

INSURANCE INDUSTRY

VP GOA 2018



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Agenda

- Introduction to Insurance Industry – General, Life, Health
- Life Insurance
- General Insurance
- Learnings from Global Insurance Industry

This Is Not ...

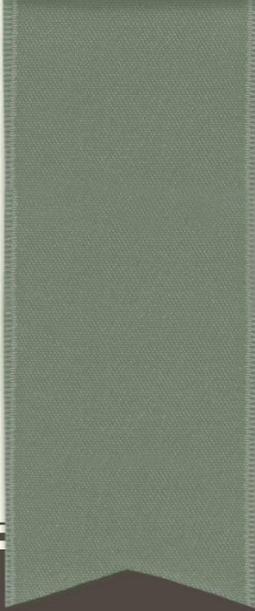
- An investment advise
- A complete reference for the insurance industry

Introduction

- Insurance Sector can be broadly classified into 2 sub-sectors
 - Life Insurance - Protection, Savings, Health
 - General Insurance – Motor, Marine, Travel, Fire, Health etc.

Difference between Life vs. General Insurance

Life Insurance	General Insurance
Life insurance products are multi-year (multi-decade) products	Largely general insurance products are annual products. Rates can be revised annually.
Underwriting profit concept has less utility	Underwriting profit is most important parameter to judge the business
Risk of concentration is low	Concentration risk exists in case of natural calamities or disease outbreaks
Risk of wide fluctuations on year to year basis are low on non-linked side of business.	Wide fluctuations can happen in premiums as well as claims. More capital intensive in that sense
Risk of fraudulent claims is low e.g. People can in general hide about smoking/drinking habits but rising life expectancy takes care of it	Risk of fraudulent claims exist e.g. Over invoicing in hospitals for reimbursement claims, car Own Damage claims
Concept of linked or participating products exist where policyholders get benefit for any excess profit.	Concept of linked or participating products does not exist

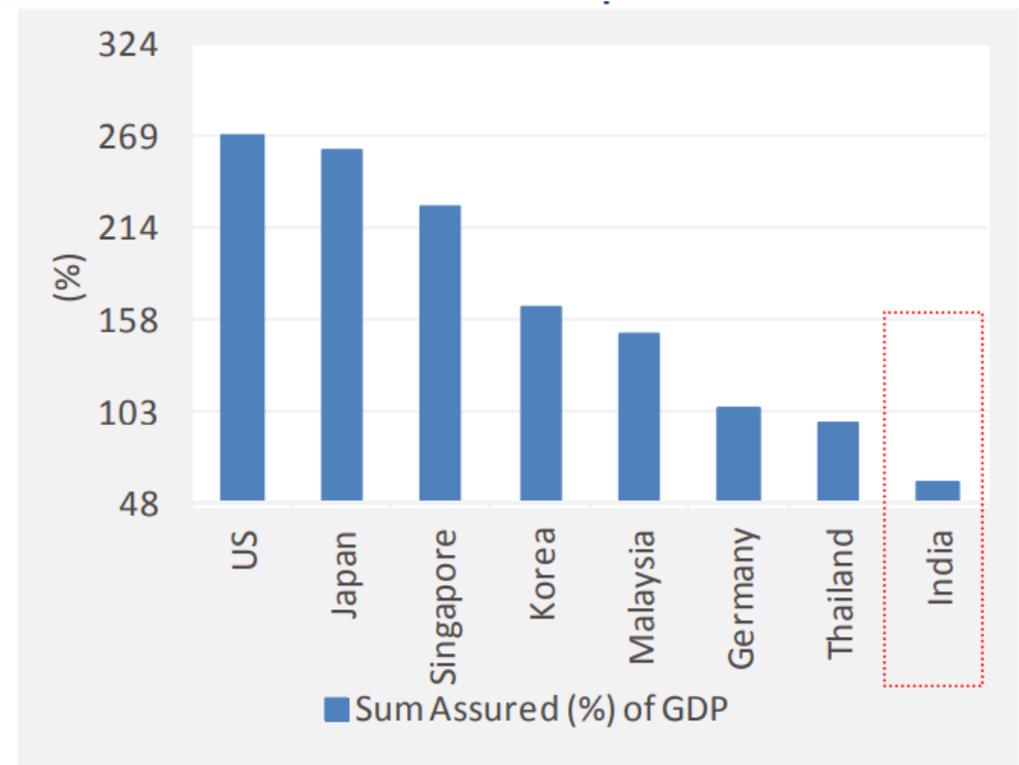
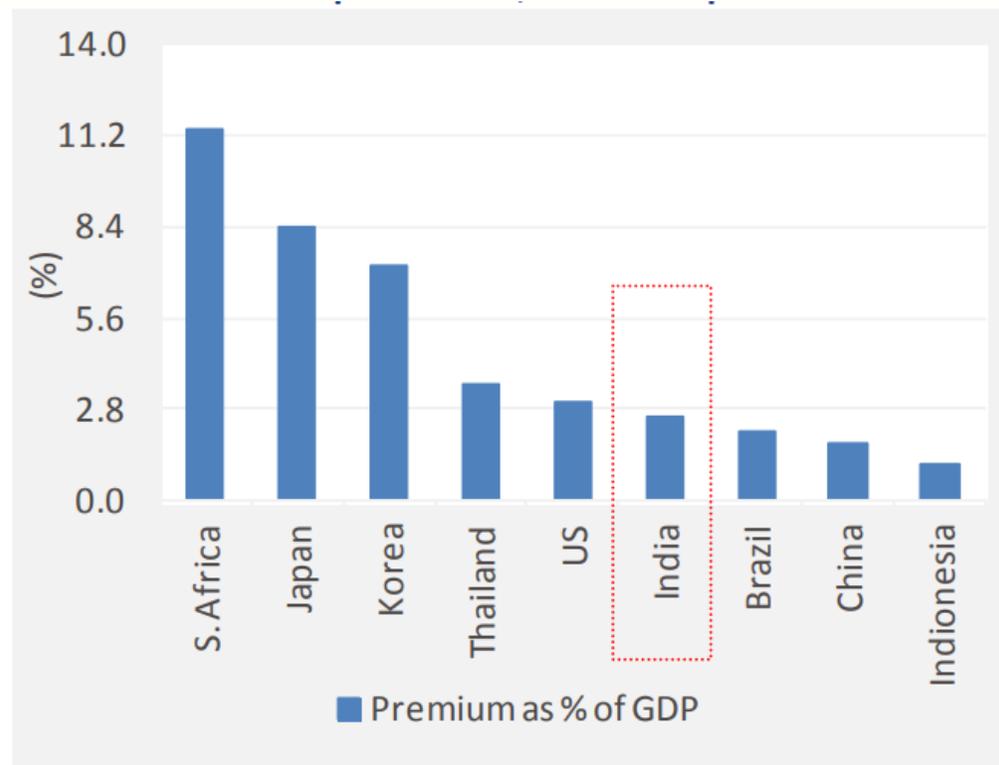


