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Life Insurance And The Actuarial Profession In India—A Decade After Liberalization

THE ACTUARIAL PROFESSION in India has witnessed a sea change in the decade after insurance liberalization. It has gone from being described as a "moribund profession" to being a "dynamic and lucrative" one. BY SANCHIT MAINI

THE MEMBERSHIP STATISTICS below (see growth chart) show the increase in interest level of those wishing to pursue the actuarial exams.

The growth in student numbers has not yet led to a similar growth in fellows and associates and this has led to a paucity of qualified actuaries available to support the growth in the financial services industry, in particular the insurance industry. Most of the actuaries still work in the traditional fields of life insurance, pensions and employee benefits, and general insurance to a smaller extent.

In 2006, the profession witnessed a transformation when The Actuaries Act made the Actuarial Society of India a chartered institute. The key objective of the act is "to provide for regulating and developing the profession of actuary and for matters connected therewith or incidental thereto." An actuary, as defined by the act, is someone who is a fellow of the Institute of Actuaries of India. In order to regulate the profession, the Act provides for a council to manage the affairs of the Institute with a membership of between nine and 12 members. The Act requires external nominees: one to represent the Ministry of Finance; one to represent the Insurance Regulatory and Development Authority (IRDA); and up to two persons nominated by the Central Government with backgrounds in life insurance, general insurance, finance, economics, law or accountancy. The Act also provides for a disciplinary committee.

The most significant element of The Actuaries Act is not to allow any company (defined as "'any corporate body and includes a firm or other association of individuals"), whether incorporated in India or overseas, to engage in actuarial practice. That means that only partnership structures are allowed to carry out actuarial practice. A fellow member of the Institute must manage each office of an actuarial firm.

Growth Chart

31ST MARCH OF:	FELLOWS	AFFILIATES	ASSOCIATES	STUDENTS
2002	204	19	122	1,494
2003	200	23	118	1,905
2004	204	24	120	2,815
2005	203	18	136	3,486
2006	213	23	131	5,552
2007	217	27	135	6,200
2008	215	18	134	6,518
2009	203	20	132	8,340
2010	216	16	130	10,216
2011	238	17	137	11,786

SOURCE: INSTITUTE OF ACTUARIES OF INDIA

The Institute of Actuaries of India has been conducting its own actuarial examinations since 1988 and has been a full member of the International Actuarial Association since 1996.

The opening up of the industry has led to many challenges for actuaries working in life insurance, in particular due to the lack of past company experience in areas like persistency, costs and mortality. An era of high lapse rates—first year lapse rates of 30- to 35-percent are common in the industry—coupled with poor surrender values at early durations have led to a large number of customers receiving poor value for money on early surrenders. This problem is accentuated by high levels of agent and sales manager attrition. For example, sales manager[1] attrition in the first year of joining may be higher than 100 percent for many private sector players.

One of the benefits of working in India is the diverse range of foreign insurance partners covering the United Kingdom and other parts of Europe, the United States, Canada, and Japan. These international partners have each brought different practices to the Indian life insurance market including product development.

As the Indian market matures there will be several interesting areas of work and challenges for actuaries including valuation work related to IPOs and M&A, advances in embedded value techniques, the development of Solvency II and its impact on the Indian solvency regime and risk management.

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Foreign direct investment (FDI) in insurance companies is currently restricted to 26 percent, although there has been a long-standing debate to increase this to 49 percent. The matter, along with other legislative matters to amend the regulations introduced in 1999/2000, will be covered in an Insurance Amendment Bill, although there is significant opposition towards any increase in FDI amongst several political parties. Another significant change under consideration is to allow reinsurance companies to set up branch licenses in India. All foreign reinsurers currently reinsure business with overseas legal entities and their Indian operations provide sales, marketing and service support. None of the foreign reinsurers have as yet incorporated a company in India.

The IRDA, along with the Securities and Exchange Board of India (SEBI, the capital market regulator) have introduced draft regulations to allow life insurers who have completed 10 years to raise capital through initial public offerings. IPOs would lead to interesting work for actuaries, besides strengthening corporate governance in insurers as a result.

THE INDIAN INSURANCE MARKET

The Indian life insurance market has seen tremendous change in the last decade due to a multitude of factors ranging from the opening up of the market to private participation and subsequent regulatory reforms; robust economic and equity market growth; increase in household savings rate; and cultural changes amongst others. This decade of change has had a significant impact on the actuarial profession as well. This article focuses on the changes in the life insurance industry and its impact on the actuarial profession in India.

