

## Risk and Capital Survey in India: Findings

In recent years, capital appears to have generally become more of a constraint for Indian life insurers. While the causes will be multifactorial, this may in part be due to a period of relatively sustained growth in sales. In particular, we have witnessed recent growth in higher guarantee, non-participating savings business.

In order to understand how insurers are managing the risks associated with these guaranteed savings products, and their increasing capital requirements more generally, Milliman conducted a short survey of Indian life insurers. A total of 17 (out of 24) life insurers participated in the survey.

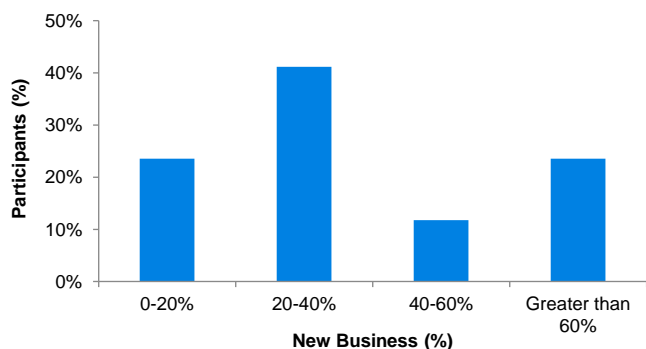
The main results of this survey are presented in this e-Alert.

### Non-participating savings products

Non-participating savings business constitutes a significant proportion of individual new business for many of the survey participants.

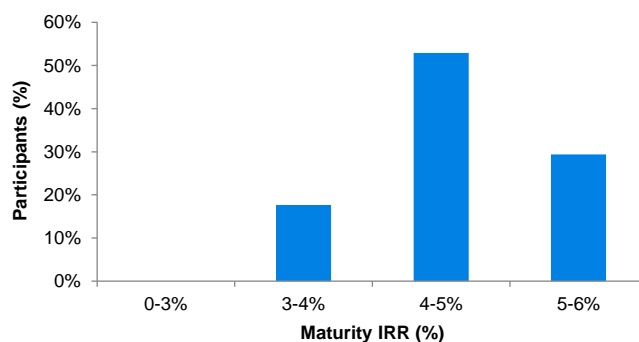
Four insurers have more than 60% of their individual new business annualized premium equivalent (APE) coming from this product category in fiscal year (FY) 2018-19. A further two have between 40% and 60% of new business APE coming from this product category.

**FIGURE 1: PERCENTAGE OF NEW BUSINESS APE FROM TRADITIONAL NON-PARTICIPATING SAVINGS PRODUCTS IN FY18-19**



Additionally, guarantee levels in the non-participating savings products are becoming more substantial, with five players offering maturity internal rates of return (IRRs) of between 5% and 6%, and a further nine insurers offering maturity IRRs of between 4% and 5%.

**FIGURE 2: MATURITY IRR OFFERED ON TRADITIONAL NON-PARTICIPATING SAVINGS PRODUCTS**



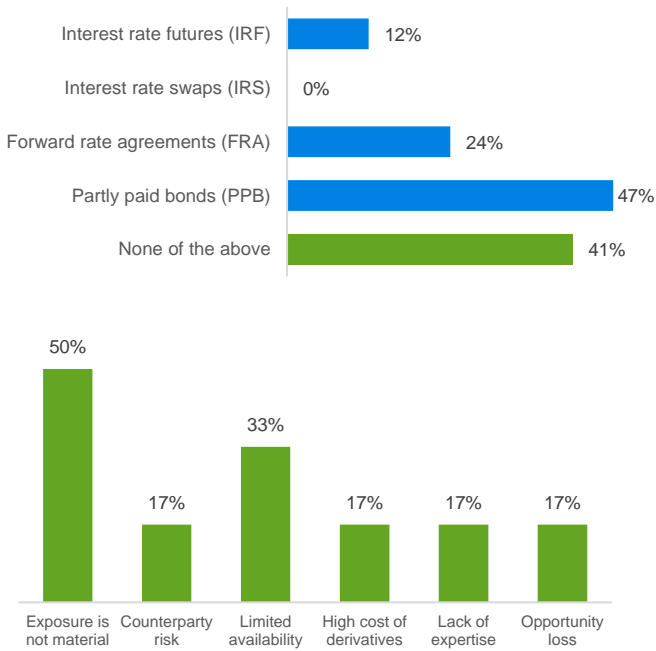
On the whole, the approach adopted by insurers to manage the interest rate risks has been to manage the policy terms of their non-participating savings products, so that interest rate exposure falls within the liquid part of the yield curve. However, in recent years we note that some insurers have started offering longer-term guarantees.