LIFE INSURANCE SECTOR

Topics

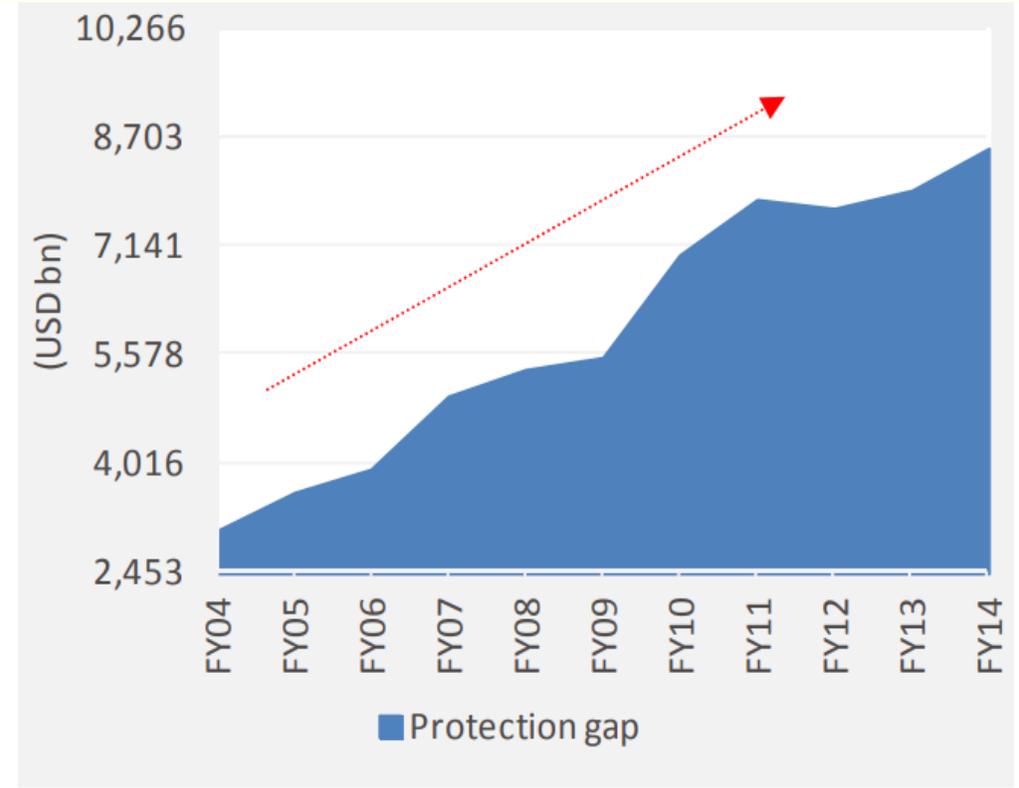
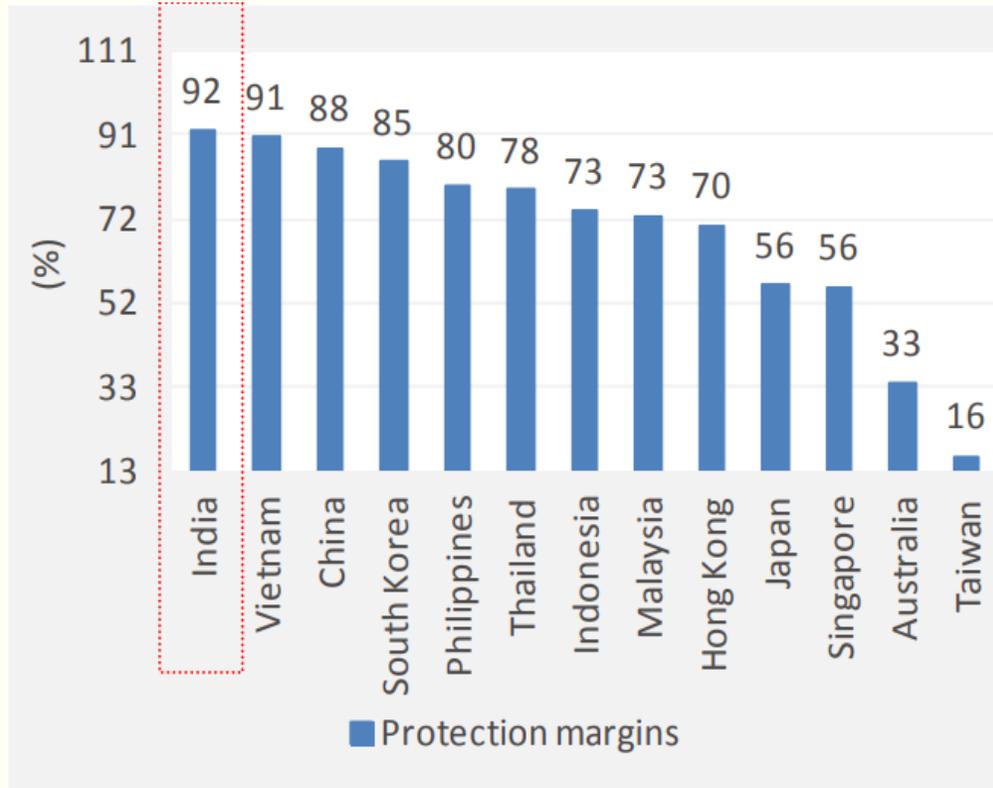
- Opportunity
- Terminology
- Evolution of Industry
- Design of Products
- Major Players
- Distribution Architecture
- Regulation
- Balance Sheet & Profit/Loss Statement
 - Actuarial Assumptions
- Valuation of Life Insurance Companies
- Conclusion

