India – A full stop or a temporary pause?

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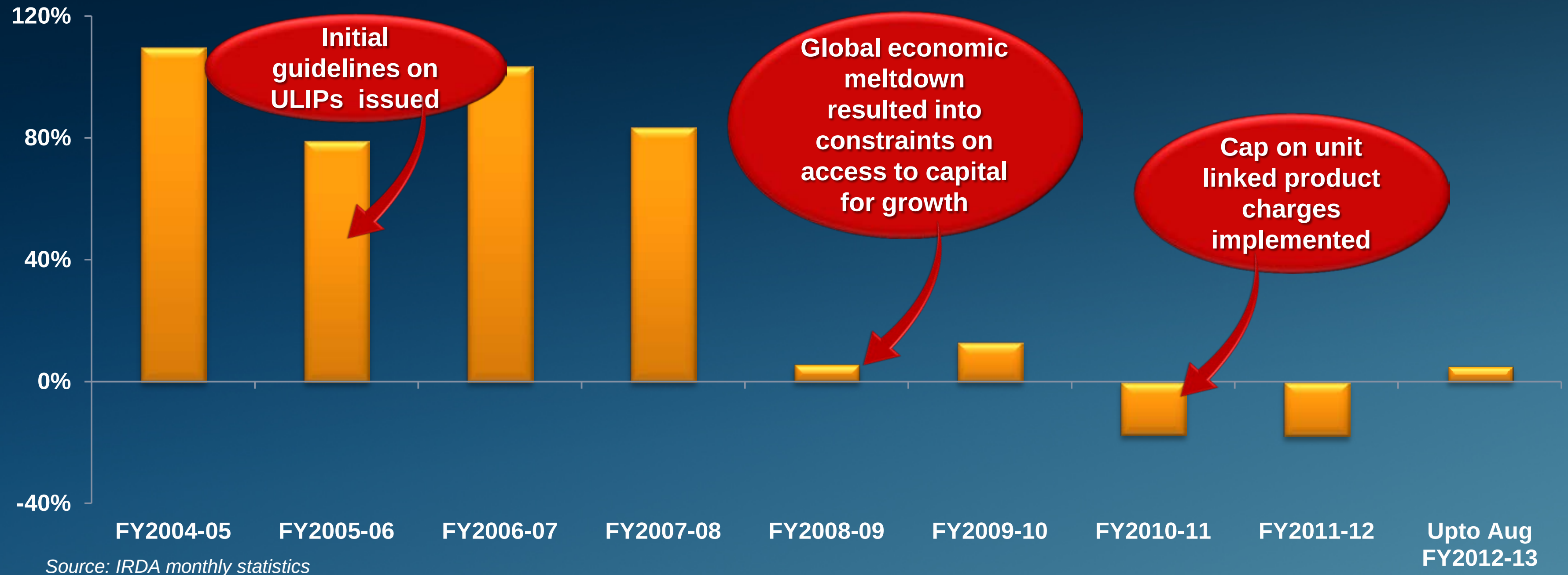
Agenda

- Why talk about India?
- Historical regulatory developments
- Impact of the regulatory changes
- Additional regulatory changes?
- Market sentiments
- Key issues faced
- Is there a solution?
- The macro picture
- Conclusion

Industry performance (1)

Weighted New Business Premium Growth Rates for Private Sector Life Insurers



Source: IRDA monthly statistics

Declining new business for two years

- New business premiums have been declining steadily since the implementation of the charge caps on unit-linked plans (ULIPs) introduced in FY2010-11.