### Hedging interest rate risks

Given the increased focus on non-participating savings plans, hedging (using derivatives, or even partly paid bonds) can be an attractive method to reduce interest rate risk and potentially reduce capital strain.

While 41% of the survey participants (seven) do not use these instruments to hedge interest rate risk, a majority do. For those who do, partly paid bonds (PPBs) are the most popular (eight).

**FIGURE 3: INSURERS USING VARIOUS HEDGING INSTRUMENTS AGAINST INTEREST RATE RISK AND REASONS FOR NOT USING ANY**



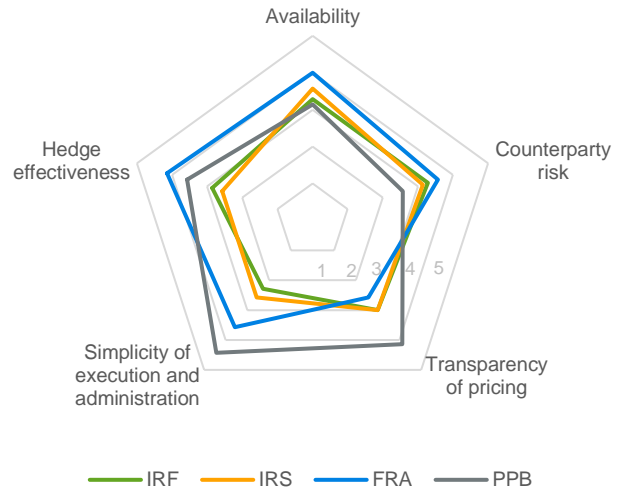
The second bar chart in Figure 3 elaborates on the reasons for some insurers choosing not to utilise these financial instruments. The majority of such participants maintain that their exposure to interest rate risk is not material, closely followed by a limited availability of suitable instruments. The reasons for this might be limited availability of PPBs or the fairly recent reintroduction of forward rate agreements (FRAs) in the market.

### Ratings of interest rate risk hedging instruments

As Figure 4 suggests, the ratings by the nine (out of 17) survey participants who have utilized at least one of the hedging instruments are as follows:

- FRAs are rated highly on 'hedge effectiveness' by eight participants. Also 'availability' and 'counterparty risk' are not seen as a problem, with only two rating them low on these measures.
- PPBs are rated highly on 'price transparency' (six) and 'simplicity of execution' (eight). Also 'hedge effectiveness' is not seen as a problem, with only one rating them low on this measure.