Opportunity



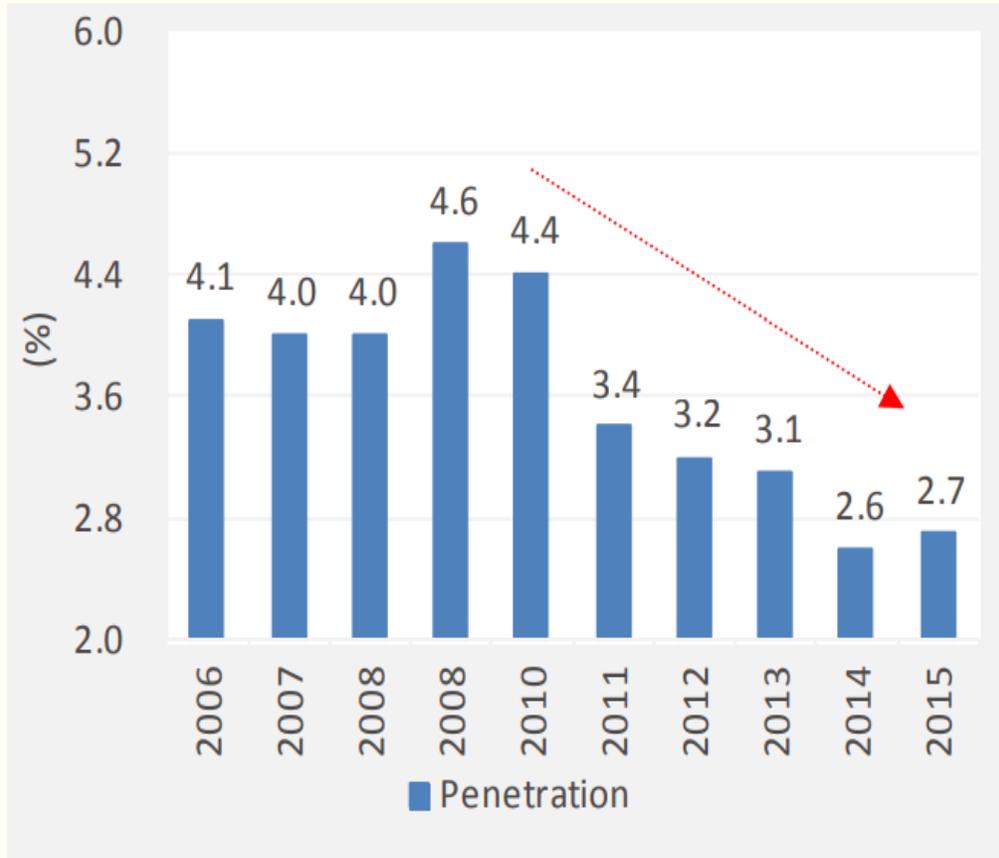
Under Penetration [1]

Opportunity



Protection Gap [1]

Opportunity



Premium/GDP in India over the years [1]

Terminology

Income Related:

- New Business Premium (**NBP**) – Gross premium received for newly issued policies
- Annual Premium Equivalent (**APE**) – 100% regular premium policies + 10% of single premium policies.
- Renewal Premium – Premium received from 2nd year onwards for life insurance policies
- Gross Written Premium (**GWP**) = NBP + Renewal Premium

Other terms like GDPI (Gross Direct Premium Income), RWRP (Retail Weighted Received Premium), TWRP (Total Weighted Received Premium) are largely similar to above terms.

Terminology

Product Related:

■ Participating Products

- In these products, policyholders “participate” in the any additional surplus that is generated
- Examples include – Participating Life products like annuity
- IRDAI mandates that 90% of the profit has to be shared back to policyholders & insurers announce bonuses from time to time.
- The life cover in these products is fixed at 10 times the annual premium.
- On absolute basis, premium is more for similar sum assured for participating products vs. non-participating products
- Risk borne by shareholders is low for these products

■ Non-participating (“Fixed Benefit”) Products

- In these products, policyholders do “not participate” in any additional surplus that is generated
- Example include – pure protection, fixed payout annuity, credit life
- On absolute basis, premium to some assured ratio is lower compared to Par products
- Higher risk borne by shareholders & generally margin is also higher for these products
- Black swan changes in assumptions – interest rate, inflation, life expectancy can cause severe losses

Terminology

■ Linked Products

- Combination of protection & investment.
- The benefits depends on the price of underlying units, which depends on underlying fund performance i.e. returns are “linked” to fund performance & insurer carries no risk on balance sheet.
- Flexibility to choose the various funds as per risk appetite i.e. All Debt, Balanced, All Equity etc.
- Linked product has two parts:
 - The non-linked portion: The sum assured for protection portion is 10x the premium.
 - The linked portion: Linked to market performance of the units
- Persistency linked with market volatility

■ Non-linked Products

- The benefits are “not linked” to the performance of underlying investments i.e. fixed benefit payouts
- Insurer gets to keep part of additional profits or has to bear risk for loss
- No flexibility for policyholder to choose where the funds would be invested
- Persistency is not linked with market volatility due to guaranteed benefits.