MARKET STRUCTURE

The life insurance market consists of 23 private players and the state-owned Life Insurance Corporation of India (LIC). It contributes just more than 4.4 percent of India's GDP with a per capita premium income of US$56. Later in this article we will cover some of the recent regulatory changes that have affected growth and resulted in penetration dropping in 2010 compared to 2009. (See chart on page 19.)

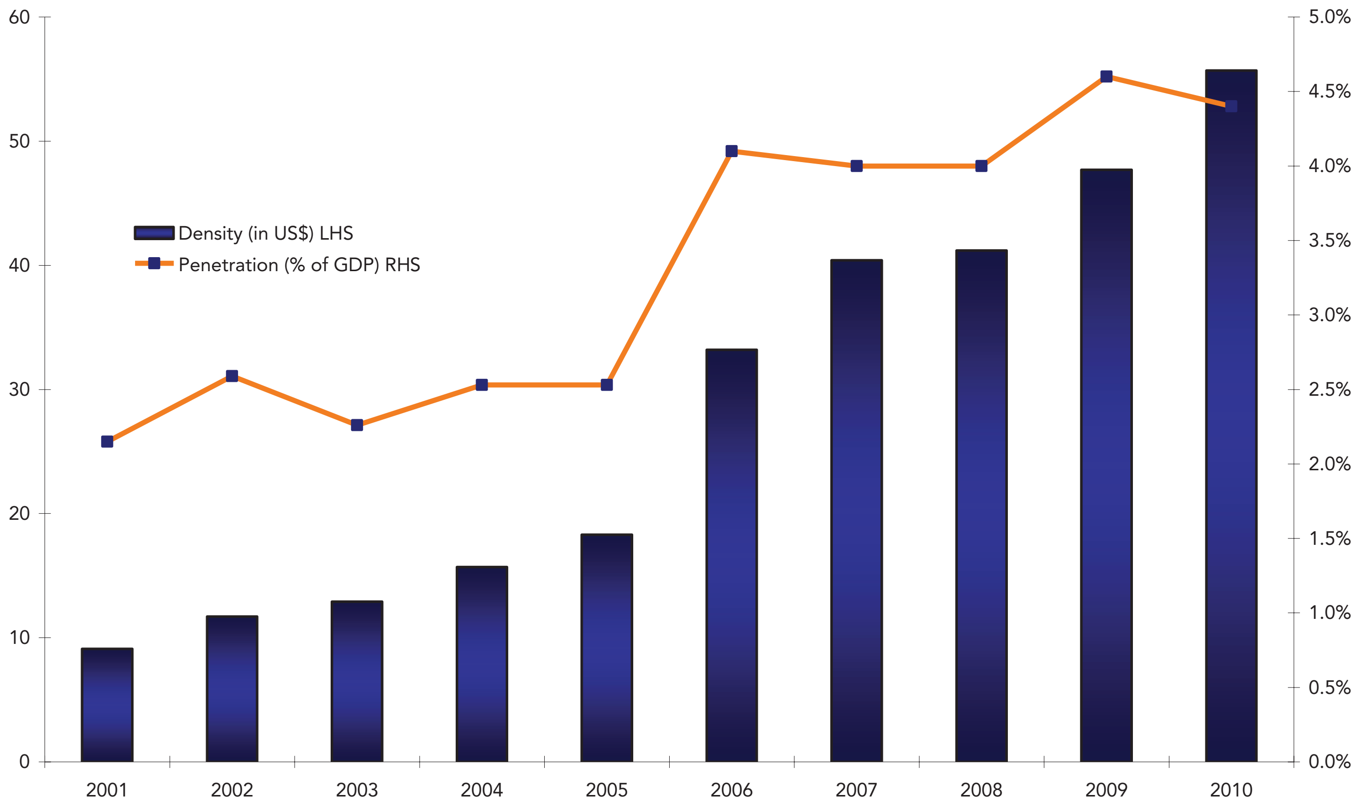
The growth in life insurance density may well be a reflection of the high inflationary environment whereas penetration has slowed down considerably since 2006.

PRODUCTS

Before 2000, the LIC mainly sold savings oriented traditional participating insurance in the form of endowments and anticipated endowments. A favorable tax regime, with life insurance premiums deductible from taxable income up to a limit, a low rate of tax applied to the LIC (12.5 percent compared to a company tax rate of 30 percent) and tax-exempt maturity benefits meant tax efficiency was a key driving force for life insurance sales. As a result, protection-oriented products without any savings elements were not really popular. The opening up of the market brought a host of new insurance products with unit-linked products becoming the main product category over the last decade.

A key regulatory change in 2002 regarding surplus transfer rules from the policyholder fund to shareholders fund made

Life Insurance Growth



Source: Various Swiss Re Sigma Reports

unit-linked products quite attractive for shareholders.

