IndiaFirst LIFE INSURANCE

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Unlocking *Value*

Despite periods of readjustment, the underlying fundamentals for a robust insurance sector in India remains strong, finds out a CII-Tower Watson Survey (Part-1)

Nearly a decade and a half since privatisation, the insurance industry in India today finds itself with a keen sense of anticipation: at the time of going to press, proposed amendments to the Insurance Act have been passed by the Parliament.

Although further clarity is still needed on the precise rules governing hike in foreign investment and other provisions of the Act, there is still a palpable nervous energy and restlessness within the industry as it tries to grasp its potential.

Business optimisation

Inefficiency prevalent within the insurance sector is one of the key challenges that needs to be overcome for all stakeholders, including policyholders, investors and distributors, to realise the true potential of the business. Business inefficiencies, like low policy persistency in life insurance, hurts the interests of multiple stakeholders (policyholders, investors and regulators to name just a few), and are a serious threat to the long- term future of the insurance business. Business optimisation is a complex issue given that insurance companies are still in growth phase to attain the critical mass required to reap full benefit from economies of scale.

However, it needs to be achieved in an efficient manner to ensure profitability and sustainability of growth. In fact, the inability to balance growth with profits was cited as one of the key challenges faced by non-life companies as per the Towers Watson-CII survey.

The future winners in the industry are expected to be those who are able to best crack this code. This claim is backed by operational efficiency being considered as one of the top differentiators by life insurers for generating good valuations for the IPOs.

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As per the Towers Watson-CII survey, distribution appears to be the area which has provided maximum challenges for the insurance sector in the recent past, as well as continues to be seen as the major driver of value by insurance company shareholders in future. A majority of the bigger challenges faced by life insurers have either been related directly (for example, retention and productivity of agency force and managing third-party distribution tie-ups) or indirectly (for example, managing policy persistency) to distribution channels.

Similarly, the balance of power being significantly in favour of the distributors was one of the major challenges faced by the non-life insurance companies as well.

Strengthening of agency force, developing third party tie-ups as well as developing alternate distribution channels like online sales came out as the top focus areas in terms of potential value drivers for both life and non-life insurance business from the survey. The importance of distribution channels and strategy is further emphasised by life insurers considering the strength of the distribution network as one of the topdifferentiator when it comes to valuation for IPOs.

The issue of low policy persistency has long plagued the life insurance sector in India and contributed directly or indirectly to a number of strict clamp downs by the insurance regulator as well as a loss in consumer confidence. With the increase in guaranteed surrender values mandated by the regulator,

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usually both the life insurance company as well as the policyholder suffer due to poor persistency. Frequent clamp downs by the regulator in the form of regular changes to life insurance product guidelines meant insurers had to continuously revamp their product portfolios. Besides the energies spent on product pricing and approval and setting up of the required administration system, this also required significant effort to re-train the sales staff regularly on the latest products, making this one of the key challenges faced by life insurers in the recent past. This is the reason why, the Towers Watson-CII survey shows, that managing policy persistency is being seen as the most important step towards business optimization by life insurance companies in the near future.

Various strategies can be and are being adopted by life insurers to manage policy persistency including, but not limited to, setting up of specialized persistency units, stronger checks to curb mis-selling, incentivising distribution agents to maintain good persistency records, maximising use of automated payments (ECS) to collect premiums.

Overall, it would appear that a lot of changes faced by life insurers can be directly or indirectly resolved by addressing the issues and opportunities in distribution. For example, the primary cause for poor persistency is mis-selling by distribution agents which the insurance companies need to curb. The revised insurance bill also has a provision for making insurance companies liable for mis-selling of their policies by distribution agents which will push insurance companies to find ways to address this issue as priority.

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A strong and diverse distribution network operating efficiently through need-based selling will meet the objectives of the policyholder,shareholder, regulator and government, and in turn will ensure that the distribution agents benefit in the long run as well The average expense ratio of Indian life insurers in 2013-14 was recorded at 19%.

Typically developed markets tend to have an expense ratio in the range of 4-12% (according to OECD Insurance Statistics) while emerging markets tend to have expense ratio in the 25-50% range (Towers Watson analysis).

Interestingly despite the relatively high expense ratios experienced by a number of life insurance companies, life insurers did not rate high operating expenses and excess capacity maintenance as among the bigger challenges faced by them in the recent past. This might be due to companies viewing the high expense ratios as the effect of other factors,like low policy persistency mentioned above, rather than past causes.

However, the survey shows that expense control is now being considered to be one of the top drivers of value for life insurance companies in future.

For life insurance companies in India, there is evidence that expense ratios depend on the size of the insurer and contribution of bank distribution channel in the new business written. In the figure above, the size of the bubble depicts total gross premium written by the insurer while the colour of the bubble represents the proportion of bank distribution in new business written. In this figure, bank-led insurers and insurers with banks as the main distribution channel appear in red while insurers depicted by yellow bubbles have negligible proportion of new business sold through banks. We can see that insurers like SBI Life, HDFC Life and ICICI Prudential Life have one of the lowest expense ratios due to a combination of their size and strong bancassurance partners. Also, smaller insurers like IndiaFirst Life and Canara HSBC OBC Life are also able to achieve lower expense ratios by distributing mainly through their bank distribution channels. Based on this,statistics would indicate that the agency channel is generally quite expensive to maintain relative to the bancassurance channel. However, in spite of the costs, strengthening the agency channel is being viewed as a key to business optimisation in future by life insurance companies. This is probably due to the realisation of the requirement of agency channels for the insurance companies to achieve a critical mass and enjoy expense efficiencies. The challenge would be to ensure that both expense controls and strengthening of the agency channel is achieved in cohesion rather than focusing on only one of these.

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Based on the survey, there is evidence of life insurers beginning to focus on aggressive investment strategy to gain competitive advantage in the market. However, the survey indicates a relatively low importance being placed on robust risk management which is increasingly being considered as necessary. Ideally, aggressive investment strategy should go hand-in-hand with a strong focus on enterprise risk management.

Non-life insurance companies considered the price wars in multiple business segments following the "detarrification" in 2007 as the biggest challenge faced by the sector in the recent past as per the Towers Watson-CII survey. One of the key drivers for accurate and fair pricing is the availability of extensive and reliable data. While the non-life insurance industry has come to realise the importance of using past transaction level data as one of the cornerstones for product development, the extent to which non-life insurers have so far succeeded in getting their data in order varies across classes of business and insurers.

There is an immediate need for insurers to invest in suitable skills and technology for data capture, validation, correction, storage, retrieval and usage. This will not only ensure that a competitive advantage is not conceded to competitors with better data management systems, but also lead to the industry in general better assessing the risks and charging appropriate premiums. The recent establishment of the Insurance Information Bureau (IIB) by the regulator should lead to better quality industry wide data for all stakeholders and is a positive step for industry.

The survey shows that quality of services and better claims management are being seen as top drivers of value in future (Figure 5.3). These are expected to be the key areas in terms of business optimisation for non-life insurance companies going forward and can act as a differentiator allowing insurers to command higher premiums than peers. Process improvement has proved to be a game changer here, for example, introduction of a cashless post-accident repair facility at select automobile garages for motor class of business. Unfortunately, such product innovations have been scant in Personal Lines and the industry needs to focus on this to benefit all stakeholders. A number of these innovations are expected to be driven by technology, with a recently-published research report suggesting that the insurance sector is on the brink of a major technology-driven change.

An example of technology led innovation in non-life insurance space is telematics driven usage based car insurance that is gaining ground in many developed markets where insurers working with Towers Watson have introduced a significant product development.

To be continued in the Next Issue.....

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