Terminology

■ Individual Products

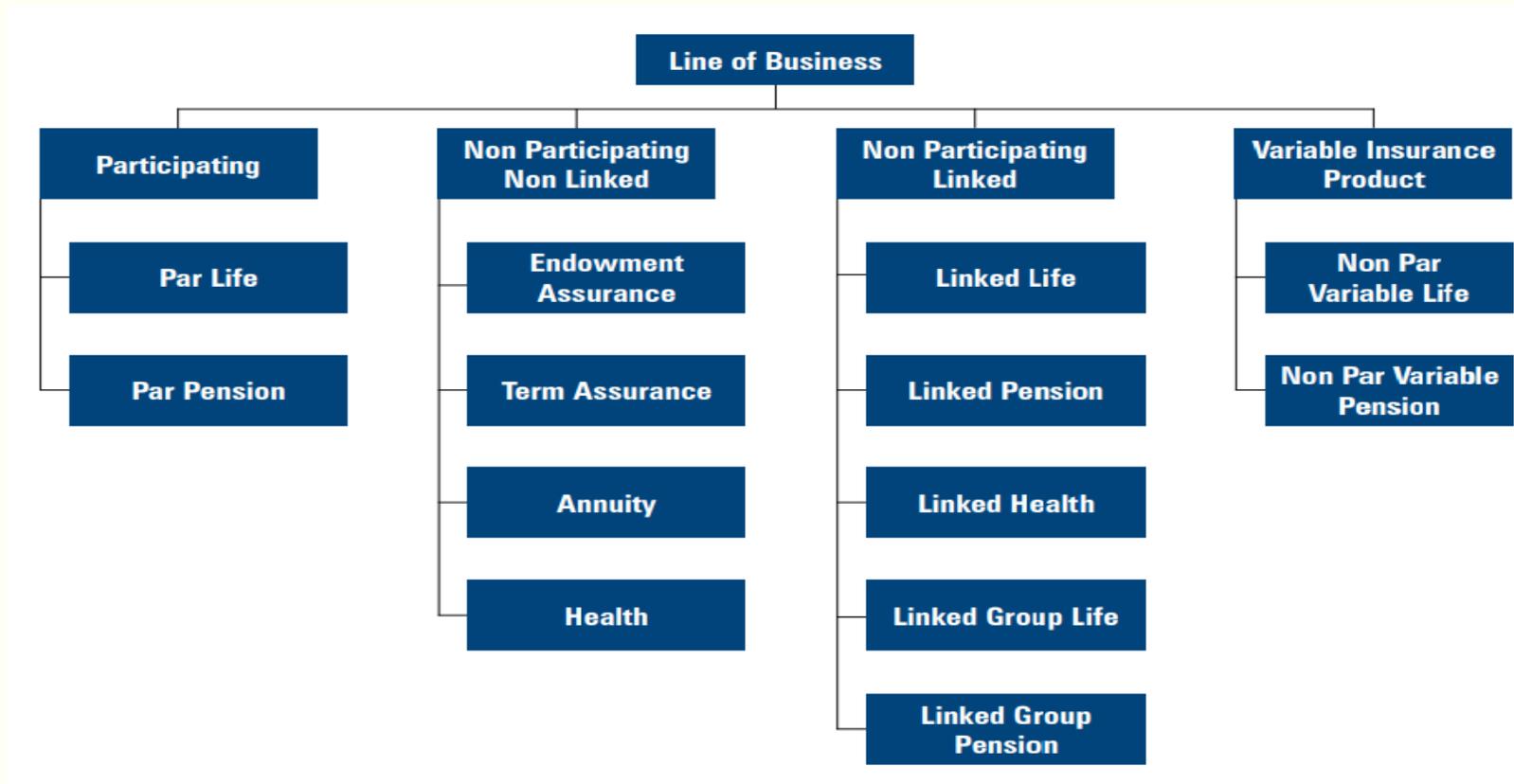
- Products are sold to individuals
- Cost of Acquisition per Rupee is higher compared to group products
- Brand + Claim Experience plays some role

■ Group Products

- Products are sold to a group e.g. corporate pension plans or corporate life protection plans
- Generally insurers have lesser bargaining power compared to individual products
- Can cause fast growth & de-growth
- The period is generally a year
 - No/Lower renewal premium
 - Competition can under-cut and take business away
- Low operating costs

Terminology

Putting it all together ->



Ratios

■ Persistency Ratio

- % of policyholders who have continued with policies second year onwards
- Indicates ability of company to retain customers i.e. measure of “right” selling
- Costs are front ended in customer acquisition, higher persistency => higher profitability

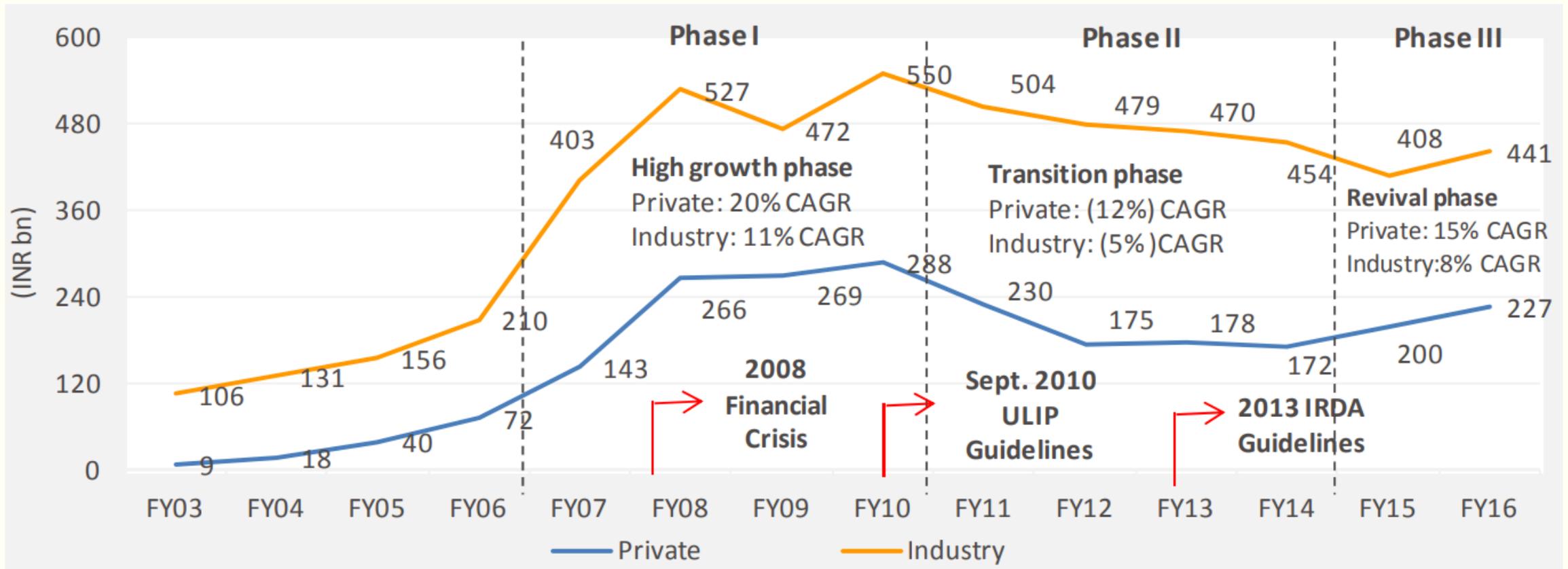
■ Solvency Capital & Ratio

- This is similar to capital adequacy ratio
- Solvency capital denotes the capital required to meet the future liabilities so as company remains solvent
- Solvency ratio = Available Capital / Required Capital
- IRDAI mandates solvency ratio of 150%

