Traditional Savings type life insurance products – low policy persistency and low surrender values (vis-à-vis premiums paid) in the context of PRE – implications for the industry and profession and suggestions to address these issues

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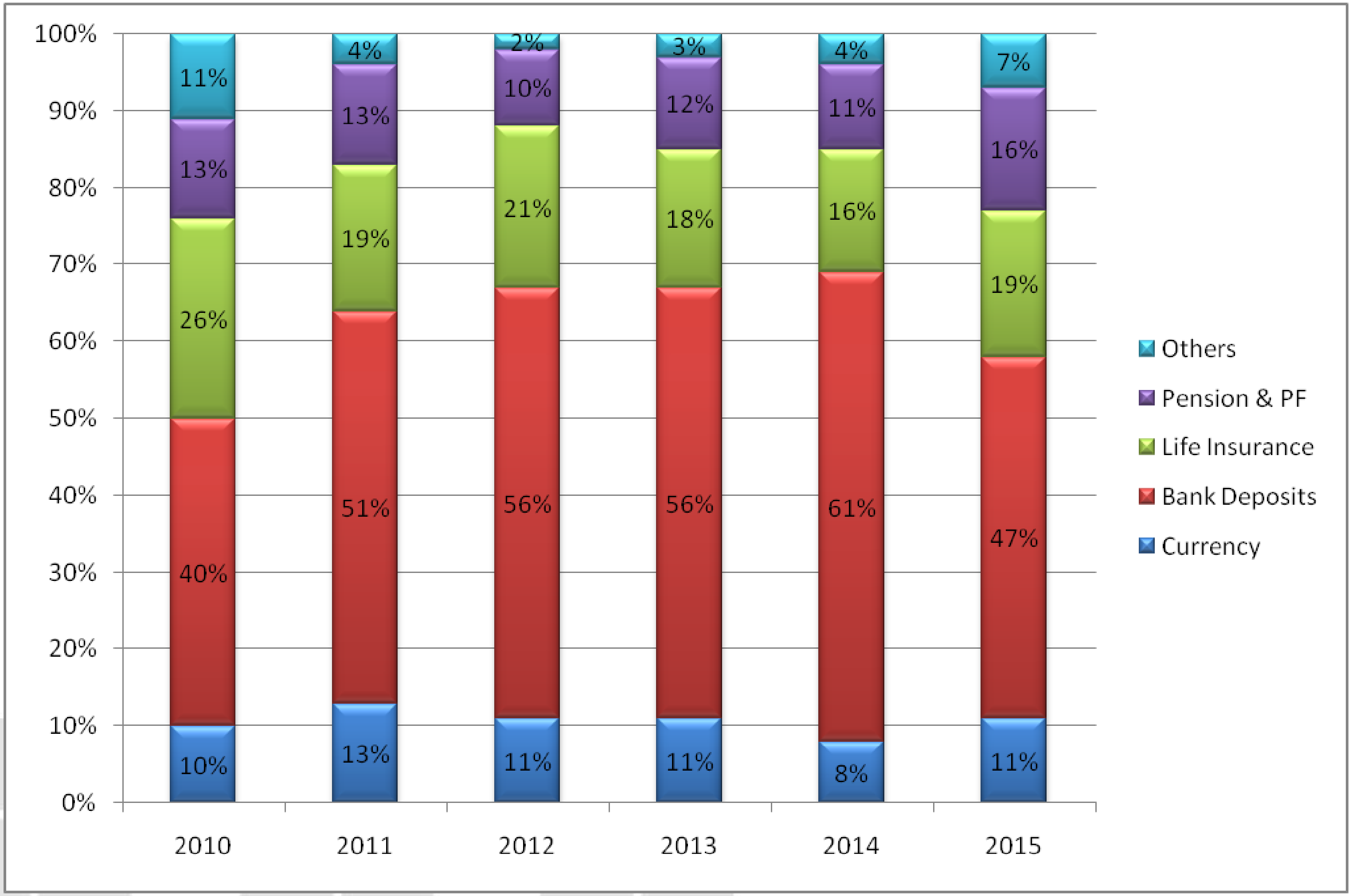
Agenda:

- **Market Share & Global comparison**
  - Market Share Financial instruments
  - Insurance Penetration
  - Insurance Density
- **India Traditional market & PRE – Surrender value**
  - India Traditional market
  - PRE – Surrender Value
- **Low persistency & Surrender Value**
  - Background
  - Glance at regulations
  - Reasons
- **Implications**
  - For all stakeholders
- **Suggestions**
  - Outside India – Secondary Market
  - Cost control
  - Need based sell – SH point of view
  - Improve persistency & Surrender value
  - Improve value of distribution stakeholder
  - Retain client on overall platform

