Asia e-Alert

Milliman

Following the completion of consultations on the draft regulations issued in October 2018, the Insurance Regulatory and Development Authority of India (IRDAI) released final non-linked and linked insurance product regulations on 8 July 2019, which supersede the 2013 regulations.

In this e-Alert, we highlight the key changes in regulations from 2013 to 2019 and discuss the business implications for life insurers.

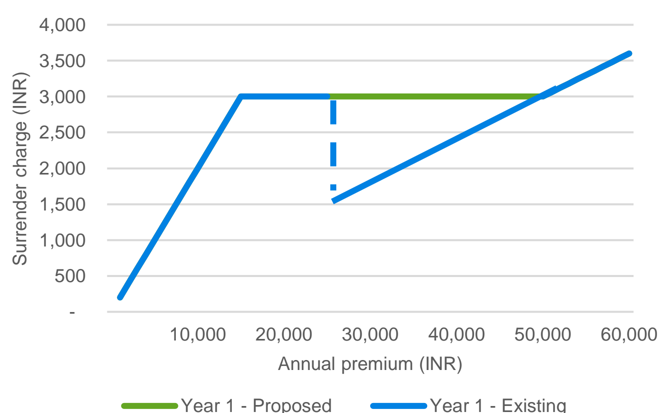
A tabular summary is set out at the end of this e-Alert. Our high-level comments on the implications are summarised in the paragraphs below.

Surrender values

Guaranteed surrender values for regular premium non-linked products will now be available from the second policy year for all policies, rather than the third year in the case of policies with longer premium paying terms. There is some increase to the guaranteed surrender values in Year Three. The changes will increase the onus on insurers to improve policyholder persistency in order to recover the upfront costs incurred during the sales process. Also, a higher minimum guaranteed surrender value at early policy durations may result in higher capital requirements.

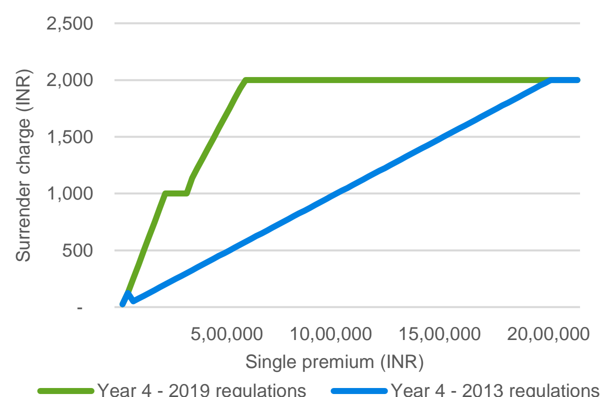
The regulations have also made changes to the discontinuance penalties for unit-linked insurance products (ULIPs).

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



The maximum surrender charges have increased for policies with regular premiums in the range INR 25,000 to INR 50,000 (remains unchanged for other levels of premiums). 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: ESTIMATED CHANGES IN MAXIMUM SURRENDER CHARGES FOR SINGLE PREMIUM ULIPS (FOURTH POLICY YEAR)



Large increase in the maximum surrender charges for single premium policies with premium greater than INR 25,000.

For regular premium policies with an annualised premium between INR 25,000 and INR 50,000 and for single premium policies with premiums greater than INR 25,000, the maximum charges have increased.

Together with the increased charging structure flexibility now available (detailed below), these changes should enable insurers to recoup more of their initial expenses upon early discontinuance by the policyholder.

Unit-linked business

The regulations give more flexibility to insurers when they are designing early years' charging structures in respect of ULIPs. This flexibility can help to better match the incidence of charges with the expenses incurred and may help reduce new business strain.

Premium paying riders can now be attached to unit-linked policies, which could help the growth of protection business 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. 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.

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) upon termination of the policy. This relaxation should ease the administrative burden on insurers and lower the implied cost of such guarantees.