Evolution of Industry in India – Brief Timeline

- 2000 - Insurance sector was opened for private players with FDI limit capped at 26%
- 2010 – IRDAI ULIP Regulations
- 2013 – IRDAI Guidelines for Traditional Products
- 2014 - FDI cap was raised to 49%
- 2015 – Open Banking Architecture
- 2016-17 – Listing of Life Insurance Players

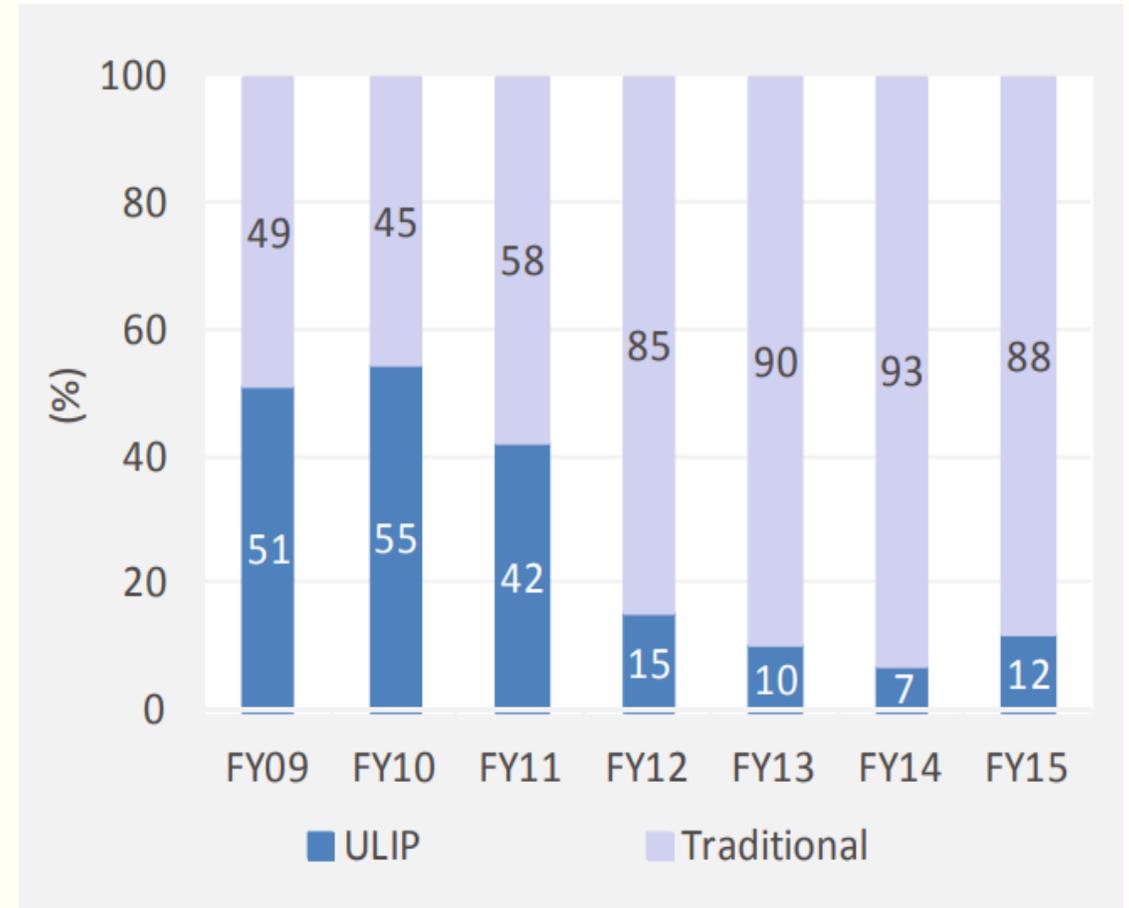
Evolution of Industry in India



Life Insurance Industry Evolution [1]

2010 ULIP Guidelines

- Cap on charges (commission) & surrender charges
- Lock-in period of ULIP increased from 3 to 5 years
- Minimum premium paying term of 5 years for all regular ULIP products
- ULIP charges to be evenly spread & not front ended
- Mortality sum assured to be 10x of premium for age < 45
- ULIP Pension/Annuity products to offer minimum 4.5% return



ULIP Vs. Traditional Split APE [1]

2013 Guidelines on Traditional Products

Non Linked

- Cap on commissions
- Minimum death benefit varying by age
- Minimum policy term & policy paying term of 5 years
- Minimum sum assured
- Guaranteed surrender value
- IALM 2006-08 table introduced
- NAV Guaranteed products were banned

Last major regulatory change except open banking architecture. Improved transparency & benefits to policyholders has set base for next phase of growth.