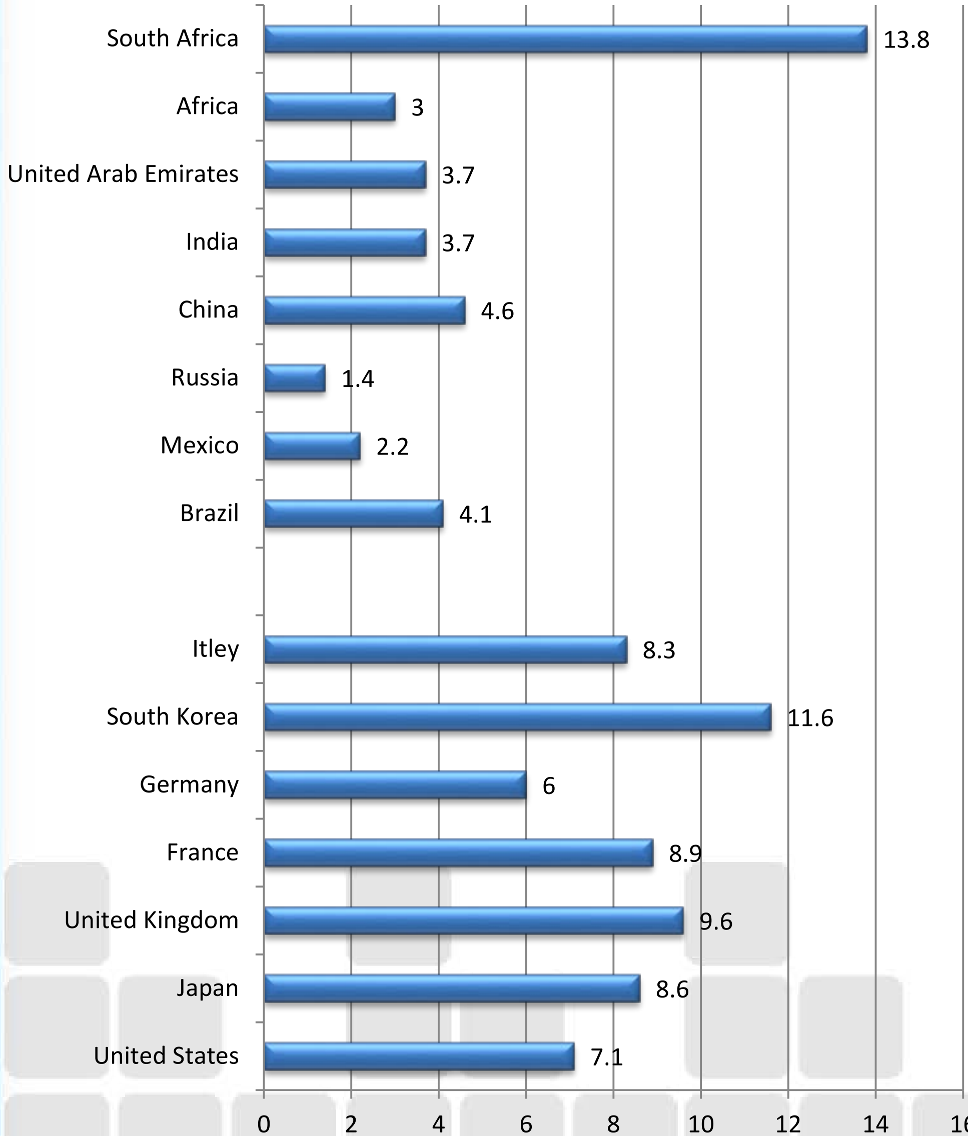
Market share between financial instruments

Share of Life Insurance as a proportion to savings



Insurance Industry Reach

Insurance Penetration(2017)



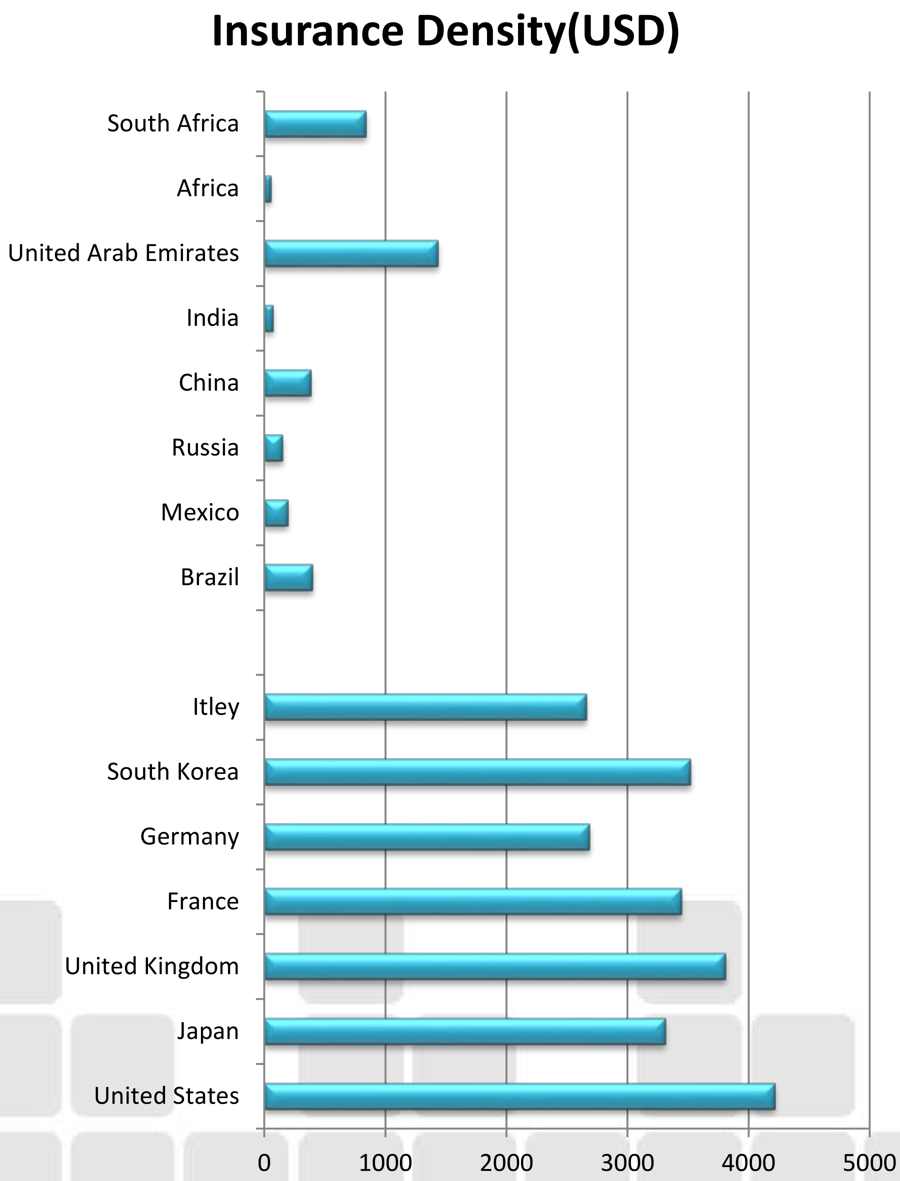
- **Insurance penetration --** the ratio of premium underwritten in a given year to the gross domestic product (GDP) .

