Indian life insurance industry: Ready for consolidation?

It has been over two years since the IRDA issued guidelines restricting the design and pricing of unit linked insurance plans (ULIPs). This was just the beginning of a series of regulatory changes. **Milliman**'s **Mr Sanket Kawatkar** and **Mr Richard Holloway** take stock of the current state of the industry and explore if consolidation is needed in the near future.

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The new business growth rates experienced by the industry in recent periods are set out in the table 1 below.

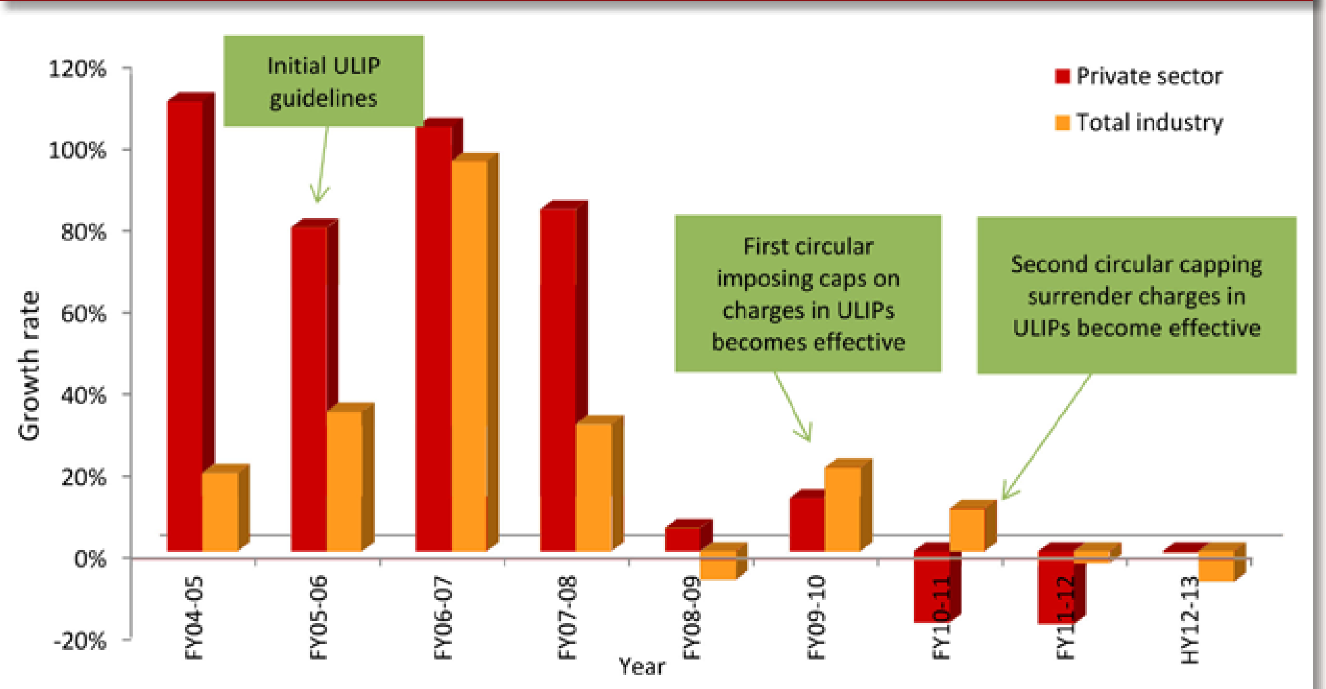
Against the backdrop of the significant decline in new business volume over the past two years, the almost flat growth in new business volumes experienced by the private sector players in HY12-13 is not at all encouraging. For many companies, new business volumes are far behind their expectations and based on our recent survey of CEOs, many companies are not expecting much of a recovery during FY12-13.

Continued regulatory uncertainties

The ULIP changes in September 2010 were just the start of a series of measures that have been introduced by the IRDA over the past two years. Some of the more significant guidelines issued during this period include:

- November 2010: Guidelines on universal life (known as 'VIP') products: These guidelines essentially made launching universal life products unattractive due to the requirement of a minimum guaranteed interest rate throughout the policy term and caps on surrender penalties.
- February 2011: Guidelines on outsourcing activities: These guidelines made it mandatory for insurance companies to retain 'core' functions within the companies and resulted into lost opportunities to achieve potential cost savings through outsourcing.
- February 2011: Guidelines on agent persistency and productivity requirements: These guidelines introduced minimum performance requirements for agents.
- July 2011: Guidelines on fund approval and NAV calculations in ULIPs: These guidelines required companies to modify their unit pricing methodology and standardised the approval process for launching new funds under ULIPs.
- November 2011: Amended guidelines on pension products: These guidelines were designed to increase the attractiveness of 'pension' products to insurance companies through amendments in the nature of investment guarantees required to be provided in the products, but failed to do so.
- December 2011: Regulations in IPOs of life insurance companies: These regulations made it possible for insurance companies that meet certain criteria to raise capital on

Table 1: Weighted new business premium growth rates for private sector and total industry



Source: IRDA monthly disclosures

the stock market, but no company is planning to do so just as yet, given that the prevailing business environment and the lack of a growth story in particular, make it difficult for them to attract good valuations.

- January 2012: ALM and stress testing circular: This circular made it mandatory for companies to submit the results of their ALM and stress testing analysis to the IRDA on a regular basis.