Disappointing growth in the current financial year

- Many insurers are expecting a flat year at best

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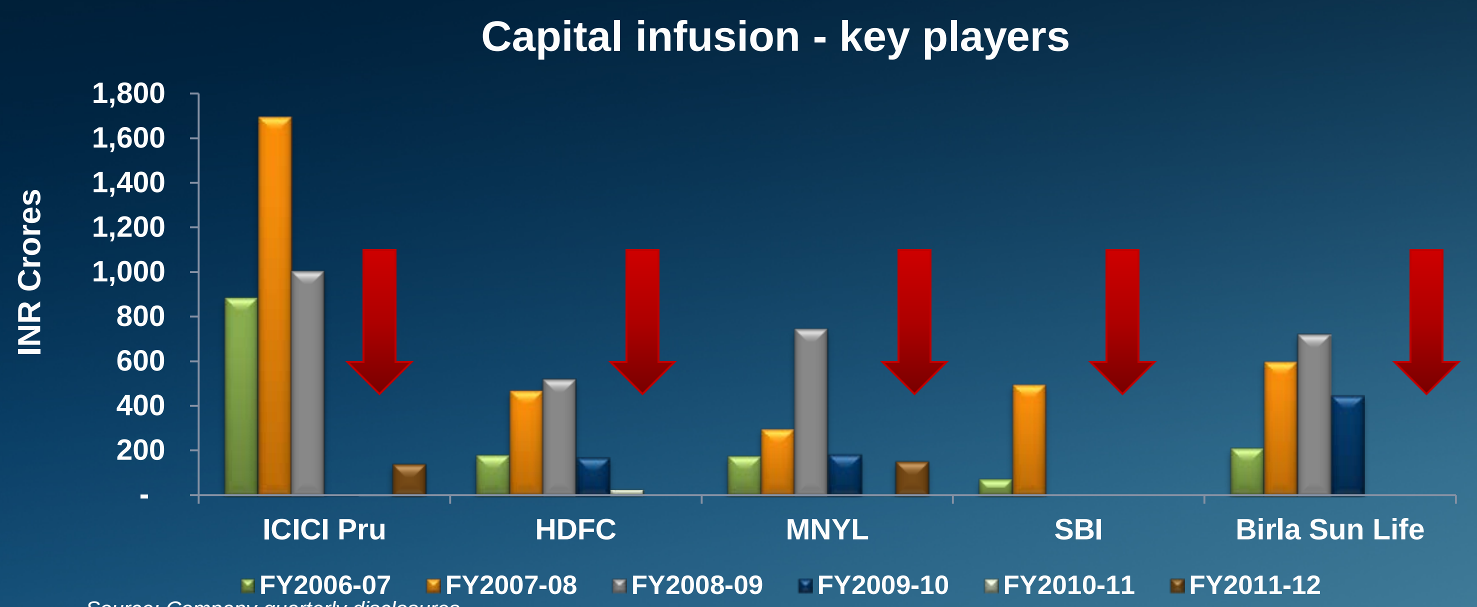
Industry performance (2)



Source: Company quarterly disclosures

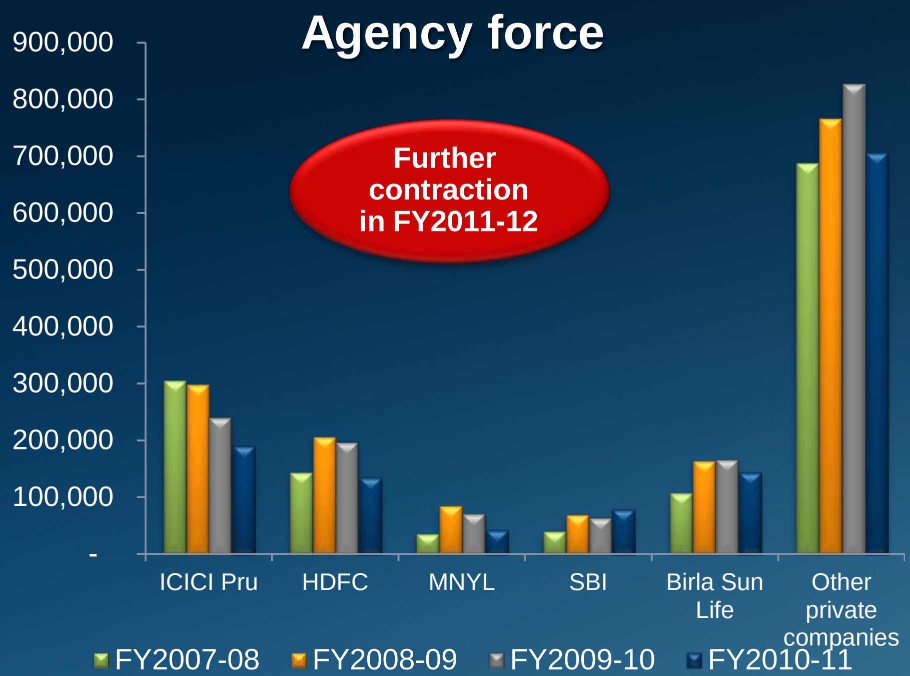
Capital infusion has come down significantly