- Penetration provides view of spread of insurance among GDP producers.

- India Life business 2.7% of GDP in 2017 compared to 3.5% global average.

NOTE : These % include insurance penetration for non life insurer also.

Insurance Industry Reach (contd…)



- Insurance density :ratio of total insurance premiums to whole population of a given country
- Density allows for spread of insurance allowing for skewness of income distribution, i.e. indicating financial inclusion gap
- India Life business premium USD 55 (Rs 3500) per capita in 2016 compared to global average of approx. USD 300 (Rs 19500)

NOTE : These % include insurance penetration for non life insurer also

India premiums and business mix 2016/17

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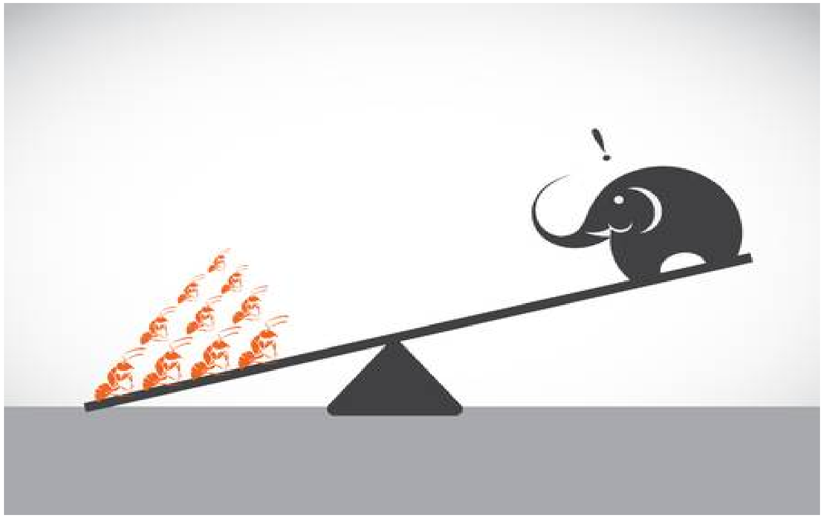
Premium (Rs. Cr)	FY 2016-17			
	Non-Linked	Linked	Total	Non-linked/ Total
New business	**1,53,998**	**21,205**	**1,75,203**	**88%**
Regular Premium	41,859	17,491	59,350	71%
Single Premium	1,12,139	3,713	1,15,852	97%
Renewal	**2,11,633**	**31,641**	**2,43,274**	**87%**
Total	**3,65,631**	**52,845**	**4,18,477**	**87%**
Renewal/New bus	**5.1**	**1.8**	**4.1**	

(Regulator handbook of statistics 31 March 2017)

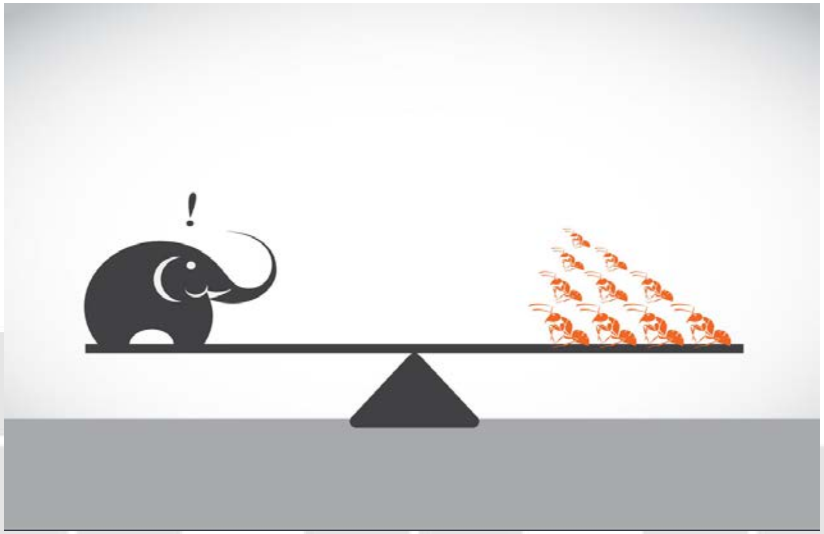
Comparison of Financial Products

- **Traditional Savings(Par, Non Par) v/s other Financial Saving Products**
  - **Term of investment**
  - **Investment return**
  - **Withdrawal flexibility**
  - **Tax benefits**
  - **Life cover/Pure investment**
- **Traditional Savings(Par, Non Par) v/s ULIP**
  - **Purpose**
  - **Return on investment**
  - **Flexibility**
  - **Security**
  - **Switching options**