Major Players

First Year Premium of Life Insurers for the Period ended 31st March, 2018					
Sl No.	Insurer	Up to 31st March, 2017	Up to 31st March, 2018	Up to 31st March,	Up to 31st March,
1	HDFC Standard Life	8696.21	11349.13	4.97%	5.85%
2	SBI Life	10145.76	10965.29	5.80%	5.66%
3	ICICI Prudential Life	7863.40	9118.07	4.49%	4.70%
4	Max Life	3667.38	4348.03	2.10%	2.24%
5	Bajaj Allianz Life	3290.18	4290.85	1.88%	2.21%
6	Kotak Mahindra Old Mutual Life	2849.74	3404.21	1.63%	1.76%
7	Aditya Birla Sun Life	2534.60	2662.91	1.45%	1.37%
8	Tata AIA Life	1131.50	1489.01	0.65%	0.77%
9	DHFL Pramerica Life	876.56	1449.84	0.50%	0.75%
10	PNB Met Life	1150.18	1427.05	0.66%	0.74%
11	India First Life	1670.85	1424.97	0.95%	0.74%
12	Canara HSBC OBC Life	982.97	1227.46	0.56%	0.63%
13	Reliance Nippon Life	1051.58	915.62	0.60%	0.47%
14	IDBI Federal Life	793.55	833.03	0.45%	0.43%
15	Shriram Life	739.36	815.92	0.42%	0.42%
16	Exide Life	865.20	760.09	0.49%	0.39%
17	Bharti Axa Life	609.02	730.71	0.35%	0.38%
18	Star Union-Diachi Life	700.11	700.72	0.40%	0.36%
19	Future Generali Life	399.89	582.20	0.23%	0.30%
20	Edleweiss Tokio Life	228.14	342.52	0.13%	0.18%
21	Aviva Life	243.96	325.57	0.14%	0.17%
22	Aegon Life	91.42	147.10	0.05%	0.08%
23	Sahara Life	44.68	4.26	0.03%	0.00%
	Private Total	50626.23	59314.55	28.93%	30.60%
24	LIC	124396.27	134551.68	71.07%	69.40%
	Grand Total	175022.50	193866.24	100.00%	100.00%

NBP for FY18 [7]

Distribution Architecture

Products can be sold through following distribution channels –

- Bancassurance
- Agency
- Direct (Online, Own Sales Force)

Bancassurance

- Products are sold via bank branches. Either bank employees or insurer employees present at branch can sell the products.
- Low cost distribution channel & hence most suitable for selling of low margin products like ULIP.
- Prior to 2015, one bank was allowed to tie up with maximum one life/general/health insurer each.
- With introduction of open banking architecture, each bank is allowed to tie up with up to three life/general/health insurers each.
- This has reduced disadvantage for insurers promoted by non-banking entities.
 - E.g. Max Life
- The banks with large branch network but no in-house insurance has also been quite sought after.
 - E.g. Axis Bank

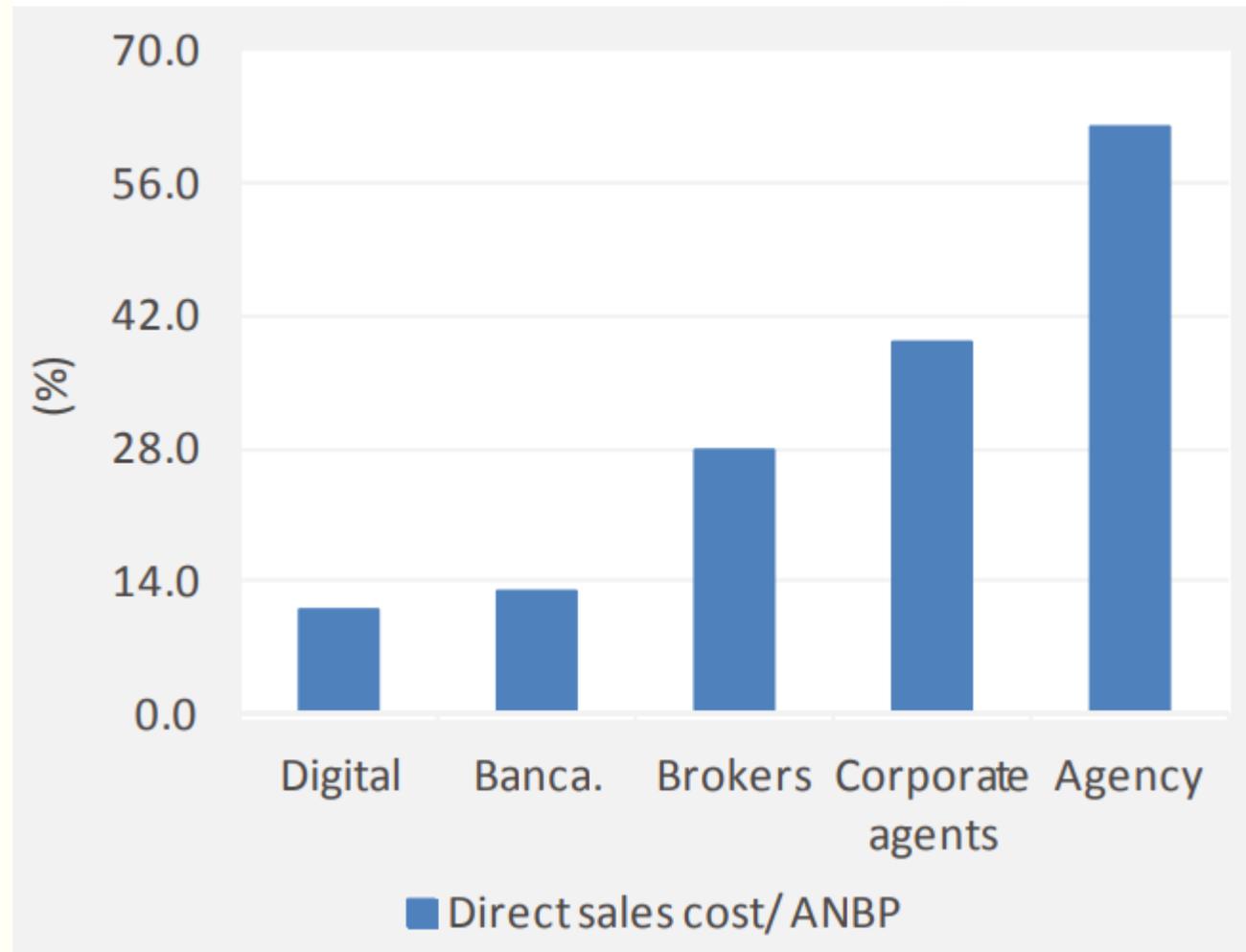
Agency

- Products are sold through insurance agents who work on commission.
- One of the high cost distribution channel e.g. Online term plans are cheaper than buying same plan through agent (10-20-50%).
- Because agents are incentivized through commissions, higher chances of mis-selling. This is what happened before 2013 where agents sold ULIP policies due high upfront commissions & also large churn in new policies was present.
- IRDAI has put cap on commissions for both ULIP & Traditional products. Many agents exited the ULIP distribution post capping of commission.
- Usually agents are not exclusive to the insurer & can sell products from multiple insurers.