- Expansion plans put on hold by several insurers
- Constraints with some of the domestic promoters
- Cost cutting measures / move towards more capital efficient products has lowered the need for capital to some extent

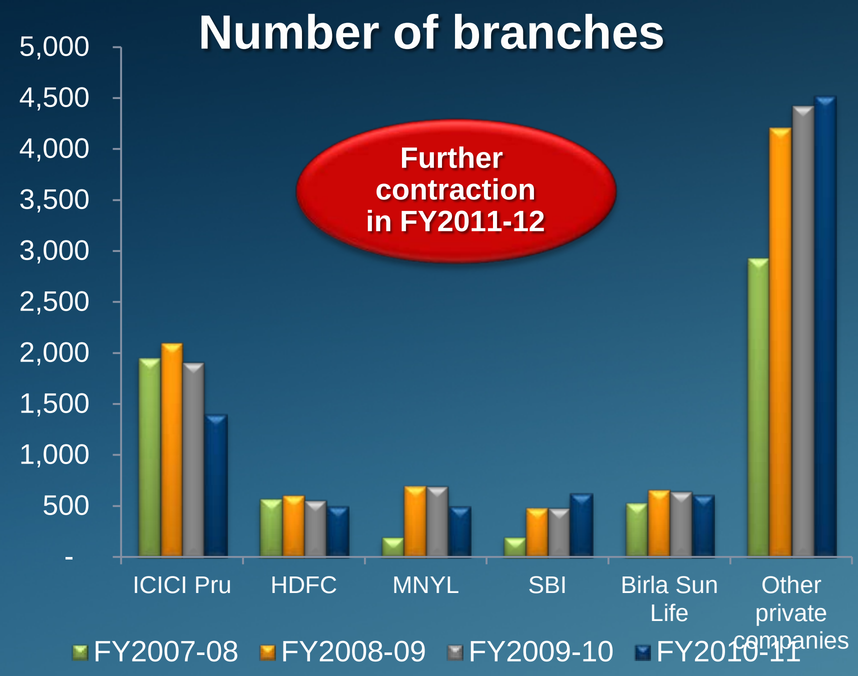
But the need for capital to support future growth continues…

- "The estimated capital requirement in insurance sector is about USD 5-6 billion in the immediate future" the Indian Finance Minister, Mr. P. Chidambaram (as reported in Economic Times of 9 October 2012)

Industry performance (3)



Source: IRDA annual report



Source: IRDA annual report

Significant reduction in agency network in recent years

- **Companies have either lowered or slowed their recruitment of agents in the face of reduced level of new business volumes**

Reduction in branch network

- **Several insurers have reduced the number of branches as a cost reduction measure**
- **Consolidation of branches**

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Several questions

Is the India growth story over?

Should one continue to invest in the Indian life insurance sector?

Would MNCs be ever allowed to increase their stakes to / beyond 49%?

Would the Indian life insurers reach a sustainable profitable stage in the near future?

Would tied agency model work in India?

Would there be light at the end of the tunnel?

Historical regulatory developments

2000-2004 | 2005-08 | 2009-10 | 2011-12

"D" phase

"R" phase

2000-2004 (Startup)

- IRDA setup
- Entry of private sector
- Initial regulations and guidelines

2005-2008 (Growth)

- Unit linked products guidelines introduced in 2006
- Revisions / updates to previous regulations and guidelines

2009-10 (Margins control, market conduct)

- Unit linked guidelines capping charges and surrender penalties
- Restrictions on VIP products
- Guidelines on health-life combo products, anti-money laundering, disclosure requirements

2011-12 (Further regulations)

- Unit linked guidelines on NAV calculation and discontinued polices
- Guidelines on pension products
- Asset liability modeling, outsourcing, agent persistency guidelines
- IPO guidelines