Policyholder’s Reasonable Expectations



Actual Condition

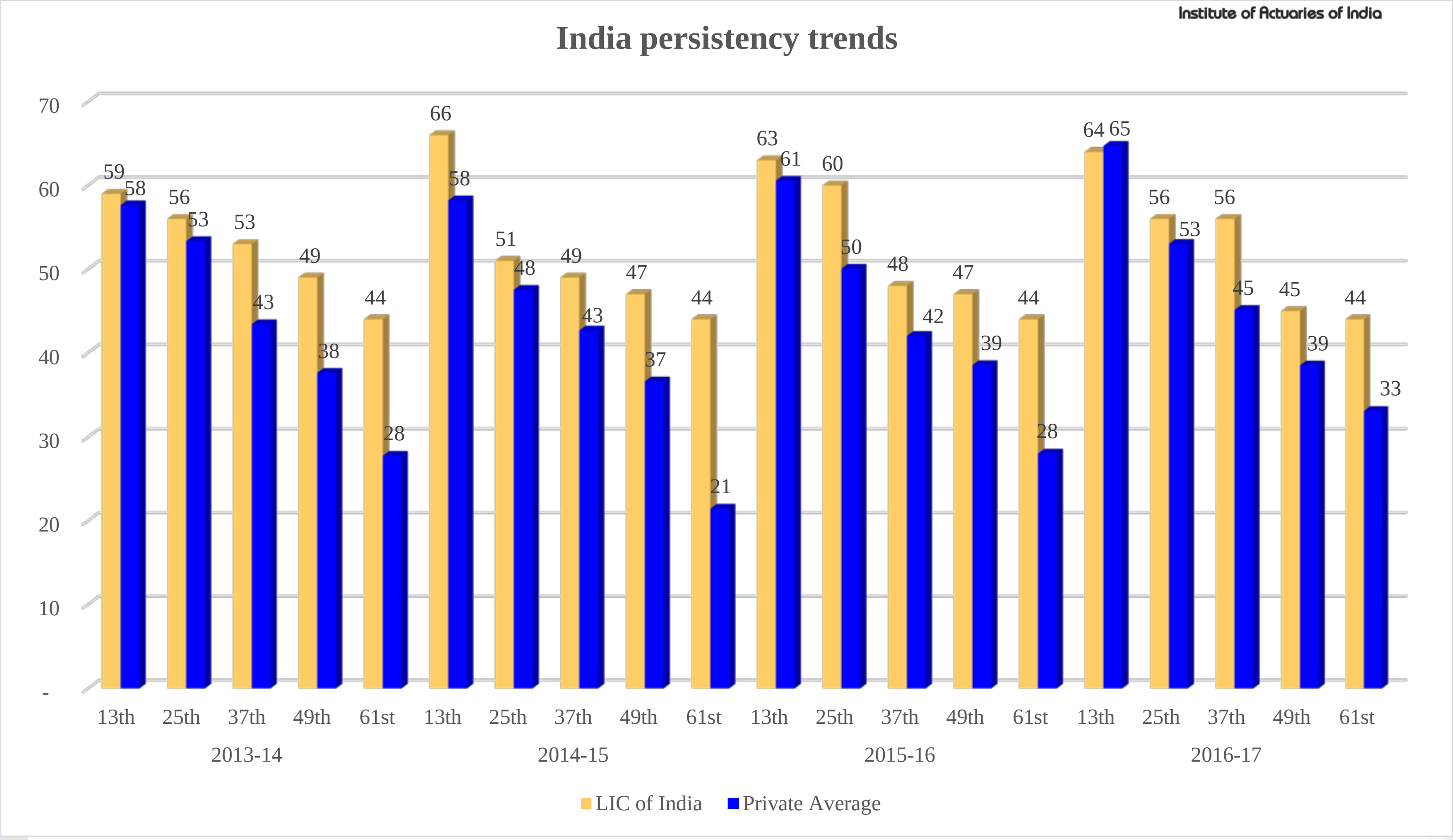


Ideal Condition

PRE-Surrender Value

- ❖ PRE arise due to discretion available to an insurer for benefits payable to PH.
  - Created by policy literature or policy bond, past practices, Marketing material, benefit illustration, Bonus philosophy
- ❖ BI provided at time of New business provides information for death, surrender, maturity or survival benefits payable
  - BI illustration for 4%/8% gross return reflects surrender value but doesn't reflect cost in terms of surrender IRR
  - Surrender IRR for customer vary over term- Negative in first few years, gradually increases and positive close to maturity
  - Single premium polices surrender IRR is higher
  - Surrender IRR low compared to combination of bank deposit account less risk charges

Life Insurance Persistency Ratios



❖ Globally, the persistency ratio is close to 90% in the 13th month and above 65% after 5 years.

(Regulator handbook of statistics 31 March 2017) – Based on policy count

Note: This include Linked and Non Linked Business

Why low persistency?

- Lack of need based selling
- Lower expected IRR/Better alternatives available in the market
- Mis-selling
- Changing consumers financial and lifestyle needs
- Increase in risk appetite/More Income
- Lack of trust in the insurance industry

Surrender Value Regulations in India:

Policy shall acquire a surrender value only when:	
Product with Premium payment term	**Consecutively paid for:**
Less than 10 years	2 years
10 years or more	3 years

Minimum Surrender Value linked to year of surrender:		
Durations	**Single Premium Policy**	**Regular Premium Policy**
Within 3 year	70% of Total Premiums	30% of Total Premiums
4^{th} year	90% of Total Premiums	50% of Total Premiums
Last 2 years(if PT is less than 7 years)	90% of Total Premiums	90% of Total Premiums

Surrender Value Regulations in India (Contd..):

Special Surrender Value	
Represent Asset Share in **Par policies**, calculated in accordance to the practice standards/Guidance Notes	Represents Proxy Asset Share in **Non-Par policies** – Reflecting experience

SV = Max(Guaranteed SV, Special Surrender Value)

Surrender Value Calculation:

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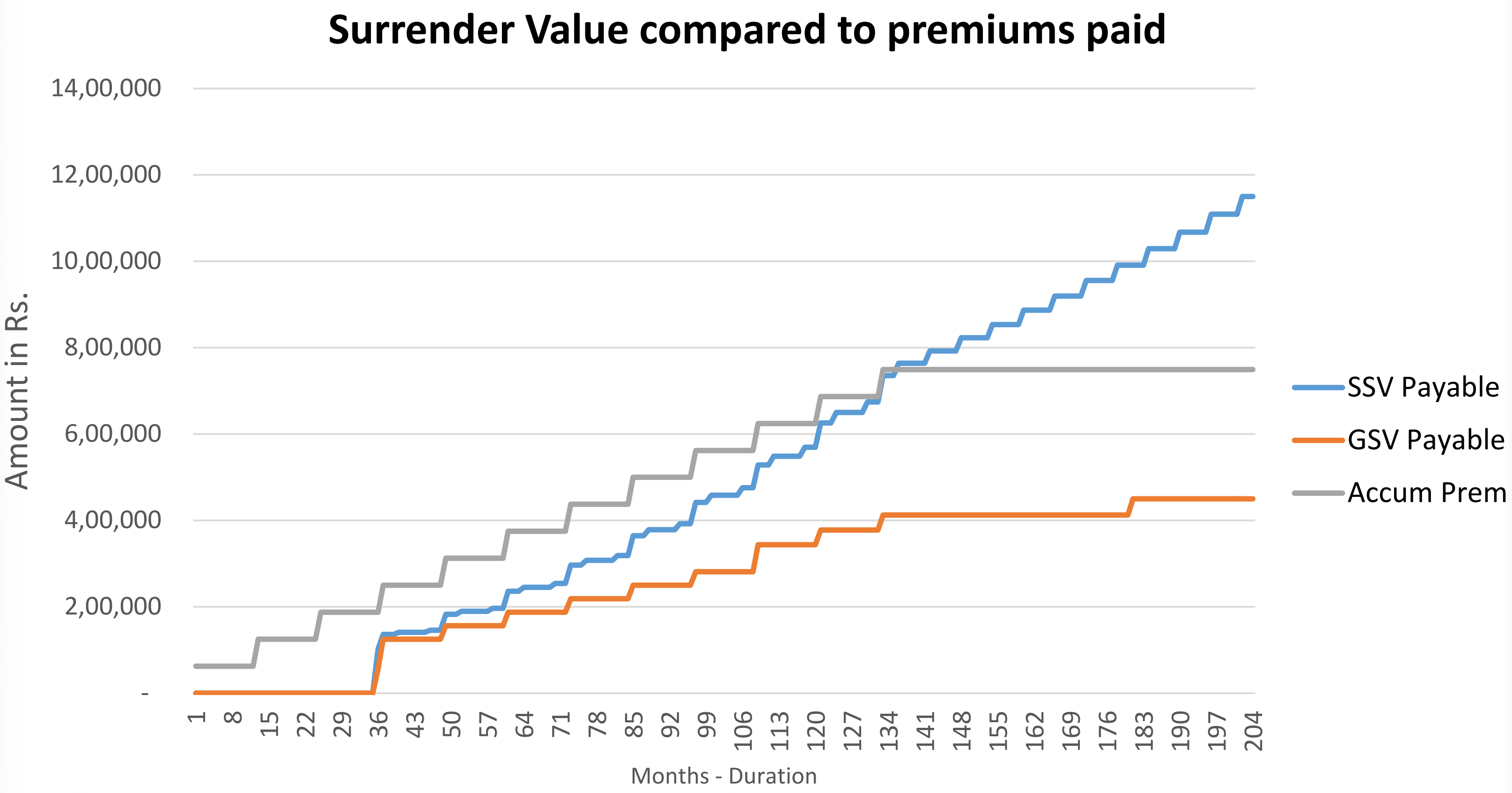
Surrender Value = **Asset Share** − **Surrender Penalty**

Discretionary

Lower SV vis-à-vis Premiums Paid

- Companies do not want to promote surrenders
- Cover acquisition cost
- Loss of future profits to the company due to discontinuance of the policy
- Spreading fixed cost to a smaller base of policies
- Need to modify and change investment strategy/Investment expenses

Surrender Value Trend



Product = PAR, qx = 90% of IALM rates, Interest rate= 7.75%, Policy Term= 17 years, PPT = 12 years

Implications:

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❖Lack of trust in Insurance Industry

