = 0.021765 US$; FY05: 1 INR = 0.022295 US$; FY06: 1 INR = 0.022625 US$; FY07: 1 INR = 0.022135 US$; FY08: 1 INR = 0.024835 US$; FY09: 1 INR = 0.021755 US$; FY 10: 1 INR = 0.02104 US$; FY11: 1 INR = 0.02186 US$; FY12: 1 INR = 0.020775 US$; FY13 (Apr-Nov 2012): 1 INR = 0.018365 US$).

Insurance sector has strong growth potential

The past

- Only public sector players existed - Life Insurance Corporation (LIC) which was formed in 1956; four general insurers and one reinsurer commenced business in 1973
- Open competitive and unregulated sector

Key drivers for change

- In 1999: liberalization with a foreign direct investment (FDI) limit of 26% in both life and general insurance sectors; participation of private companies begins
- In 2000: formation of Insurance Regulatory and Development Authority (IRDA)
- Favorable demographics
- Growing awareness about insurance and rising incomes
- Launch of innovative products — unit-linked insurance products (ULIPs)
- Emergence of new distribution channels to increase reach

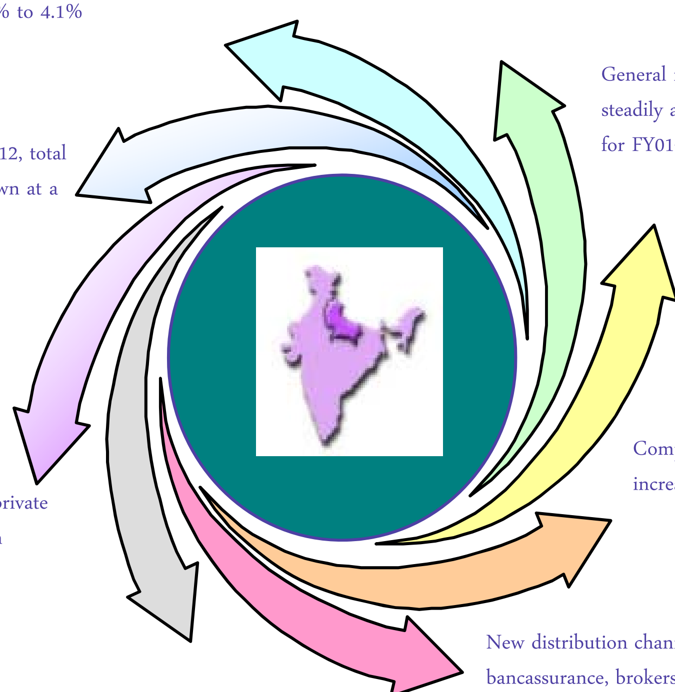
Current state

Increased penetration: from FY01 to FY12, premium income as a % of GDP has increased from 2.3% to 4.1%

From FY01 to FY12, per capita premium income has increased from INR439 to INR2,828