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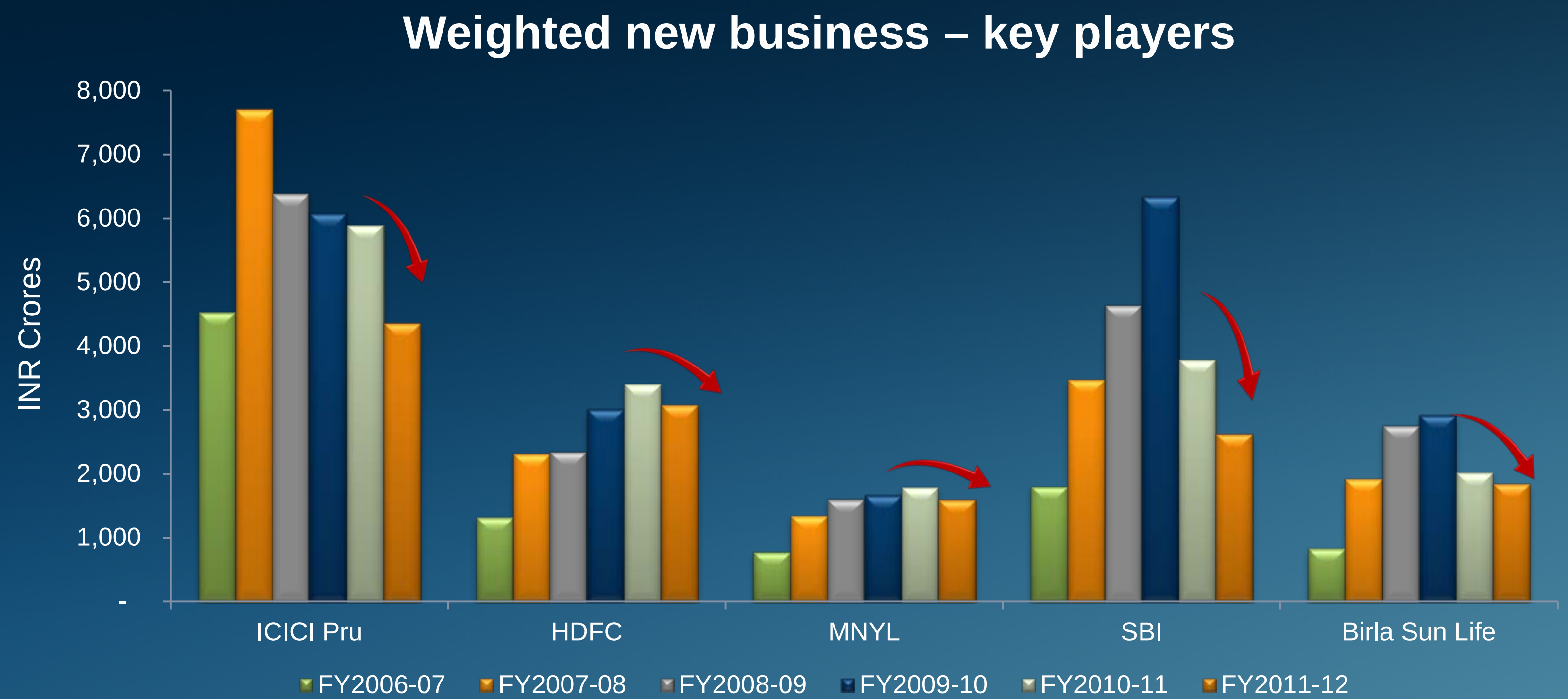
Impact: New business



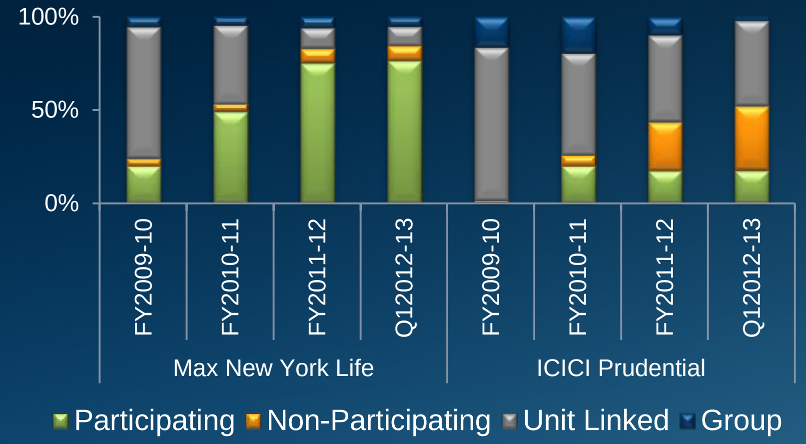
Source: IRDA monthly disclosures

Significant reduction in new business volumes

- **New business volumes for private sector down by around 32% over the past two years**
- **Those with bancassurance distribution have been less affected**