❖Further lower penetration levels

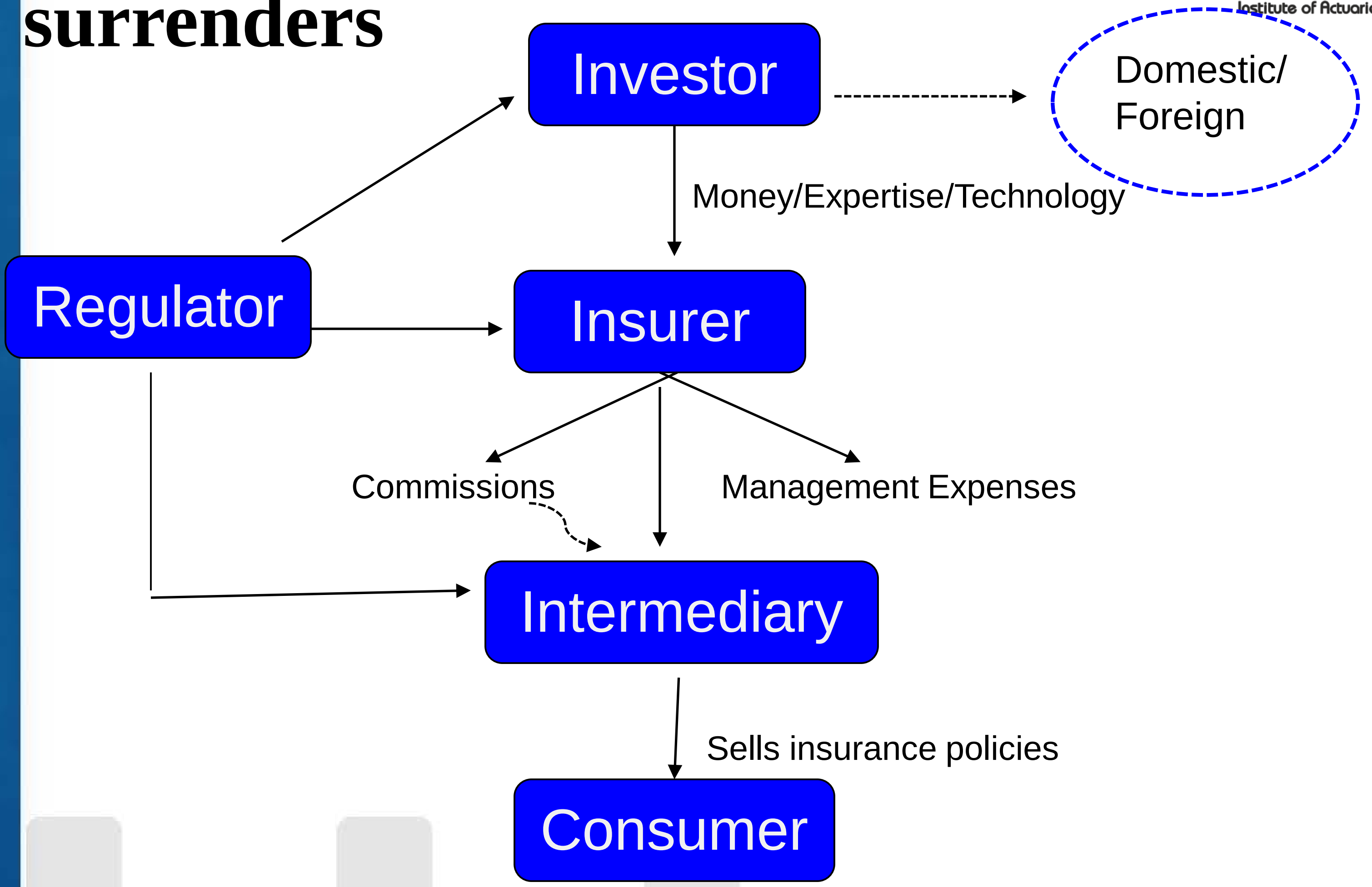
❖Reduced sale of insurance products

❖ Impact on tax income for government

❖ Lack of trust for sales force

❖ Bad publicity for profession

Insurance industry stakeholders: Holistic approach needed for surrenders



(Regulatory Impact Assessment in Insurance Sector in India: Facilitating Investments and Enabling Access, April 2016)

Spread of value at surrender: Single policy experience

Premium cancel Year	Shareholder		Customer		Distribution
	Surrender PM	Paid-up PM	Surrender IRR	Paid-up IRR	PV Commission/ PV Premium
1	15.3%	-	-	-	30.0%
2	42.3%	-	-	-	19.4%
3	21.1%	-2.1%	-36.5%	2.6%	15.9%
4	19.0%	1.5%	-22.9%	2.8%	13.7%
5	15.7%	2.8%	-13.6%	2.9%	12.3%
6	12.1%	3.0%	-7.4%	3.1%	11.4%
7	8.6%	2.4%	-3.0%	3.4%	10.8%
8	5.3%	1.4%	0.0%	3.6%	10.4%
9	2.4%	0.1%	2.1%	3.9%	10.0%

Traditional Non-Participating Policy term 10 years

Stake holder share to maturity (overall book):

Profit Margin (PM) 4.0% IRR 4.5% PV comm/ PV Premium 9.7%

Surrender impact on Stakeholder value:

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Stakeholder	Value out	Measure

Investor	Investment growth	• Surrender PM protected through pricing
		• BUT:
		    • Market share reduction
		    • EV negative experience variance

	Social-economic contribution	• Low income sector Surrenders higher, and • impact on financial security greater.
Insurer	• Functional efficiency • Corporate entity formation	• High acquisition cost ratios to replace business lost with new business • Pressure on customer consultation process to advise on alternative options at surrender

Distribution	Product marketing and selling	• Commission without claw-back
		• Commission share of Premium is high
		• BUT:
		    • De-growth in individual intermediary client network of or cross-selling
		    • Resulting de-growth in overall distribution force -> affect distribution management

Surrender impact on Stakeholder value (contd…)

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Stakeholder	Value out	Measure

Consumer	• Risk cover
	• Savings benefit
	• Financial instrument meeting needs
		• Withdrawal flexibility: partial withdrawal, full surrender if need access to funds
		• BUT:
		  • Surrender IRR low/ negative
		  • Premium flexibility: Paid-up IRR higher (80% of premium cancellations in years 3-5 result in paid-up rather than surrender), but paid-up sum assured low
		  • Surrender and Paid-up opportunity cost: Loss of future fund growth, risk cover

Regulator	Fair/ equitable distribution of value between stakeholders	• Commission and Marketing cost strain for Investor • Sustainability of Distribution model for industry • Fairness of surrender/paid-up IRR to Consumers • Consumer perception about insurance product
Actuarial profession	Expertise, professional standards	• Stakeholder engagement to improve soundness of insurance industry as a whole

Suggestions

Outside India-Secondary market

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- In USA,UK & Germany secondary market for lapse and surrendering policies is well developed, due to sufficient size of primary market
- In UK it is supervised by FSA, and allowed after 5 years(When guarantee accumulated, and initial cost recovered by primary PH)
- Average payment 7-15% above the SV to primary PH
- It is more famous if market interest rate < Insurer crediting interest rate which insurer can manage due to smoothing
- Offsetting effects for insurer due to lower lapse/surrender(low liquidity risk) vs stable investment(higher return)
- It leads to more innovative new product from insurer to compete for secondary market investors.
- It is criticized for not meeting insurable interest
- It lacks transparency in regards to fees and commission

When the cost of acquisition is higher than customer life-time value to an enterprise, that business is not viable.