General insurance has grown steadily at a CAGR of 1.6% for FY01-FY12

From FY01 to FY12, total premium has grown at a CAGR of 20.3%



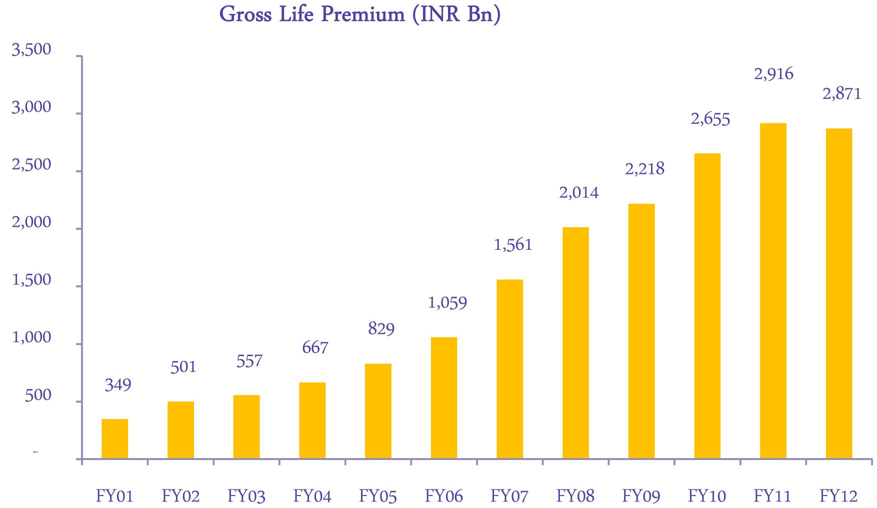
Competition has increased

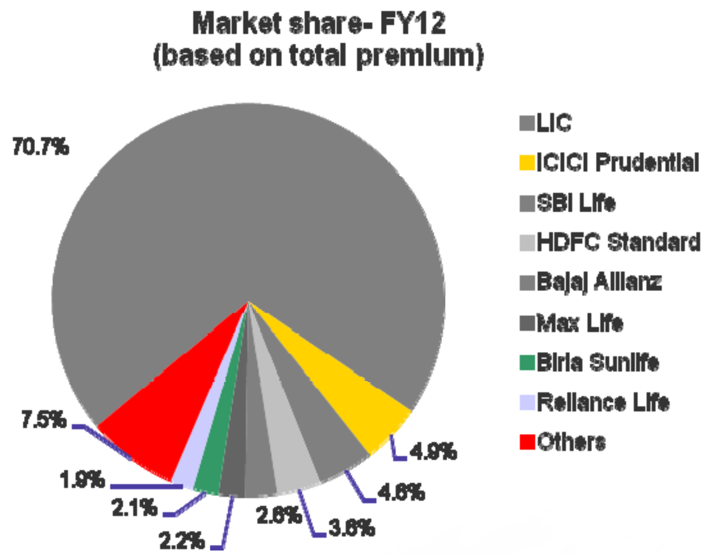
Market share of private players has grown

New distribution channels — bancassurance, brokers and e-channels have emerged

From FY00 to FY12, number of players have increased from 12 to 51 (24 in life and 23 in general and 4 standalone health insurance)

Life insurance - robust growth but facing headwinds





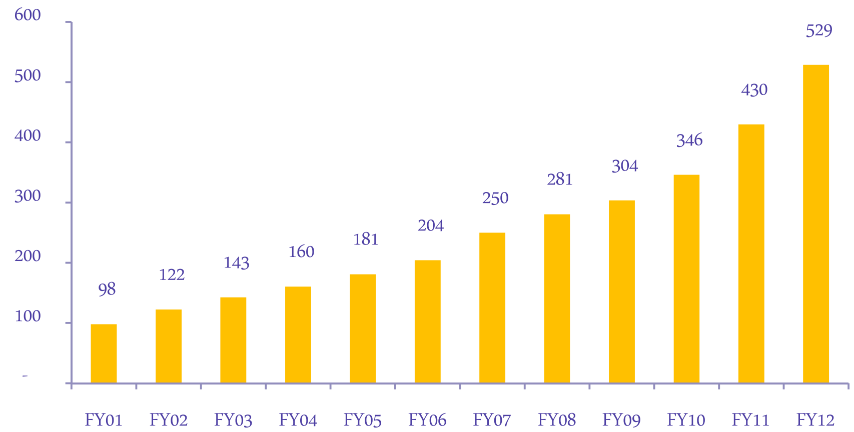
Source: IRDA

- Robust growth at a CAGR of approximately 21% in premium income during FY01–12
- Growth at around 3.3% CAGR in the number of new policies issued during FY03–12
- Sum assured to GDP ratio of 52% in FY12
- Penetration has increased from 2.3% in FY01 to 4.1% in FY12. However it has fallen from a high of 5.0% in FY08
- 14 life companies reported net profit in FY12. The life industry reported a profit of INR59.74 bn
- FY13 first year premium is expected to be approximately around INR1,150-1,200 billion (same as FY12) as almost 40% of total premium is collected in the last fiscal quarter

Non-life insurance: still to take off substantially

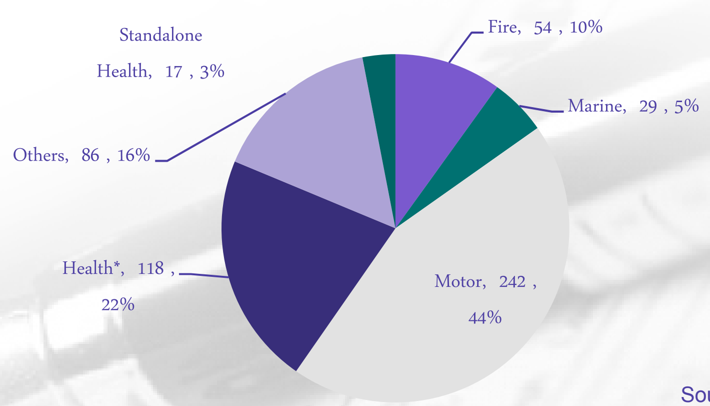
- Gross premium increased at a CAGR of 16.6% during FY01-FY12
- An increase in the share of private sector in total premiums from 0.005% in FY01 to 42% in FY12
- Trends in products
  - Motor insurance has the biggest share in the general insurance market (44% in FY12).
  - Health segment has shown the highest growth with the total market share increasing from 12.8% in FY07 to 25% in FY12
  - Public sector companies hold the entire market share in marine insurance segment.
- The incurred claims ratio of the non-life insurance industry reduced slightly and stood at 88.85% during FY12, as compared to 93.30% in FY11.
- The total net profit of non-life insurance industry was INR 0.32 bn in FY12 as against a net loss of INR 10.19 bn in FY11

Non-life Insurance Industry Premium (INR Bn)



Source: IRDA

Segmental breakup FY12 (INR Bn)