Index-linked products

Prior to 2013, index-linked products were a popular alternative to both participating and non-participating traditional savings products. Following the issuance of 2013 regulations, index-linked products were permitted only on a unit-linked platform, resulting in insurers not finding them attractive to sell. The market has since moved on somewhat to favour fully guaranteed products. However, the 2019 regulations again appear to permit, or to at least not prohibit, index-linked products on a traditional platform. This could make this class of products an attractive option to insurers looking to reduce investment risks whilst still maintaining product margins.

Pensions business

Pension products have undergone significant change in the draft regulations, with insurers no longer needing to provide a positive guaranteed rate of return on maturity of ULIP pension plans. This change should make these products more attractive to insurers as this requirement has caused reluctance to enter this space in recent years.

Pensions have also become more consumer friendly, with the allowance for policyholders to commute up to 60% of the pension amount on surrender or maturity to a lump-sum. Partial withdrawals are also allowed (with certain restrictions) from a unit-linked pension policy, 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 annuitisation, although the corpus that can be annuitised with another insurer is currently capped at 50%.

Participating business

The regulations have strengthened the governance framework of participating business, placing greater responsibilities on the With Profits Committee (WPC) of the life insurer's Board. 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 constitutes policyholders' reasonable expectations (PRE)
- The quantum of expenses allocated to the participating fund
- The bonus earning capacity of the business
- Treatment of surplus assets within the fund
- Changes in surrender value scales

Variable insurance

The variable insurance product (VIP) line, which for retail products has largely been ignored by insurers since it was codified in the 2013 regulations, has been removed as a product category. It appears that non-participating group savings products will continue to be permitted, although the discretion to set crediting rates has been explicitly curtailed.

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 better customise products to the needs of the consumer. However, the impact of this change 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 deduction).

Transition timelines and other modifications

It is not as yet clear when insurers will need to update their product offerings to comply with the new regulations.

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 regulations are welcome and address many of the issues facing the industry today. We hope that they 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

FIGURE 3: SUMMARY OF CHANGES PROPOSED

SUBJECT	DESCRIPTION / TOPIC	2019 REGULATIONS	2013 REGULATIONS	COMMENTS
Sum assured	Minimum sum assured on non-linked products.	7 x Regular Premium (RP) (or 105% of premiums received) life plans; 1.25 x Single Premium (SP) life plans.	Below age 45 of life plans: 10 x RP (or 105% of premiums received) and 1.25 x SP. Above age 45 of life plans: 7 x RP (or 105% of premiums received) and 1.1 x SP.	More restrictions on SP products, although less restrictive for regular premium products sold to those under age 45.
	Minimum sum assured on ULIPs.	Life – 7 x RP (or 105% of premiums received); 1.25 x SP. Health – 5 x AP 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; 7 x RP (or 0.25 x RPxT if higher) for life; 5 x RP (or 100,000 if higher) for health.	
Surrender benefits	ULIP surrender charges.	Two tiers of surrender charges are in operation, with the lower tier applicable to policies with annual premiums less than INR 50,000 for regular premiums, and INR 300,000 for single premiums. In addition, charges have increased for single premium policies above INR 300,000.	The lower tier was applicable only to policies with annual/single premiums less than INR 25,000.	Surrender charges increase for regular premium policies in the middle range of policy sizes. For single premium policies up to INR 20,00,000, surrender charges increase.
	Non-linked minimum guaranteed surrender values (GSV).	GSV of 30% of premiums paid to be available after two full years of premiums are paid. 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 guaranteed surrender values in early years
	Revival periods for lapsed policies.	5 years for non-linked plans and 3 years for ULIPs	2 years.	Longer revival period for lapsed policies.
ULIP charges	Reduction in yield (RiY) for ULIP.	Insurers are required to demonstrate compliance of the charging structure with RiY only at the time of filing of the product, based on a gross yield of 6% p.a., 8% p.a. and 10% 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 the product, at gross yields of 6%, 8%,10%,15%, 20% and 25% p.a., and were required to add non-negative claw-back additions (NNCA) after the policy completed 5 years to ensure compliance with RiY on an ongoing 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 five years cannot be more than three 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 five years cannot be more than 1.5 times. No allocation charge caps.	New regulation appears less restrictive, given the greater flexibility in charges over the first five years. In practice the cap on premium allocation charges of 12.5% is not a constraint as market players would typically set premium allocation charges below that level anyway.
Pensions	Commutation of pensions.	Product regulations specify that policyholders are able to commute up to 60% of pension amounts upon surrender/maturity.	Commutation allowed as per the Income Tax Act.	The removal of investment return guarantees on ULIP pension may help insurers re-introduce such plans.
	Minimum guaranteed defined benefit, resulting in a non-zero investment return	For unit-linked pension plans, the requirement to compulsorily offer a minimum guaranteed defined benefit upon maturity has been removed.	Insurers were required to offer a non-zero investment return guarantee upon maturity	The less restrictive product structure may make the product more attractive to insurers. Enhanced liquidity and commutation options make it much more flexible from a consumer standpoint and