Impact: Products

Change in new business product mix (by weighted premium)



Reduction in proportion of pension products written (by weighted premium)

Source: Company quarterly disclosures

Declining proportion of ULIPs

- High proportion of ULIPs in the past (around 90% for private sector)
- A decline in ULIP sales volumes over the past two years due to reduction in margins available to pay distributors
- Poor stock market performance also to be blamed

Increased level of traditional business

- Re-focus on traditional participating and non-participating products as they continued to offer higher level of distributor compensation

Disappearance of pensions business

- No takers for the high guarantees on pension products required by the regulator
- New guidelines also requires compulsory annuatisation with the same company

Other experiments have met with limited success

- Protection products and annuities
- Some insurers enhancing group products
- Limited volume

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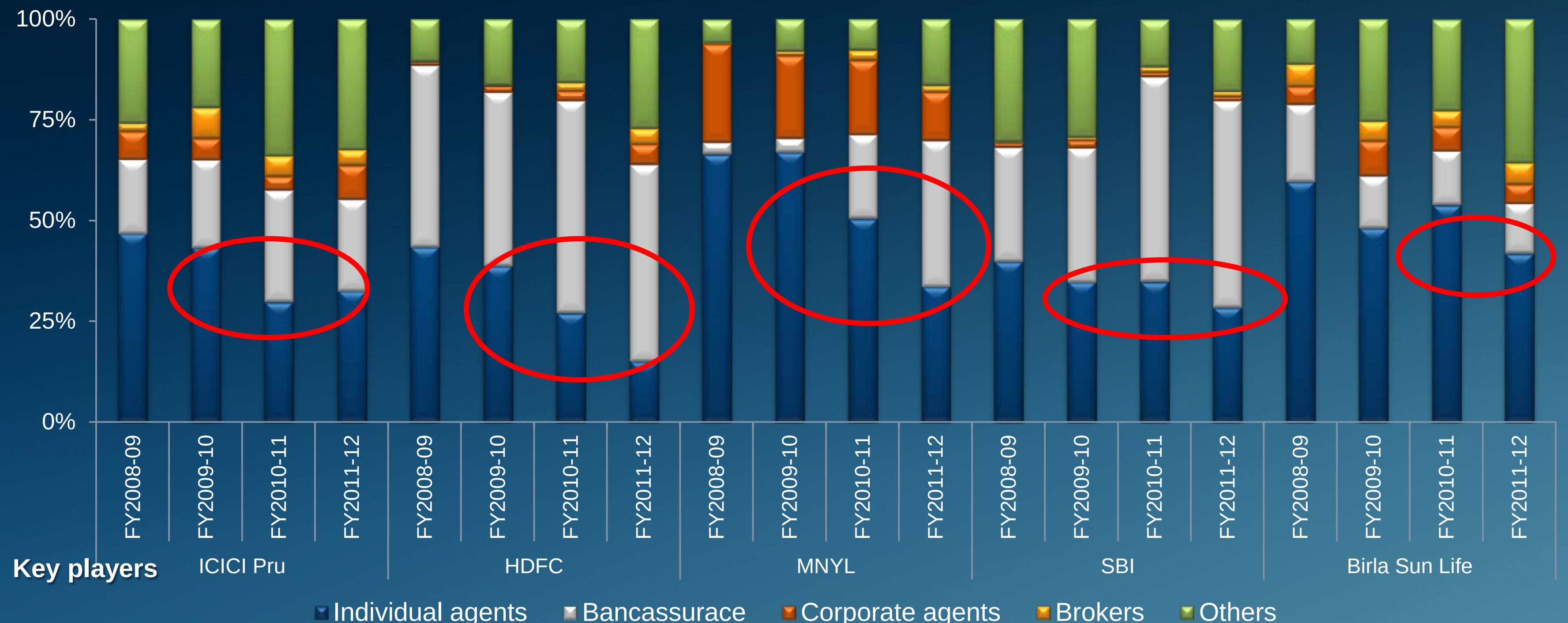
Impact: Distribution channel mix



Source: Company quarterly disclosures

Significant decline in tied agency business

- **Sales through the agency channel has declined significantly**
- **Cost reduction measures taken by insurers**

Bancassurance distribution has helped insurers

- **Sales through the bancassurance channel has increased in proportion**
- **Insurers are either actively looking for bancassurance partners or strengthening existing bancassurance relationships.**

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Additional regulatory changes?