The industry has been struggling to react to the fast pace at which regulations have been changing. Many of the new guidelines have required significant changes in processes and systems as well as fundamental changes to product offerings, with several new rules having been introduced at very short notice.

More importantly, the IRDA is also contemplating the issuance of further new guidelines covering other types of product areas. Although the consultations on the draft guidelines are still continuing, the various areas that may be addressed may include:

- Minimum surrender values for traditional products;
- Minimum death benefit and maximum commissions for traditional products;
- Restrictions on the design and pricing of group products and remuneration offered to group policyholders for the various administrative services provided;
- Restrictions on design and pricing of index-linked insurance products; and
- Guidelines on reinsurance arrangements, including limits on retention levels.

Pending finalisation of these guidelines, many insurers are facing serious delays with the launch of new/innovative products, where the features are close to the product guidelines that are under consideration. Many players fear that once these guidelines are issued, it may further unsettle the market. There may also be significant work and costs involved in re-launching existing products, changing of existing systems, re-training of agents etc.

There are also questions as to whether an 'open architecture' bancassurance will be allowed and in what form, as well as the long standing uncertainty regarding the tax treatment of life insurance. Both these issues make it very difficult for insurers to plan for the future.

The IRDA appears to have become more active over the past two years in carrying out inspections of insurers and imposing fines for non-adherence to regulatory requirements. This is, undoubtedly, a welcome change and something that should have happened several years ago when the initial signs of mis-selling, overpayment to distributors etc. first emerged. Such an approach may have helped to avoid some of the more drastic steps that the IRDA has since taken.

However, considering that current investigations are happening at a time when the industry is trying to adapt to the new environment and react to the other uncertainties, it is not helping to keep industry morale.

Negative sentiments due to external factors

As the industry grapples with its sector specific issues, there are also several external factors which are also adversely affecting the industry:

- There has been material delay in the economic/policy reforms programme of the Government. The proposal to increase the FDI limit for insurance is part of these reforms. At the time of writing this article, there are some indications that the Insurance Amendment Bill will be reintroduced in the winter session of the Parliament. However, the real question is whether the Government will be able to get this passed.
- The inaction on policy reforms is seen to be contributing to a volatile stock market movement, which in turn has affected the sale of ULIP policies

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- Although the IPO guidelines are already in place, raising additional capital on the stock market at this time is not an option given, amongst other things, poor stock market sentiment.
- The high interest rate environment maintained by the Reserve Bank of India to control the high inflation rates experienced is also having an adverse impact on the sale of traditional life insurance products, making the policyholder returns on such products look significantly worse than those currently available on bank deposits.
- Continued negative press about agency sales practices, ULIP mis-selling etc have also resulted into insurers finding it difficult to recruit good quality agents.

'Change' is not going to be easy

A recent Milliman survey of prominent Indian life insurance company CEO suggests that going forward, to be successful in India, companies need to address the following fundamental issues faced by the industry:

- improve the activity/productivity level of the distribution channels, especially the tied agency channel;
- improve the level of training and professionalism amongst intermediaries;
- keep the market conduct of the distributor under control to avoid mis-selling;
- improve the quality of business by controlling the high policy lapse rates; and
- refrain from entering into expensive third party distribution arrangements and enhancing the overall cost efficiency of the businesses.

However, such changes are not easy to implement! The business practices/models adopted by the industry are now over a decade old and there needs to be a behavioural/mindset change across all levels in the organisations. Such a change will happen only gradually, especially in the current uncertain environment.

Also, despite the experience over the past decade, new business volumes/market share are still seen by many shareholders to be the most important performance parameter. Given this, there may be a conflict in the short term as companies try to address some of these fundamental issues at the cost of achieving the desired level of new business volumes/market share. This in itself will make the change process difficult.

As a result many domestic promoters may be losing patience and that of some of the foreign promoters may also be fast running out.

Recipe for consolidation?

New York Life's exit from its joint venture with Max New York Life and ING's rumoured exit from India would both appear to be part of the realignment of their regional and global strategies respectively, as opposed to actions in response to the challenges of the Indian market. However, in our opinion, the current difficult environment in the life insurance sector could also lead to consolidation in the industry.

Any consolidation is also not going to be easy, however, as:

- In the current environment, there may be limited interest by investors in those companies with no third party distribution relationships (eg banks).
- The joint venture structure of the insurance companies means that the process of exit by any promoter would be complicated, and might involve complex discussions around valuation of the business, which is difficult to get a consensus on in the current market environment.
- The current cap on FDI limit means that the number of domestic companies able to enter the life insurance sector is limited, although this may change if the raising of FDI limit to 49% can really be introduced. Also, the global economic issues mean that many European and North American insurers may adopt a 'wait and see' policy before taking a strategic decision to invest in India in the current environment.

So how will the shareholders react?

- Postpone any decision until the regulatory environment stabilises?
- Exit the business, but settle for a low valuation?
- Reduce or cut back on distribution network, and in more extreme cases, closing to new business and running companies as 'closed books'?
- Merge with existing companies?

Indeed, this article raises many questions but does not go so far as to suggest solutions given the many uncertainties hanging over the Indian life insurance sector.

We can only hope that insurers and investors see through these trying times and focus more at the longer term potential of the industry and the country as a whole. We sincerely hope that the new Finance Minister and the IRDA take urgent steps to revive the industry and put it back on a positive growth trajectory. It is surely the time for the IRDA to balance its responsibility for 'Development' as well as 'Regulation' of the industry in the coming years, to give the industry the impetus that it desperately needs.

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