Asia e-Alert

Milliman

On 26 October 2018, the Insurance Regulatory and Development Authority of India (IRDAI) released draft non-linked and linked insurance products regulations for comments, which, once finalised, will supersede the existing 2013 regulations.

In this e-Alert, we highlight the key changes proposed in the draft regulations and discuss the business implications for life insurers should they be finalised in the current form.

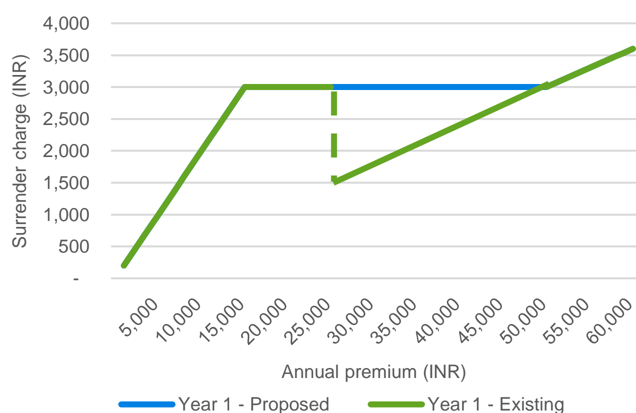
A tabular summary of the key changes proposed is set out at the end of this e-Alert. Our high-level comments on the implications are summarised in the paragraphs below.

Unit-linked business

The draft regulations give more flexibility to insurers while designing early years' charging structures in respect of their unit-linked insurance products (ULIPs). This flexibility can help to better match the incidence of charges with the expenses incurred and may help reduce new business strain under such products.

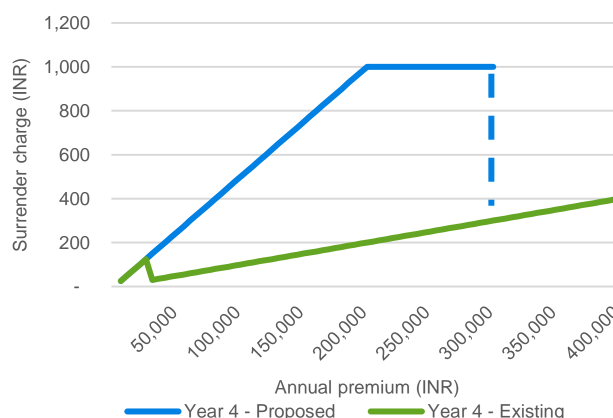
The draft regulations have also made changes to the discontinuance penalties for regular premium policies with an annualised premium between INR 25,000 and INR 50,000. This is also true for single premium policies with premium between INR 25,000 and INR 3 lakhs. Together, with the increased flexibility to design other charges, these changes should enable insurers to recoup more of their initial expenses upon early discontinuance by the policyholder.

FIGURE 1: CHANGES IN MAXIMUM SURRENDER CHARGES FOR REGULAR PREMIUM ULIPS (FIRST POLICY YEAR)



The maximum surrender charges have as much as doubled for policies with regular premiums in the range INR 25,000 to INR 50,000. This may not have a big impact for insurers writing larger ticket sizes but could provide some insurers with significantly better cost recovery upon early termination of the policy.

FIGURE 2: CHANGES IN MAXIMUM SURRENDER CHARGES FOR SINGLE PREMIUM ULIPS (FOURTH POLICY YEAR)



Manifold increase in the maximum surrender charges for single premium policies with premium between INR 25,000 and INR 3 lakhs.

Premium paying riders can now be attached to unit-linked policies, which could help in the growth of protection business in the Indian market by enabling insurers to incentivise distributors appropriately for the rider premium.

Greater flexibility has been given to policyholders, as they will no longer be required to pay level premiums throughout the life of a contract. Furthermore, for unit-linked contracts, insurers are now permitted to give policyholders the option of reducing premiums by up to 50% after paying the first five years' premiums. This may also help lower ultimate surrender rates to some extent.

Insurers will no longer have to provide the "non-negative clawback additions" (NNCA) currently required under these products, although they will still need to ensure compliance with reduction in yield (RIY) on termination of the policy. This relaxation should ease the administrative burden on insurers and lower the implied cost of such guarantees.