Source: IRDA

Evolving regulatory landscape: life insurance

Traditional products	▶ Transparency of cost structures ▶ Benefits and cost caps to be defined for non-participating products ▶ Minimum sum assured linked to annual premium ▶ Minimum surrender value to be made more comprehensive ▶ Products should specify minimum death benefits, minimum life protection component and minimum guaranteed surrender value
Norms on Distribution	▶ Agency ▶ Bancassurance ▶ Alternate channels

Norms on IPO	▶ IPO eligibility conditions
	    ▶ Min 10 years of operations, required solvency margins
	    ▶ Should have reported net profit for at least 3 of preceding 5 financial years or embedded value of atleast twice the paidup capital
	▶ Tier II capital – Enabling clauses on other forms of capital

Norms on M&As	▶ Norms on voluntary mergers ▶ Norms on forced merger ▶ Policy holder protection ▶ Runoff handling

Evolving regulatory landscape: non-life insurance and reinsurance

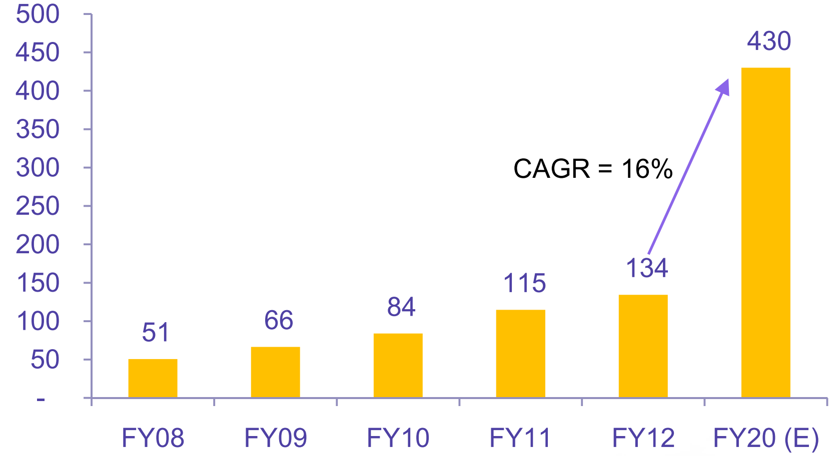
Non-life insurance	
	Strengthening of solvency norms
	Aligning of risk premium and pricing
	Strengthening underwriting processes
	Amalgamation norms
	Development of distribution channels
	Industry wide data repositories

Reinsurance	
	Entry norms for global reinsurers
	Branch/ subsidiary norms
	Differential norms for Lloyd's

Health insurance – significant emerging opportunity

- Total health expenditure in India is estimated to be INR 3,000 billion. Against that, the present level of health insurance implies only about 4% penetration
- 75% of health spend in India is out of pocket
- Government and other insurance schemes cover only 20% of total expenses; private insurance contributes 4%-5% of total health expenditure in 2012

Growth in health premiums (INR Bn)



Source: IRDA annual reports, EY analysis

- IRDA has taken a favorable stance towards health insurance with the focus being on enhancing the penetration
- Health premiums are expected to grow significantly over next few years
- Industry estimates have projected Health Insurance Premiums to rise to INR 430 billion by 2020 (includes retail and group health by health and general insurers)
- The retail health insurance market (for health & general insurance players) is expected to grow to ~INR 260 billion by 2020 at a CAGR of ~23% (approximately 60% of the total health segment)

Challenges facing the industry

- **Expectation of moderation in business growth**
  - Exponential growth was witnessed over the past few years. This period is a mid-term course correction towards stabilization.
  - Shift towards traditional products and sales of ULIPs, which had been a major growth driver, impacted due to new product norms
- **Capital requirements are likely to increase**
  - Transition to solvency II, high investment in building distribution networks besides business growth are likely to increase capital requirements.
- **More disclosures**
  - Growth in the number of insurance companies and increase in their risk appetite has raised the demand for increased disclosures.
- **Low operating efficiencies**
  - Insurance companies are facing low operating efficiencies due to heavy investment in their distribution networks.
- **High claims ratio in health insurance**
  - Claims ratio is increasing due to high healthcare costs, fraudulent claims, and inefficient claims management processes.
- **High expense ratio**
  - Though showing a decreasing trend, the expense ratio is on the higher side. In FY12, the private sector life insurance segment had an expense ratio (operating expense and commission expense) of 22.8% while the general insurance sector registered 14.3%.
- **Low financial literacy**

Way forward for the industry

- Products
  - Simplify product design rather than just adding features and riders
  - Focus on long term rather than investment products
  - Risk based pricing of non-life products
  - Basic simplified health insurance products to allow easy portability
- Customer centricity – treating customers fairly
  - Suitable advice
  - Suitable product
  - Suitable post sale service
- Cost optimization
  - Leverage ICT for operations efficiency
  - Strengthening claims investigation mechanisms through data mining and analytics

Thank you

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