Participating business governance framework: Need to strengthen significantly

As the growth of new participating products continues to outpace other product lines, there has been a greater need to put a sound governance framework in place.

Accordingly, the Insurance Regulatory and Development Authority (IRDA) has introduced regulations requiring insurers to constitute a With-profits Committee (WPC) and use 'asset shares' to determine surrender value payouts. The Institute of Actuaries of India has also issued professional guidance (Guidance Note 6) covering the broad framework to be adopted by actuaries in the management of participating business. It has been more than a year since the insurers have adopted these new regulations.

Against this backdrop, Milliman has carried out a survey of the Appointed Actuaries of life insurance companies in India to ascertain the experience of the industry in this area and the practices adopted in respect of the governance framework around participating business. Out of the existing 24 life insurance companies in India, we received responses from 10 companies.

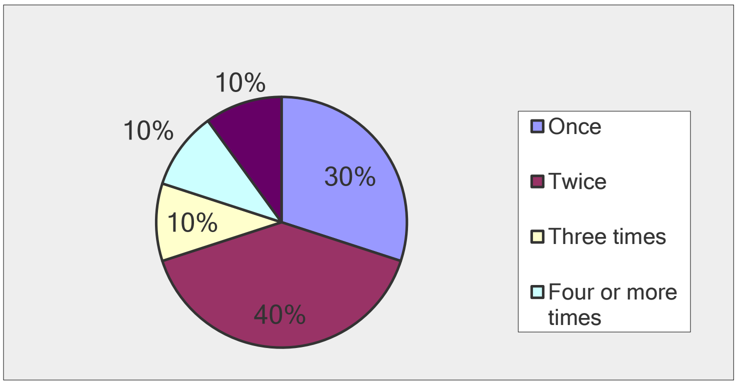
Our survey revealed that although some progress has been made, there is still scope to significantly strengthen the existing governance framework. This is important to ensure an orderly growth of participating business in India.

We are pleased to present the results of our survey.

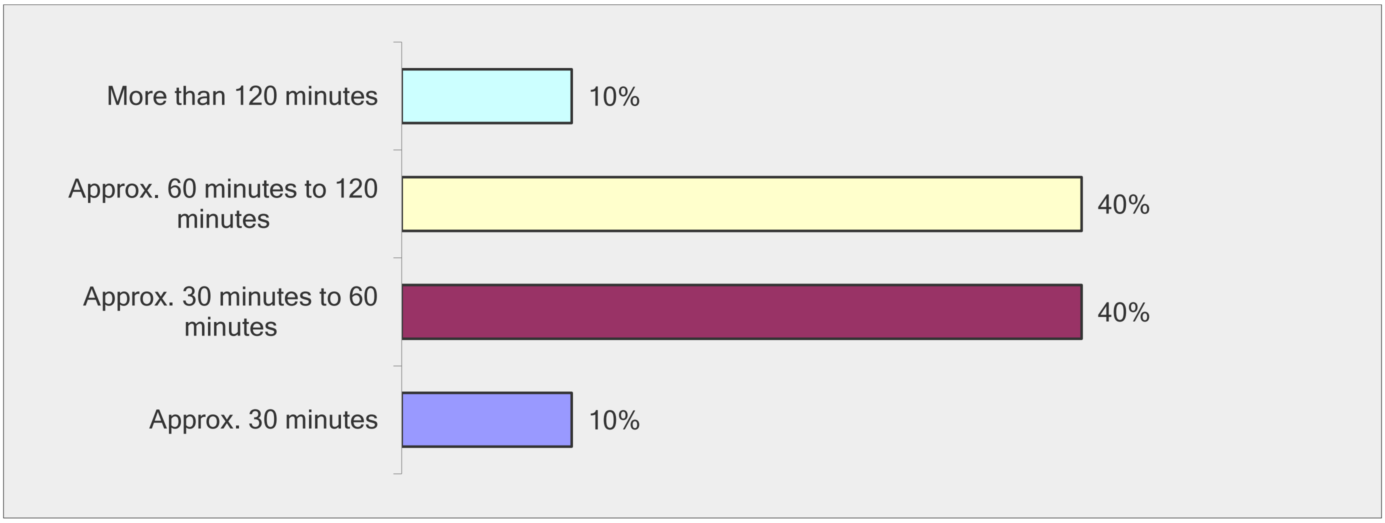
Results

Composition of the With-profits Committee (WPC)

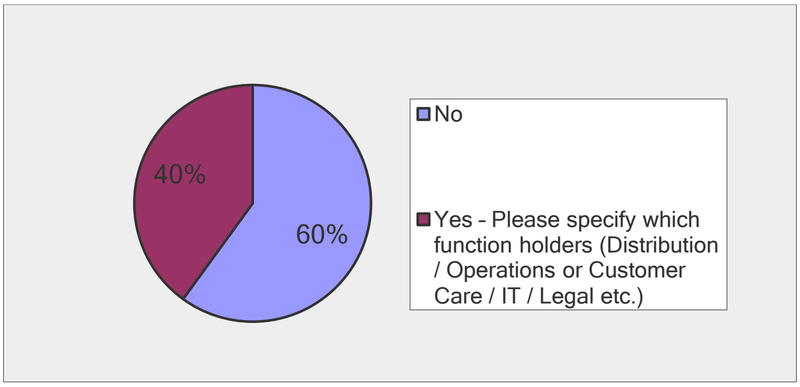
Q1. Please indicate the frequency of meetings of your With-profits Committee (WPC) in each financial year. [Select only 1]