Pensions business

Pensions products have undergone significant change in the draft regulations, with insurers no longer needing to provide a positive guaranteed rate of return on maturity. The change should make these products more attractive to insurers as this was a major reason insurers were reluctant to enter this space in recent years.

Policies have become much more consumer friendly, with the ability of policyholders now to commute up to 60% of the resulting pension amount on surrender or maturity to a lump-sum. Also, the nominee of a deceased policyholder can now commute the entire resulting pension amount to a lump-sum benefit rather than having to annuitise at least two-thirds of these proceeds. Partial withdrawals are also allowed (with certain restrictions), which will bring life insurers on a more level footing with other 'pension' / retirement savings provider frameworks such as National Pension System (NPS). Furthermore, in relation to annuitisation, policyholders are now allowed to shop around for the best annuity rates from any insurer at the time of vesting their pension.

Participating business

The draft regulations strengthen the governance of participating business, placing greater responsibilities on the With Profits Committee (WPC). Companies will now have to devote more time and attention to this part of the business, ensuring sound documentation and a governance framework in respect of:

- The methodology and bases underlying the calculation of policyholders' asset shares
- What exactly constitutes policyholders' reasonable expectations (PRE)
- The quantum of expenses allocated to the participating fund
- The bonus earning capacity of the business
- Ensuring equity between different groups and generations of policyholders

Variable insurance products

The individual variable insurance product (VIP) line, which has largely been ignored since it was codified in 2013, has been significantly revamped, with fewer design restrictions. The earlier requirement to have 'non-negative' interest credits for non-participating VIPs has been removed. This change could give more design flexibility and potentially make this product line attractive to insurers once more.

Death benefits changes

The change in the minimum life cover requirements from 10 times to seven times the annual premium for younger age brackets will enable insurers to customise products more to the needs of the consumer. However, the impact of this on business may be muted unless the tax deductibility provisions for life insurance contracts are also amended (which currently specify 10 times the premium as the minimum level of cover to be eligible for tax deductibility).

Transition timelines

The regulations appear to envisage a two-year implementation window, during which insurers can modify their existing products in order to ensure compliance. Given that many of the changes are not fundamental to existing products, this should provide insurers enough time to prepare for the change. We do not expect a significant depression in growth as experienced during 2010 and 2013, when the changes in the product regulations were more far reaching and transition periods were short.

Other modifications

There are a number of other modifications made to the regulations which, while less significant, give important risk management and operational benefits to insurers and solve long-standing technical issues. We have described these in detail in Figure 3 at the end of this e-Alert.

Conclusion

The recently issued draft regulations are welcome and address many of the issues facing the industry today. We hope that after they are finalised, the regulations will make it easier for insurers to do business and also give consumers more freedom and choice.

CONTACT

Heerak Basu
heerak.basu@milliman.com

Philip Jackson
philip.jackson@milliman.com

Sanket Kawatkar
sanket.kawatkar@milliman.com

Richard Holloway
richard.holloway@milliman.com

© 2018 Milliman, Inc. All Rights Reserved. The materials in this document represent the opinion of the authors and are not representative of the views of Milliman, Inc. Milliman does not certify the information, nor does it guarantee the accuracy and completeness of such information. Use of such information is voluntary and should not be relied upon unless an independent review of its accuracy and completeness has been performed. Materials may not be reproduced without the express consent of Milliman.