SUBJECT	DESCRIPTION / TOPIC	2019 REGULATIONS	2013 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.	bring the product in line with the other options available such as the NPS.
	Open market option for annuities. Currently 50% of corpus only.	Open market option allowed for annuities (both individual and group pension policies) and also the ability to offer differential rates to existing customers. This option is only available on 50% of the amount to be annuitised, with the balance to be placed with the same insurer from whom the pension plan was purchased.	Policyholders must use their pension policy proceeds to buy an annuity from the same insurer from whom they purchased the pension policy.	A boost for policyholders who are now able to 'shop around' for the best annuity rates on a portion of their corpus on retirement / maturity of the policy. 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 mandatory annuity types to be offered.	Although policyholders have typically favoured the 'return of premium' option for annuities, the requirement to offer life annuities as well may lead to annuity writers accepting more longevity risk.
Linked and non-linked Variable insurance products (VIP) – now a removed product category	Group funds management business.	*Now under the 'vanilla' non-participating product structure.* Board-approved policy required for interest credits. No specific requirement for these credits to be non-negative. No discrimination or discretion in crediting rates permitted (except on the basis of fund size) across group policyholders and a separate account to be maintained for each policy.	*Under the VIP product structure.* Interest credits must be non-negative. Requirement to have a 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 removed. It appears there will be fewer restrictions on non-participating group savings contracts, although the restrictions on discriminatory interest credits may change this market, with insurers having to credit identical interest rates on policies of similar sizes.
Index-linked products		No explicit wordings suggesting that these products are disallowed on a traditional platform – suggesting they may now be approved by the IRDAI.	Not permitted.	Could become an attractive product line for insurers once more. Has the potential to improve customer returns while reducing investment risk to the insurer when compared with fully guaranteed non-participating traditional savings products Has the potential to generate higher returns to insurers when compared with participating products, as surplus is earned outside of the 90:10 profit-sharing gate.
Riders	Riders.	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.
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. A life cover of 105% of premiums paid must be maintained during the settlement period (cost of cover may be charged for ULIPs). For ULIPs, fund switches are allowed during the settlement period.	The insurer may pay such death benefit in instalments, calculated using 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 (for example, linking to a benchmark interest rate) would reduce these risks.
	Level premium requirement for ULIPs.	ULIP policyholders may be allowed to lower the premiums by a maximum of 50% of annualised premium after	Not permitted.	More product structure flexibility.

SUBJECT	DESCRIPTION / TOPIC	2019 REGULATIONS	2013 REGULATIONS	COMMENTS
		payment of five annual premiums.		
	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 reduce the moral hazard inherent in policies.
	Advance premium.	Collection of renewal premium in advance shall be allowed within the same financial year. The commission shall only be paid after adjustment of premium on the due date.	Collection of renewal premium in advance shall be allowed up to 30 days before the due date (up to 3 months in advance for monthly premium policies at the time of policy issuance).	More customer flexibility in terms of premium payment – may improve persistency.
With-profits management	Governance framework through the With Profits Committee (WPC).	Enhanced scope of the WPC – approval of asset shares, PRE, expenses allocated to the participating fund, bonus earning capacity, treatment of surplus assets within the fund, changes in surrender value scales. Chief Financial Officer to be included in the WPC. Minimum eligibility requirements specified for the Independent Actuary on the WPC.	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.

© 2019 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.