REGULATIONS

The IRDA was set up in 1999 and promulgated regulations in 2000 to open the insurance sector to private participation, including foreign ownership restricted to 26 percent. Since then the IRDA has been actively playing its dual role of supervision and development of the insurance industry in India.

Follows is a description of some of these regulations and their impact in shaping the life insurance industry.

IRDA Regulations, 2000

The key elements of the initial set of regulations focused on opening up the industry to private participation, including foreign ownership. The IRDA specified minimum capital requirement of INR100 Crore (cUS$22m); foreign ownership restricted to 26 percent through foreign direct investment; single license for operating in the entire country. The regulations introduced the appointed actuary role as a statutory position with significant responsibilities. The IRDA was particularly progressive in its regulations surrounding products with virtually no restriction on the types of products that companies could launch. All products required the appointed actuary to certify the premium rates, terms and conditions as being fair and adequate.

Distribution of Surplus, 2002

The LIC is governed by the LIC Act, 1956, when more than 250 insurance companies were folded into the state company. The LIC Act restricted surplus distribution to shareholders to 5.0 percent for all funds including participating and non-participating funds. The IRDA Regulations in 2000 allowed transfer to shareholders of up to 10 percent (thus creating the so-called 90:10 gate for distribution of surplus between policyholders and shareholders). This restricted the development of non-participating business, including unit-linked business. The Distribution of Surplus Regulations, 2002, allowed a 100 percent surplus transfer from non-participating funds to shareholders thereby creating a favorable regulatory regime for launching unit-linked business. Although the LIC had launched unit-linked business prior to the opening

up of the sector to private players (and the Unit Trust of India had launched mutual funds with insurance wrappers even before that) this regulation made unit-linked products attractive from a shareholder value creation viewpoint and subsequently led to the launch of several products.

THE IMPACT OF THESE FAR-REACHING REGULATORY CHANGES WILL NO DOUBT CREATE A STRONGER, MORE RESILIENT AND CUSTOMER-FRIENDLY INSURANCE INDUSTRY.

Unit-Linked Guidelines

The period between 2002 and 2006 saw the development and growth of unit-linked business and, coupled with the strong equity markets in India, became a dominating product form in India. The transparency of benefits and charges, together with the ability to participate in equity markets, proved to be a potent formula of success for unit-linked business in India.

Despite the introduction of the Unit-Linked Guidelines in 2006, one of the key objectives of which was to ensure fair treatment for customers, there were mounting concerns surrounding the appropriateness of unit-linked products being sold to the broad market. The Unit-Linked Charge Cap introduced in 2009 ensures that customers will receive a minimum maturity benefit by capping the amount of reduction in yield due to the levy of all charges at a hypothetical interest rate of 10 percent. The minimum maturity yield has been set at 7.0 percent for contracts up to a duration of 10 years and 7.75 percent for durations greater than 10 years. There is no cap for surrender values except for the requirement of surrender values to equal the account value from year six onwards. This focus of the guidelines on maturity values led to many unit-linked product designs that were arguably tontine, given the high lapse rates prevalent across the industry.

Early 2010 saw the mutual fund and life insurance industry turf war take an unprecedented turn with SEBI (the mutual fund regulator) issuing notice to 14 life insurers and asking them to register all unit-linked products with the SEBI in addition to the IRDA. It asked for new sales to be stopped at a short notice. This regulatory turf war went on for a few months and finally the matter was resolved through a Presidential Order giving the sole regulatory rights of unit-linked products to the IRDA.

Soon after this, the IRDA announced a revised set of unit-linked regulations that extended the net reduction in yield caps to all durations from six onwards and included surrender charge caps from years one to five.

These changes have led to a fundamental shift in the life insurance industry and companies have been forced to revise their business strategies. The initial changes evident since these regulations came into force include increased focus on bancassurance while companies consider changes to the agency channel, increased focus on traditional and single premium products, reductions in commissions and costs, and an enhanced focus on persistency. It remains to be seen whether the changes will lead to M&A; this being complicated with private players typically having two shareholders. Foreign insurers may also bide time until the FDI caps are increased to 49 percent.

The impact of these far-reaching regulatory changes will no doubt create a stronger, more resilient and customer-friendly insurance industry. ■

Sanchit Maini, CERA, FIAA, FIAI, is currently the appointed actuary of Max New York Life Insurance. He is chair of the Enterprise and Financial Risks Advisory Group of the Institute of Actuaries of India. He can be contacted at *Sanchit.Maini@maxnewyorklife.com.*

ENDNOTES

[1] The first level of employees in the agency structure who directly recruit and develop agents. The Life Insurance Corporation of India and some private life insurers use the title of Agency Development Manager or Development Manager for this position, which describes the role more accurately.