FIGURE 3: SUMMARY OF CHANGES PROPOSED

SUBJECT	DESCRIPTION / TOPIC	PROPOSED REGULATIONS	EXISTING REGULATIONS	COMMENTS
Death benefits	Death benefits on non-linked products.	7 x Regular Premium (RP) (or 105% of premiums received); 1.25 x Single Premium (SP).	Below age 45: 10xRP (or 105% of premiums received) and 1.25xSP. Above age 45: 7xRP (or 105% of premiums received) and 1.1xSP.	More restrictions on SP products, although less restrictive for regular premium products sold to those under age 45.
	Death benefits on ULIPs and VIP products.	Life – 7xRP (or 105% of premiums received); 1.25xSP. Health - 125%SP or 100,000 if higher (SP); 5xAP or 100,000 if higher (RP).	Below age 45: 125% SP; 10xAP (or 0.5xRPxT if higher) for life; 5xRP (or 100,000 if higher) for health. Above age 45 110% SP; 7xRP (or 0.25xRPxT if higher) for life; 5xRP (or 100,000 if higher) for health.	
Surrender benefits	ULIP and VIP surrender charges.	Two tiers of surrender charges are in operation, with the lower premium tier applicable to policies with annual premiums less than INR 50,000 for regular premiums, and INR 300,000 for single premiums.	The lower tier was applicable only to policies with annual/single premiums less than INR 25,000.	Surrender charges increase for those in the middle range of policy sizes.
	Non-linked minimum guaranteed surrender values (GSV).	After 2 years, to include minimum surrender value of bonuses of 30% of bonuses. Minimum GSV for third policy year increased from 30% to 35% for RP and 70% to 75% for SP.	Minimum GSV applicable after 2 years (PPT less than 10 years); after 3 years (PPT more than 10 years).	Higher surrender values in early years with a longer revival period for lapsed policies.
	Non-linked revival period.	5 years.	2 years.	
ULIP charges	RiY for ULIP.	Insurers are required to demonstrate compliance of the charging structure with RiY at the time of filing only based on a gross yield of 6% p.a. and 15% p.a. and must only ensure compliance with RiY upon maturity of the policy.	Insurers were required to demonstrate compliance with RiY at the time of filing at gross yields of 6%, 8%,10%,15%, 20% and 25% p.a., and were required to add non-negative clawback additions (NNCA) after the policy completed 5 years to ensure compliance with RiY on a regular basis.	Significantly reduced operational burden on insurers to demonstrate and ensure RiY compliance. In addition, the requirement to only comply upon maturity reduces the implied cost of meeting these guarantees.
	ULIP charges in early years.	The difference between minimum and maximum charges during the first 5 years can't be more than 3 times. The premium allocation charge in any year shall not exceed 12.5% of the premium paid.	The difference between minimum and maximum charges during the first 5 years can't be more than 1.5 times. No allocation charge caps.	New regulation appears less restrictive, and insurers do not typically exceed the 12.5% cap. More flexibility to vary charges in line with the incidence of costs would add flexibility in design.
	ULIP risk charges.	Health score-based reductions in charges permissible.	Fixed-risk charges required based on underwriting at outset.	Will allow insurers more freedom to rate lives and offer health-based customisations to policies. A positive move for promoting more protection elements in ULIPs.
Pensions	Commutation of pensions.	Commutation of pensions up to 60% at surrender/maturity for policyholders and up to 100% for nominees on policies of the deceased allowed.	Commutation allowed as per the maximum specified in the Income Tax Act.	A new lease of life for pension products which have not been sold in significant volumes in recent years.