- Open architecture in bancassurance
- Changes in investment regulations
- ‘Use and file’ system for standard products
- Guidelines on design of traditional product
- Easier KYC norms
- Reduction in service tax payable by insurers
- Fiscal incentives - separate income tax exemption for pension policies
- Unified regulator for the financial sector?
- Increase in limit for foreign equity from 26% to 49%

The Government is committed to reforms.

However, there is still uncertainty over the final guidelines and the timelines or effectiveness of these proposed measures.

Uncertainty

- Lack of certainty over regulatory changes
- Instability in external environment
- Internal instability within the industry

Market sentiments: CEO views(WIP) (1)

Market outlook

- Positive about long term prospects, but significant pain over the next 6 to 12 months
- Need macro economic conditions (stock markets and interest rates) to perform for the industry to revive
- Only life insurers, given their network, can help deliver the financial inclusion target of the Government. So the Government will have to change policies for the industry to perform
- One has to be an optimist!

Products

- Need to have ‘templated’ products, but free the distribution area
- No further product regulations
- More streamlined product approvals / process required

Functioning of IRDA

- Significant capacity building required in IRDA’s office
- Need to move towards principle based regulatory approach
- Need predictability of regulatory changes
- Fines are fine, but need consistency and clarity

Market sentiments: CEO views(WIP) (2)

Distribution

- Tied agency model will not sustain unless structural flexibility is permitted
- Open architecture on bancassurance is good / not good
- Need to allow commission flexibility

Valuation of insurers

- Valuations attributed to recent transactions are high. They shouldn't be taken as benchmarks
- One should look at the longer term prospects in order to be able to justify the valuations

Industry

- Mindset change required at all levels, including shareholders
- Inexperienced domestic promoters and aggressive top line targets with less regard for bottom line is the root cause of the issues in the industry
- Increase in FDI to 49% may help, but what's required is a fundamental change in the way insurers do business – should keep consumer focus
- Given the time, private sector players can show at least as good a performance as the LIC

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Shareholder responses

- Stay put / wait and watch
- Restrict capital infusions / restrict new business volumes
- Consider exit / consolidation
- Lobby for regulatory changes

Key issues currently faced

- Unaligned shareholder interests
- Low new business volumes
- Lowered new business margins on ULIPs
- Low productivity of distribution channels
- High cost ratios
- Poor quality business – high lapse rates
- Distrust between IRDA and insurers
- Negative perception about the industry
- Capital constraints for some insurers
- Lack of domain expertise in senior management teams

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Is there a solution?

Yes

Shareholders
- Align interests, educate inexperienced domestic promoters

Management
- Careful KPIs, training and developing domain expertise

FDI limit
- Raise to 49% from the current 26%

IRDA
- Capacity building required, transparent and streamlined processes

Products
- Clarity on guidelines, removal of unnecessary and restrictive features on certain products (e.g. pensions)

Bancassurance
- Open architecture, but cut operational issues

Tied agency
- Flexibility in structuring of agency channel

Distributor compensation
- Full flexibility within the overall limits

Investment norms
- Allow hedging through derivatives, third party funds, outsourcing of investment functions

Consumer awareness
- Intensive consumer awareness campaigns

The macro picture

Intact and promising

Growing economy

- India ranks amongst the fastest growing economies in the world, with GDP growth rates consistently in excess of 6% - 8% p.a.
- Although there has recently been a slow down in GDP growth, the long term growth is expected to be high