Direct (Online, Own Sales Force)

- Online distribution is one of the lowest cost distribution channel. This channel will grow at decent pace as digitization takes place.
- But this channel is also very competitive & large portion of the benefit has to be passed on to consumers.
- Own sales force is emerging as one of the most important distribution channel because of – ability to “right” sell the product, ability provide “good quality” service, no need to bargain with banca partners, lesser churn & more loyalty than agency channel.

Cost Comparison



Channel Cost Comparison [1]

Regulation - Investments

S.No	Type of Investment	Percentage
i)	Government Securities	25%,
ii)	Government Securities or other approved securities (including (I) above)	Not less than 50%,
iii)	Approved Investments as specified in Schedule I	
a)	Infrastructure and Social Sector Explanation: For the purpose of this requirement, Infrastructure and Social Sector shall have the meaning as given in regulation 2(h) of Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations, 2000 and as defined in the Insurance Regulatory and Development Authority (Obligations of Insurers to Rural and Social Sector) Regulations, 2000 respectively	Not less than 15%
b)	Others to be governed by Exposure/ Prudential Norms specified in Regulation 5	Not exceeding 20%
iv)	Other than in Approved Investments to be governed by Exposure/ Prudential Norms specified in Regulation 5	Not exceeding 15%

Regulation - Investments

Equity Share and Preference Shares (at their face value).	Not exceeding 15% in general of the paid up equity/ preference capital of the institution or the existing holding % level, if higher.
Investment in Equity Capital, Bonds, Debentures, Term Loans.	Not exceeding 10% of the capital employed by an institution as per the last audited Balance Sheet.
Total Investment vis-à-vis Net Worth of the Company.	Not exceeding 60% of Net Worth of the institution.
Total Investment in a Financial Year.	7.5% of annual accretions.
Total Investments in all the Financial Institutions.	Annual aggregate financial assistance to all Development Financial Institutions put together in a single year shall not exceed 20% of the estimated annual accretions for the year.

Type of Investment	Limit for Investee Company	Limit for the entire group to which the investee company belongs	Limit for the industry sector to which the investee company belongs
(a) Equity/ Preference Shares/ Convertible portion of Debentures at face value.	(i) As on any date Not exceeding 20% of the total capital employed*.	(i) As on any date Not exceeding 15% of the total capital employed* of the group companies.	Not exceeding 15% of the total capital employed* in all such companies.
(b) Debentures - (face value) including private placed NCD and Non convertible portion of Convertible Debentures.	(ii) During the year Not exceeding 5% of estimated annual accretion of funds.	(ii) During the year Not exceeding 10% of estimated annual accretion of funds.	
(c) Short/ Medium/ Long Term Loans and any other direct financial assistance.			

Regulation – Commissions

Table II – Regular Premium

Sl No	Category of Life Insurance Product or Policy	Maximum Commission/ Remuneration on Regular Premium Products or Policies payable to insurance agent/ insurance intermediary	
		First year premium	Renewal Premiums
1	Regular Premium		
A	Individual Pure Risk	40%	10%
B	Individual Other than Pure Risk		
i)	In respect of policies with premium payment terms of		
	5 years	15%	7.5%
	6 years	18%	7.5%
	7 years	21%	7.5%
	8 years	24%	7.5%
	9 years	27%	7.5%
	10 years	30%	7.5%
	11 years	33%	7.5%
	12 years or more	35%	7.5%
C	Individual Deferred Annuity / Pension	7.5%	2%
D	Group Pure Risk (incl Group credit) and Group Savings Variable Life	7.5% (only on pure risk premium)	7.5%
E	Government Scheme-Life-Health	As per Government Notification	As per Government Notification

Financial Reporting

- Policyholders'/Technical Account
- Shareholders'/Non-Tech Account (P&L Account)
- Balance Sheet

Technical Account/Policyholders' Account (Revenue Account)

Sr No.	Particulars	Three months ended/ As at			Year ended/ As at	
		March 31, 2018	December 31, 2017	March 31, 2017	March 31, 2018	March 31, 2017
		(Audited)	(Audited)	(Audited)	(Audited)	(Audited)
POLICYHOLDERS' A/C						
1	Gross premium income					
	(a) First Year Premium	202,132	193,394	211,133	735,619	634,463
	(b) Renewal Premium	614,761	453,903	501,968	1,785,702	1,449,070
	(c) Single Premium	55,999	38,266	44,847	185,556	151,867
2	Net premium income ¹	865,582	679,513	752,642	2,681,068	2,215,525
3	Income from investments: (Net) ²	(161,338)	654,417	657,634	1,126,146	1,497,694
4	Other income	1,915	1,749	1,444	7,001	5,905
5	Transfer of funds from Shareholders' A/c	7,528	-	(6)	7,528	180
6	Total (2 to 5)	713,687	1,335,679	1,411,714	3,821,743	3,719,304
7	Commission on					
	(a) First Year Premium	31,781	28,275	14,772	102,447	46,009
	(b) Renewal Premium	11,606	8,451	10,057	34,406	29,032
	(c) Single Premium	1,272	1,002	246	2,474	951
8	Net Commission ¹	44,659	37,728	25,075	140,327	75,892
9	Operating Expenses related to insurance business (a + b+c):					
	(a) Employees remuneration and welfare expenses	25,722	24,412	20,384	96,530	80,802
	(b) Administration support expenses	-	-	17,337	-	58,320
	(c) Advertisement and publicity	12,300	4,771	7,545	25,229	19,549
	(d) Other operating expenses	22,453	22,931	25,416	81,234	77,048
10	Expenses of Management (8+9)	105,134	89,842	95,757	343,320	311,611
11	Provisions for doubtful debts (including bad debts written off)	75	47	91	308	607
12	Provisions for diminution in value of investments	-	-	389	509	651
13	Service tax charge on linked charges ⁴	15,960	15,167	11,505	56,451	41,627
14	Provision for taxes (a+b)	4,749	2,365	1,944	12,007	7,882
	(a) Current tax	4,749	2,365	1,944	12,007	7,880
	(b) Deferred tax	-	-	-	-	2
15	Benefits Paid ³ (Net) ¹	455,552	468,516	490,200	1,728,079	1,499,788
16	Change in actuarial liability	104,812	726,020	787,988	1,544,750	1,749,756
17	Total (10+11+12+13+14+15+16)	686,282	1,301,957	1,387,874	3,685,424	3,611,922
18	Surplus/(Deficit) (6-17)	27,405	33,722	23,840	136,319	107,382
19	Appropriations					
	(a) Transferred to Shareholders	19,666	27,416	23,914	108,921	113,154
	(b) Funds for Future Appropriations	7,739	6,306	(74)	27,398	(5,773)
20	Details of Surplus/ (Deficit)					
	(a) Interim bonus paid	1,805	1,426	1,077	5,492	3,347
	(b) Allocation of bonus to policyholders	41,187	-	35,135	41,187	35,135
	(c) Surplus shown in the Revenue Account	27,405	33,722	23,840	136,319	107,382
	Total Surplus	70,397	35,148	60,052	182,998	145,864