**FIGURE 4: AVERAGE RATING OF EACH INSTRUMENT BY INSURERS THAT HAVE UTILIZED AT LEAST ONE OF THESE INSTRUMENTS**

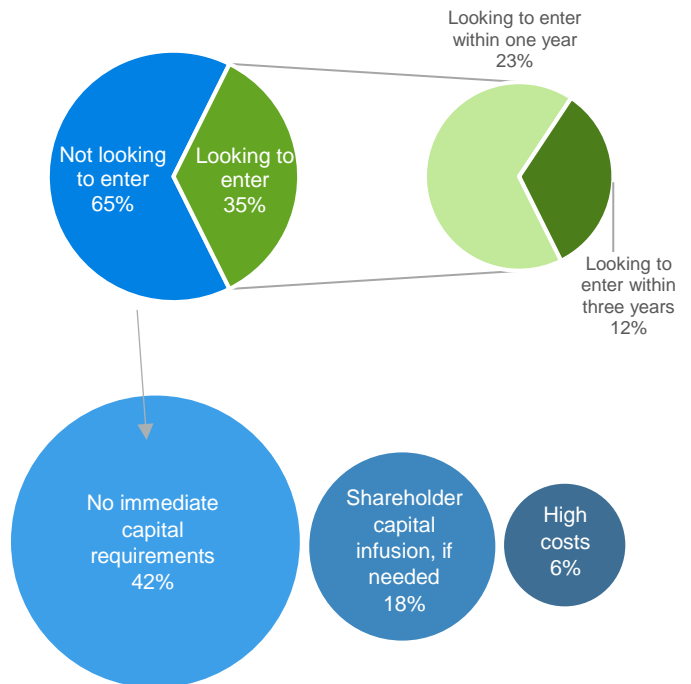


### Financial reinsurance

As an alternative to hedging, another method of managing capital requirements is through increasing available capital via financial reinsurance.

Eleven of the survey participants (65%) are currently not looking to enter into financial reinsurance (Fin Re) arrangements, mainly because they have no immediate capital requirements.

**FIGURE 5: PERCENTAGE OF COMPANIES LOOKING TO ENTER INTO FINANCIAL REINSURANCE ARRANGEMENTS**



## Ratings of different sources of capital

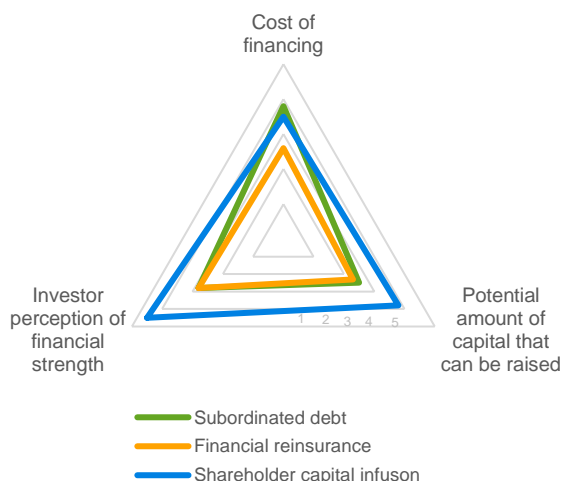
In addition to looking at Fin Re, we also asked insurers to rate other sources of capital.

As Figure 6 suggests, when asked to rate the different sources of capital, the participants had a clear preference for 'shareholder capital injection' over 'subordinated debt' and 'financial reinsurance.'

A number of participants have rated shareholder capital injections as high on 'cost of financing,' possibly considering the absence of 'contractual' cash cost of financing, instead of considering the shareholders' expected higher rates of return.

There are mixed views by the participants on the potential investor perception of financial strength with regard to raising capital through subordinated debt or financial reinsurance.

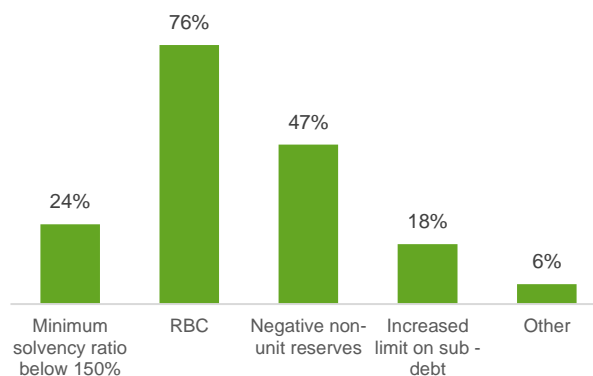
**FIGURE 6: AVERAGE RATING BY INSURERS OF DIFFERENT SOURCES OF CAPITAL**



## Regulations and capital management

We asked participants whether changes in regulations would help better manage capital requirements. Most (13) favour the introduction of a risk-based capital (RBC) regime to help them in terms of capital management. Another popular suggestion (eight) was permitting negative non-unit reserves on unit-linked plans (within defined limits).

**FIGURE 7: IN WHICH OF THE FOLLOWING AREAS WOULD YOU LIKE TO SEE A CHANGE IN THE REGULATIONS, ALLOWING YOU TO BETTER MANAGE THE CAPITAL REQUIREMENTS OF THE COMPANY?**



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