SUBJECT	DESCRIPTION / TOPIC	PROPOSED REGULATIONS	EXISTING REGULATIONS	COMMENTS
	Partial withdrawals on ULIP pensions.	Partial withdrawals allowed (max 25% of fund; max 3 times in policy tenure; on specific life events).	Partial withdrawals not allowed.	Significantly less restrictive product structure and removal of guarantees make the product more attractive to insurers. Enhanced liquidity and commutation options make it much more flexible from a consumer standpoint and bring the product in line with the other options available such as the NPS.
	Pension guarantees.	Pension products are no longer required to provide guaranteed returns on maturity, although minimum death benefits of 105% of premiums paid are required.	Pension products are required to provide maturity guarantees.	
	Open market option for annuities.	Open market option allowed for annuities (both individual and group pension policies) and also the ability to offer differential rates to existing customers.	Policyholders must use their pension policy proceeds to buy an annuity from the same insurer from whom they purchased the pension.	A boost for policyholders who are now able to 'shop around' for the best annuity rates on retirement / maturity of the policy. The market for annuity providers can now access the pension customers of their competitors.
	Annuity options.	For insurers offering annuities, the options offered should at least cover a life annuity and an annuity with return of premium.	No restrictions on annuity types to be offered.	Policyholders have typically favoured the 'return of premium' option for annuities, and this requirement may lead to annuity writers accepting more longevity risk.
Variable insurance products	Product structures.	Interest credits can be declared in arrears and can be negative in the case of non-par VIP. No requirement for a minimum guaranteed interest credit.	Interest credits must be non-negative. Requirement to have minimum guaranteed interest rate, and interest credits declared in advance. Need to maintain a shadow policy account.	The individual VIP product line, which has largely been ignored since it was codified in 2013, has been significantly revamped, with fewer design restrictions. The earlier requirement to have 'non-negative' interest credits for non-participating VIPs has been removed which could give more design flexibility and potentially make this product line attractive once more. A lower RiY requirement than ULIPs may result in insurers preferring this product line over ULIPs with a low equity backing ratio.
	RiY for VIP.	Relaxation of limits as compared to ULIPs for the first 10 policy years. Compliance to be demonstrated at the time of filing the product at 6%, 8%, and 10% p.a. gross yields and complied with throughout the policy life.	RiY previously as per ULIP policies.	
Riders	Riders.	Possible to 'mix and match' linked/non-linked riders with linked/non-linked policies. Also, premium paying riders (i.e. where the cost of rider cover is paid as a separate premium rather than deducted from unit fund) can now be added to ULIPs.	Insurers are required to file separate riders with the regulator for linked and non-linked business. Only charge-based riders are permitted for ULIPs.	Another boost for protection business as level premium paying riders added to new ULIPs would result in additional commission to intermediaries, thereby making them more attractive to distributors. Ability to 'mix and match' reduces the administrative burden of filing and maintaining two versions of a rider.
	Non-linked pensions.	No limit on rider premiums attached to non-linked pension plans.	Earlier cap of 15% of premium was placed on rider premiums attached to non-linked pensions plans.	
Other changes	Structure of benefits during settlement periods (i.e. benefits paid after the policy term has ended).	The instalments can be linked to an external benchmark, as applicable on the date of maturity and/or date of intimation of death. Settlement periods can be as long as 10 years (although not longer than the policy term).	The insurer may pay such death benefit in instalments over a definite period of time (maximum 5 years) at a defined rate of interest, as approved under the 'File and Use' application if such option is provided at the inception of a policy. No fund switches allowed during the settlement period.	Fixed-rate conversion options result in an interest rate risk to the insurer in the event that interest rates fall below the fixed rate of conversion later in the policy life (and less attractive conversions for customers in the case that interest rates rise). Linking these conversion rates to indices as is now permitted (say a benchmark interest rate) would minimise these risks.

SUBJECT	DESCRIPTION / TOPIC	PROPOSED REGULATIONS	EXISTING REGULATIONS	COMMENTS
		For ULIPs, fund switches are allowed during the settlement period.		
	Level premium requirement for ULIPs.	ULIP policyholders may be allowed to lower the premiums by a maximum of 50% of annualised premium after payment of five annual premiums.	This was not permitted earlier.	More product structure flexibility.
	Minor lives commencement of risk coverage.	For policies issued on a minor life, the date of commencement of risk may start anytime on or before the second policy anniversary, or on the policy anniversary after attainment of majority, whichever is earlier, from the date of commencement of the policy.	For policies issued on a minor life, the date of commencement of policy and date of commencement of risk shall be the same.	Delays between commencement of policies and commencement of risk coverage for minor lives reduces the moral hazard inherent in policies.
	Group yearly renewable term (YRT) plans.	Group YRT plans can now be sold to non-employer-employee groups.	This was not permitted earlier.	Could lead to greater protection penetration.
	Linked VIP.	Removed this category.	Earlier allowed.	This product structure was not favoured by insurers as it did not appear to add significant value over alternative product structures.
With-profits management	Governance framework through the With Profits Committee (WPC).	Enhanced scope of the WPC - approval of asset shares, equity / fairness amongst different policyholders, etc.	Approval of asset shares.	Significant expansion in the role of the WPC, with a responsibility for increased independent oversight of management of participating business.
Operational aspects	Numerous operational aspects and commission limits.	Removed from product regulations.	Earlier regulations included such details.	These aspects appear to be covered better by separate regulations and hence removed.
	Transition to new regulations.	No change for existing policies. It appears insurers can continue to sell existing products during the transition window of 2 years from the date of introduction of the regulations. Suggestion that further guidelines will be issued on the transition process.	Upon the introduction of the 2013 regulations, there was no change for existing policies. However, the transition period was around 6 months only.	Significantly more time to make the changes, which when combined with the fact that changes are less fundamental, will ease the burden on insurers and should provide for a smoother implementation.