Non Technical/Shareholders' Account (P&L Account)

SHAREHOLDERS' A/C						
21	Transfer from Policyholders' Account	19,666	27,416	23,914	108,921	113,154
22	Total income under Shareholders' Account					
	(a) Investment Income	24,728	21,602	17,473	73,955	66,470
	(b) Other income	421	18	2,792	484	2,853
23	Expenses other than those related to insurance business	1,152	932	1,206	3,876	3,796
24	Transfer of funds to Policyholders A/c	7,528	-	(6)	7,528	180
25	Provisions for doubtful debts (including write off)	-	-	-	-	-
26	Provisions for diminution in value of investments	-	-	-	-	-
27	Profit/ (loss) before tax	36,135	48,104	42,979	171,956	178,501
28	Provisions for tax (a+b)	2,077	2,894	2,137	9,973	10,278
	(a) Current tax	2,077	2,894	2,137	9,973	10,278
	(b) Deferred tax	-	-	-	-	-
29	Profit / (loss) after tax and before extraordinary items	34,058	45,210	40,842	161,983	168,223
30	Extraordinary Items (Net of tax expenses)	-	-	-	-	-
31	Profit / (loss) after tax and extraordinary items	34,058	45,210	40,842	161,983	168,223
32	Dividend per share (₹) (Nominal Value ₹ 10 per share):					
	(a) Interim Dividend	-	-	-	3.40	3.85
	(b) Final Dividend	3.30	-	3.50	3.30	3.50
33	Profit/(Loss) carried to Balance Sheet	169,603	135,545	126,830	169,603	126,830
34	Paid up equity share capital	143,550	143,547	143,535	143,550	143,535
35	Reserve & Surplus (excluding Revaluation Reserve)	511,937	477,819	468,783	511,937	468,783
36	Fair value Change Account and revaluation reserve (Shareholders)	32,959	51,242	28,486	32,959	28,486
37	Total Assets:					
	(a) Investments:					
	- Shareholders'	774,929	721,947	664,026	774,929	664,026
	- Policyholders Fund excluding Linked Assets	3,328,885	3,183,313	2,706,737	3,328,885	2,706,737
	- Assets held to cover Linked Liabilities	9,750,197	9,828,918	8,787,835	9,750,197	8,787,835
	(b) Other Assets (Net of current liabilities and provisions)	(16,643)	13,157	32,032	(16,643)	32,032

Balance Sheet

Particulars	As at		
	March 31, 2018	December 31, 2017	March 31, 2017
	(Audited)	(Audited)	(Audited)
Sources of funds			
Shareholders' funds :			
Share capital	143,550	143,547	143,535
Share application money	-	5	-
Employees stock option outstanding	-	-	-
Reserve and surplus	514,086	478,869	469,961
Credit/[debit] fair value change account	30,809	50,192	27,308
Sub - total	688,445	672,613	640,804
Borrowings	-	-	-
Policyholders' funds :			
Credit/[debit] fair value change account	205,506	244,161	178,666
Revaluation reserve - Investment property	6,145	5,840	6,035
Policy liabilities (A)+(B)+(C)	12,849,456	12,744,644	11,304,706
<u>Non unit liabilities (mathematical reserves) (A)</u>	3,099,339	2,915,812	2,516,953
<u>Provision for linked liabilities (fund reserves) (B)</u>	9,231,236	9,302,159	8,393,647
(a) Provision for linked liabilities	8,223,729	7,833,366	7,296,952
(b) Credit/[debit] fair value change account (Linked)	1,007,507	1,468,793	1,096,695
<u>Funds for discontinued policies (C)</u>	518,881	526,673	394,106
(a) Discontinued on account of non-payment of premium	518,412	526,452	393,736
(b) Other discontinuance	1,179	993	493
(c) Credit/[debit] fair value change account	(710)	(772)	(123)
Total linked liabilities (B)+(C)	9,750,117	9,828,832	8,787,753
Sub - total	13,061,107	12,994,645	11,489,407
Funds for Future Appropriations			
Linked	80	87	82
Non linked	87,736	79,990	60,337
Sub - total	87,816	80,077	60,419
Total	13,837,368	13,747,335	12,190,630

Balance Sheet

Application of funds			
Investments			
Shareholders'	774,929	721,947	664,026
<u>Policyholders'</u>	3,328,885	3,183,313	2,706,737
Asset held to cover linked liabilities	9,750,197	9,828,918	8,787,835
Loans	14,506	12,511	8,064
Fixed assets - net block	42,205	39,215	21,377
Deferred tax asset	5	5	5
Current assets			
Cash and Bank balances	20,374	8,438	21,370
Advances and Other assets	251,026	231,376	264,839
Sub-Total (A)	271,400	239,814	286,209
Current liabilities	342,541	276,472	281,573
Provisions	2,218	1,916	2,050
Sub-Total (B)	344,759	278,388	283,623
Net Current Assets (C) = (A-B)	(73,359)	(38,574)	2,586
Miscellaneous expenditure (to the extent not written-off or adjusted)	-	-	-
Debit Balance in Profit & Loss Account (Shareholders' account)	-	-	-
Total	13,837,368	13,747,335	12,190,630
Contingent liabilities	20,312	19,684	20,727