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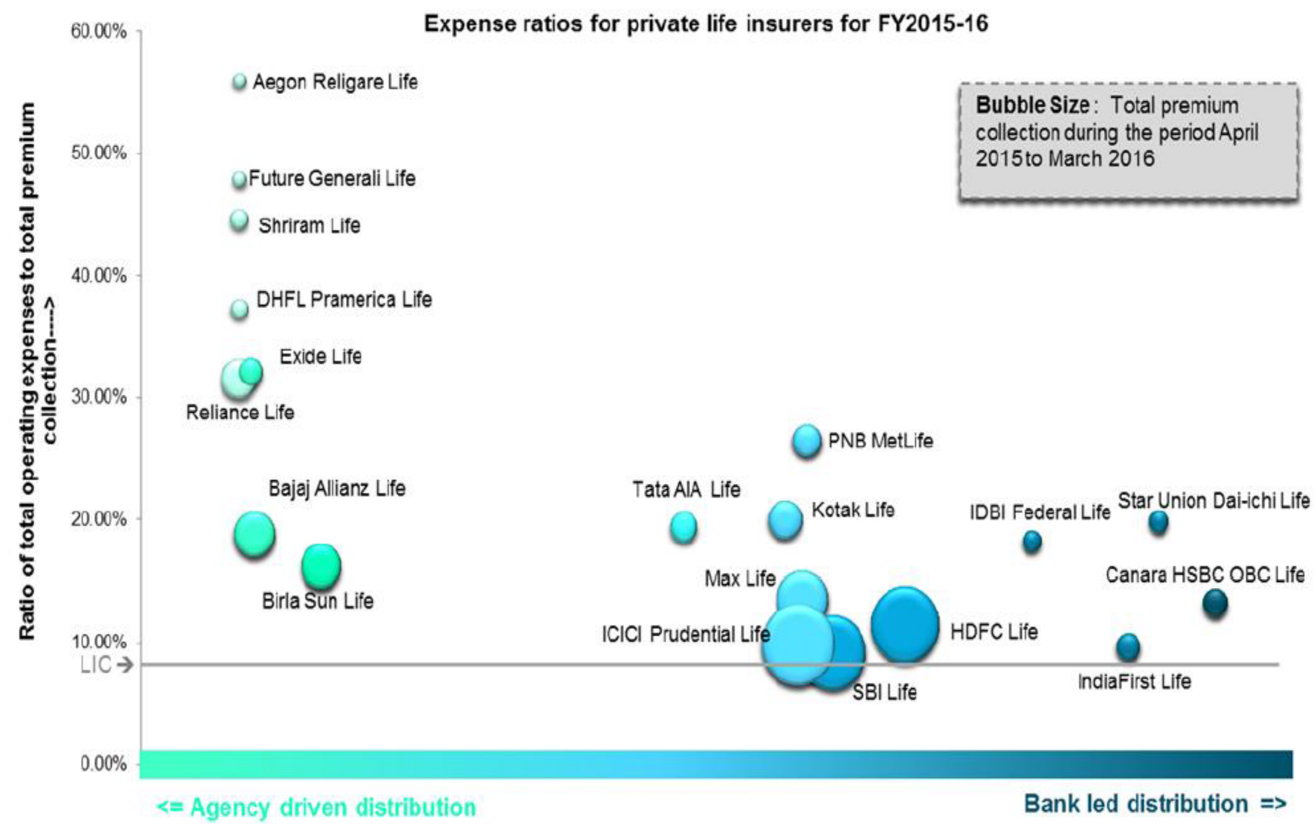

Source: Company public disclosures, Willis Towers Watson analysis
Note: Public Disclosures for Aviva Life, Bharti AXA Life and Sahara Life were unavailable at time of publishing this newsletter. Expense ratio for Edelweiss Tokio Life being in excess of 60%, has been excluded from the above analysis.

Contd…

Ways to control the cost

- Technology is opening startling new opportunities for innovation, but life carriers have been slow to embrace them. The boom in mobile computing, for example, is unveiling enormous amounts of data on consumers that is available from biosensors, wristbands and other lifestyle measurement devices that could eventually revolutionize life underwriting and monitoring processes.

- Invest in the distribution models of the future-Digitize the organization

- Operation & IT account for around 50% of atypical insurer’s cost base. Cut cost by optimizing the service level

- Other measures:
  - Rationalize operating models
  - Instead of fixed cost base experiment with variable cost structure for changing market structure
  - Consolidate & modernize IT landscape

Need-based selling for future
(From SH view)

- ❖ Match the level of consumer engagement that wealth managers have delivered in the form of financial planning, To achieve superior growth, life insurers must meet consumers' needs by offering living benefits, retirement income and a friendlier, simpler, seamless experience.

- ❖ Rethink sales force models, moving away from a product-push mode to provide customers with more unbiased advice, education and ongoing.

- ❖ Develop deep customer insights & engagement – Data analysis, research for attitudes & behavior tailoring value preposition & decision journeys.