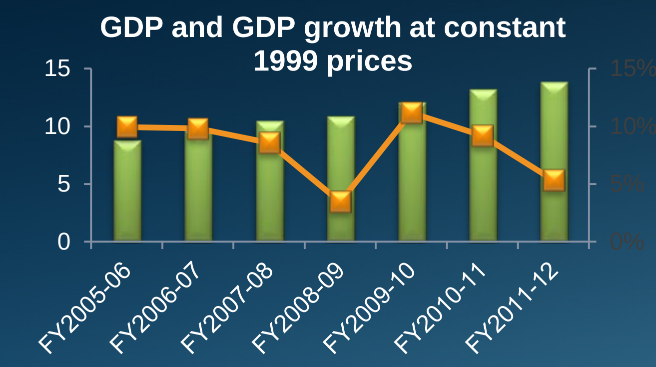
Demographic advantage

- Second largest population in the world (approx. 1.2 billion)
- Rapidly growing middle class with high disposable income
- High propensity to save (in excess of 30%)

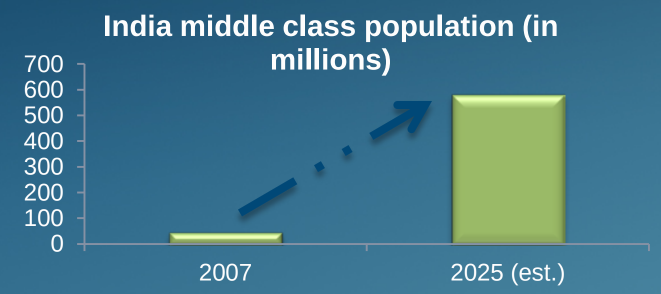
Under penetrated life insurance

- Life insurance penetration has grown from approx. 1.8% of GDP in FY2000-1 to approx. 4.4% in 2010.
- Penetration levels are lower than more developed economies
- No national social security net
- There is significant potential for pension and protection oriented products as these markets are still underpenetrated

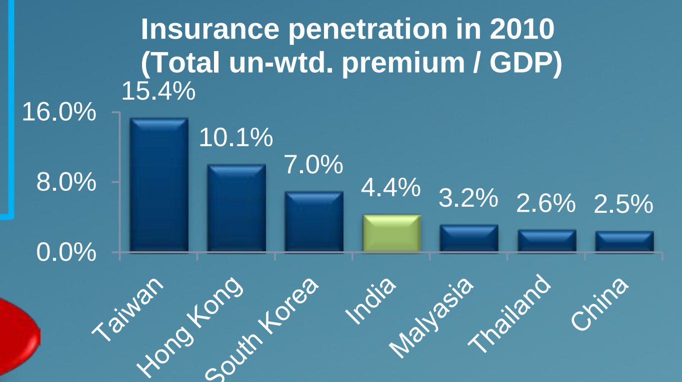
Significant growth opportunity for life insurance in the long term



Source: Reserve bank of India



Source: McKinsey & Company



Source: IRDA Annual Report

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Positive signs in the short term

- "Finance Minister P Chidambaram today announced a revival package for the life insurance sector. The steps include easing investment norms for insurance companies, faster product clearances and tax incentives to improve insurance penetration in the country"

News Report on 12 point action plan to revive industry

Business Standard 2 October 2012

- "Product approval, which was the biggest concern of the industry, will now happen quicker since the 'use and file' system is being brought in. It has addressed our concerns on the product side and will lead to growth in life insurance industry."

Sam Ghosh, CEO, Reliance Capital

Business Standard 2 October 2012

- "… private sector insurance companies which require huge amount of capital and that capital will be facilitated with increase in FDI to 49 per cent"

P Chidambaram, Finance Minister

Times of India 4 October 2012

- "It (the FDI) will give boost to the insurance sector. And it is required any way."

Hari Narayan, Chairman, IRDA

Economic Times 5 October 2012

- "The company is expanding its reach by employing 50,000 advisors and focusing on Tier II and III cities with a wide range of product and services during 2012-13"

News Report on Reliance Life's expansion plans

Economic Times 28 September 2012

- "Avantha Group is close to applying for a life insurance licence in partnership with Germany-based Munich Re group's direct insurance arm Ergo" The Times of India 2 October 2012
- "Mitsui Sumitomo has picked up 26% stake in Max New York Life Insurance Company Ltd" The Economic Times 12 April 2012

News Reports

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Conclusions

It is a only a temporary pause and not a permanent full stop in the Indian insurance industry!

….but like many other things Indian, what is required is patience (and lots of it!)

On a lighter note

Delhi Games village “unfit for athletes” *BBC News (21 Sept 2010)*

Delhi prays for another miracle *The Telegraph (28 Sept 2010)*

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