- ❖ Simplify the product and messages – Anti selection increases with complex product structure

Improving Persistency & SV

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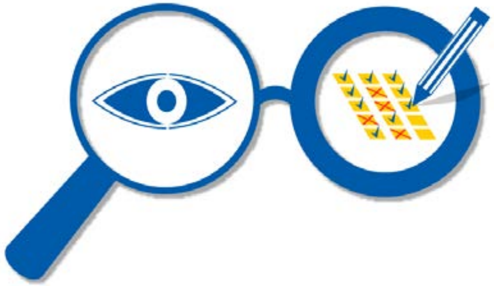

Monitoring Selling

Maximising the investment returns/Dynamic portfolio

Justifying the surrender profits and practices to improve persistency

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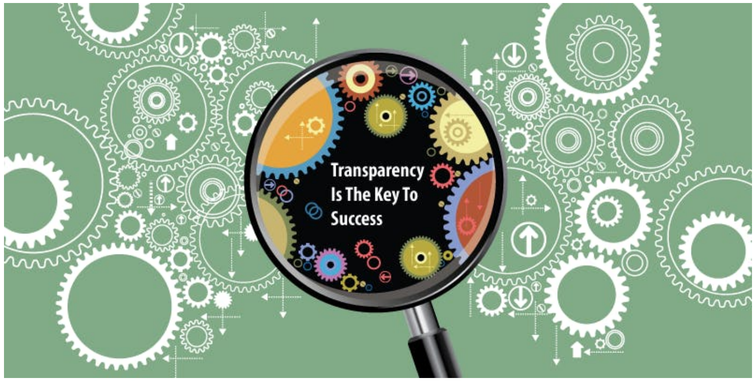

Increased transparency and disclosures

Better Sales Literature and Cheaper Distribution Channels

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Customers to know what they are buying

Government support – Tax Savings

Understand and adopt global practice to monitor persistency and justified SV

Improve value of Distribution stakeholder

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- Most of EOM cost allocated to distribution - need to ensure efficiency
- Low persistency consumers related to high attrition intermediaries?
  - Average career 2-3 years
- Product filing includes filing for channel - different types:
  - “standard” offline intermediaries
  - POS
  - micro-insurance
  - online
- Consider offline model which can transfer value to individual intermediaries evolving into distribution network owners
  - Financial inclusion and development a requirement for intermediary as well as for customer
- Design of current distribution remuneration structure inhibits this:
  - ties the intermediary to the insurer/ corporate agency
  - keeps distribution responsibility and initiative centralised with the insurer
- Requires distribution management hierarchy
- Flat structure with more distribution network owners more efficient:
  - More scalable which promotes industry growth

Improve value of Distribution stakeholder (contd…)

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EOM for Traditional regular premium policy of term 10 years or higher

Year	Commission	Marketing and other cost	Overall EOM
1	30.0%	50.0%	80.0%
2	7.5%	7.5%	15.0%
3	7.5%	7.5%	15.0%
4	7.5%	7.5%	15.0%
5	7.5%	7.5%	15.0%
Total	**60.0%**	**80.0%**	**140.0%**

- 140% overall pay-out over 5 years is sufficient, but
- If the 140% is moved forward, and spread 100%/40% over years 1-2 with no pay-out thereafter, then it can allow:
  - Network development and transfer of responsibility
  - Improved intermediary training and certification requirements – new business, persistency
  - Match product to customer needs at point of sale

Improve value of Distribution stakeholder (contd…)

- This in line with franchise type distribution model
- Efficiently implemented and regulated in other Asian countries, eg Malaysia
  - franchise is smaller scale than insurance brokerage/ corporate agent
  - business model with one senior intermediary at head
- Such large upfront pay-out will require new regulated eco-system, including claw-back in event of surrender
  - infrastructure to manage intermediary remuneration accounts
  - possible India new monetary systems for financial inclusion
  - digital synergies with other business functions, including “offline” distribution

Retain client on overall insurer platform

- Portability of savings benefit and associated surrender penalty between products with same insurer
- Regulatory adjustments required
- Modular Traditional product design may make savings benefit transfers to/from ULIP easier:
  - Traditional product pricing locks surrender penalty into overall profit margin of combined risk/savings endowment
- ULIP requires 5 year lock-in period before surrender value available from Discontinuance fund:
  - during this time no risk cover allowed
  - customer need may be met by conversion to Traditional product with paid-up sum assured
- Traditional allows surrender value and partial withdrawal from year 3 (or even year 2 under new draft regulations):
  - surrender penalty results in negative IRR
  - if costumer need is higher risk/return product then convert to ULIP
- Product Conversions may not count as new business, but will also not count as surrenders

Thank You

Insurance industry stakeholders: Value creation

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Stakeholder	Value in/ creative activity	Value out	Measure
Investor	Ownership through Capital, technology, expertise	Investment growth	Return on EV Company value = EV multiple Market share VNB
		Social-economic contribution: • Financial inclusion • Improvement in financial security, wealth	Social sector spread Benefits paid IRR to customer
Insurer	Employment through Expense of Management, Operating cost	• Functional efficiency • Corporate entity formation	Performance against strategy Operational ratios Cost ratios Claims ratios Profitability growth Solvency Cost of capital

Insurance industry stakeholders (contd…)

Stakeholder	Value in/ creative activity	Value out	Measure
Distribution	Employment through: • Commission (sales person), • Marketing cost (distribution management)	Product marketing and selling	Premiums No policies Distribution network
Consumer	Financial security and wealth creation through Premium	Risk cover Savings benefit Financial instrument meeting evolving personal financial needs	Risk, surrender, maturity benefit IRR Premium flexibility Withdrawal flexibility
Regulator	Monitor and Develop stakeholder interests for industry, socio-economic good	Fair/ equitable distribution of value between stakeholders	Investment by Investors Expenditure by Insurers Insurance penetration/ density IRR to Consumers
Actuarial profession	Employment primarily in Insurance industry by all stakeholders mentioned above	Expertise, professional standards	Performance in all of the above