Q2. Please indicate the average length of each meeting of the WPC. [Select only 1]



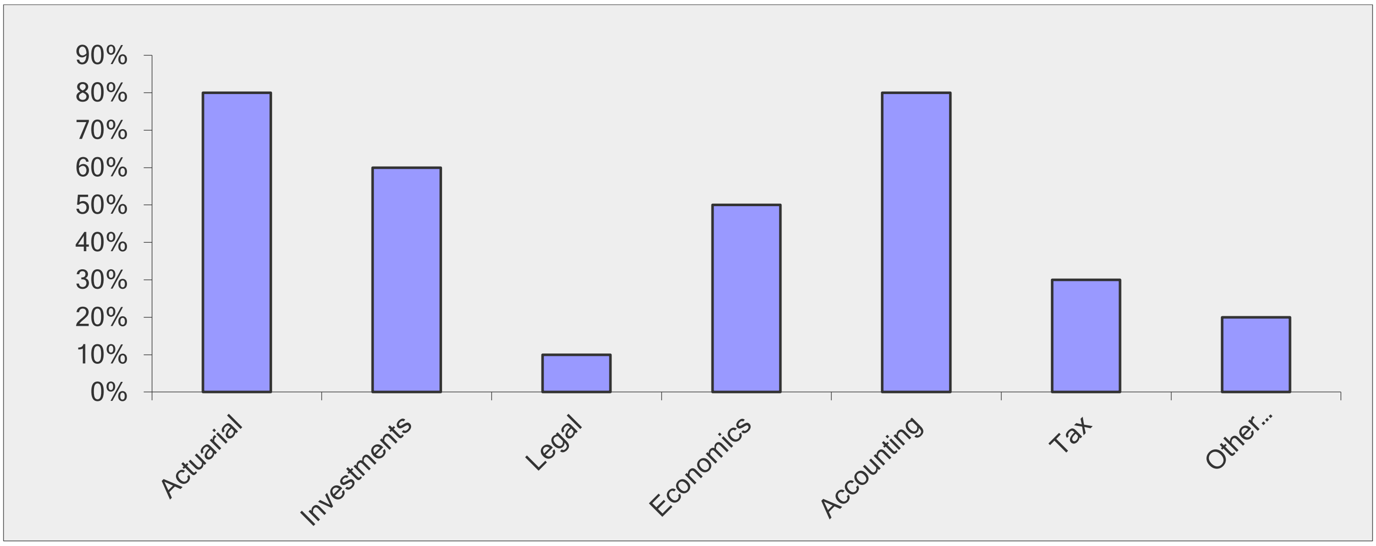
Q3. Has your WPC invited nonmembers to attend any of the meetings to discuss related matters or provide additional information? [Select only 1]



Responses under 'Yes' are set out below:

- *"CRO"*
- *"Management"*
- *"Finance, Legal"*
- *"CFO"*

Q4. Which of the following skill sets/expertise already exist amongst the members of your WPC? [Select multiple]

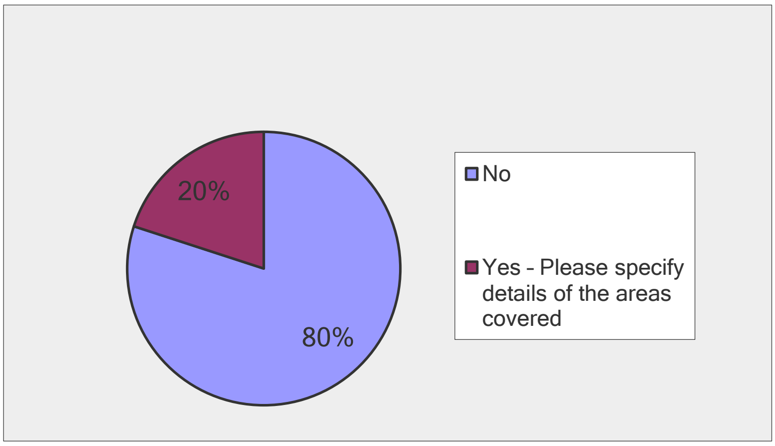


Note: It seems odd that only 80% of the respondents indicated that the WPC consist of 'actuarial' expertise, whereas the regulations require the Appointed Actuary to be part of the WPC. We suspect this is an oversight on the part of the respondents.

Responses under 'Others' are set out below:

- *"General Management"*
- *"Banking"*

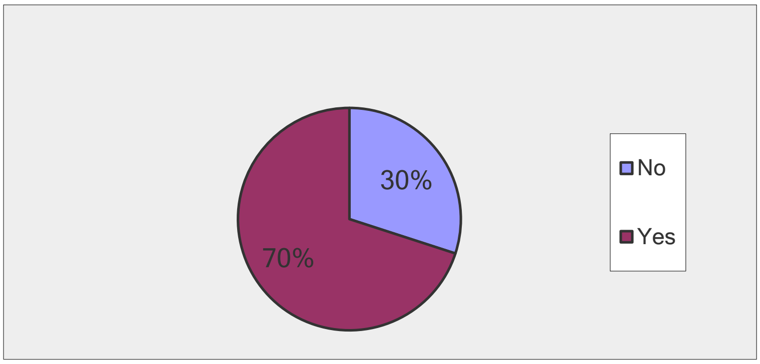
Q5. Have the non-actuarial members of your WPC undergone any formal/informal training to prepare them for their role on the committee? [Select only 1]



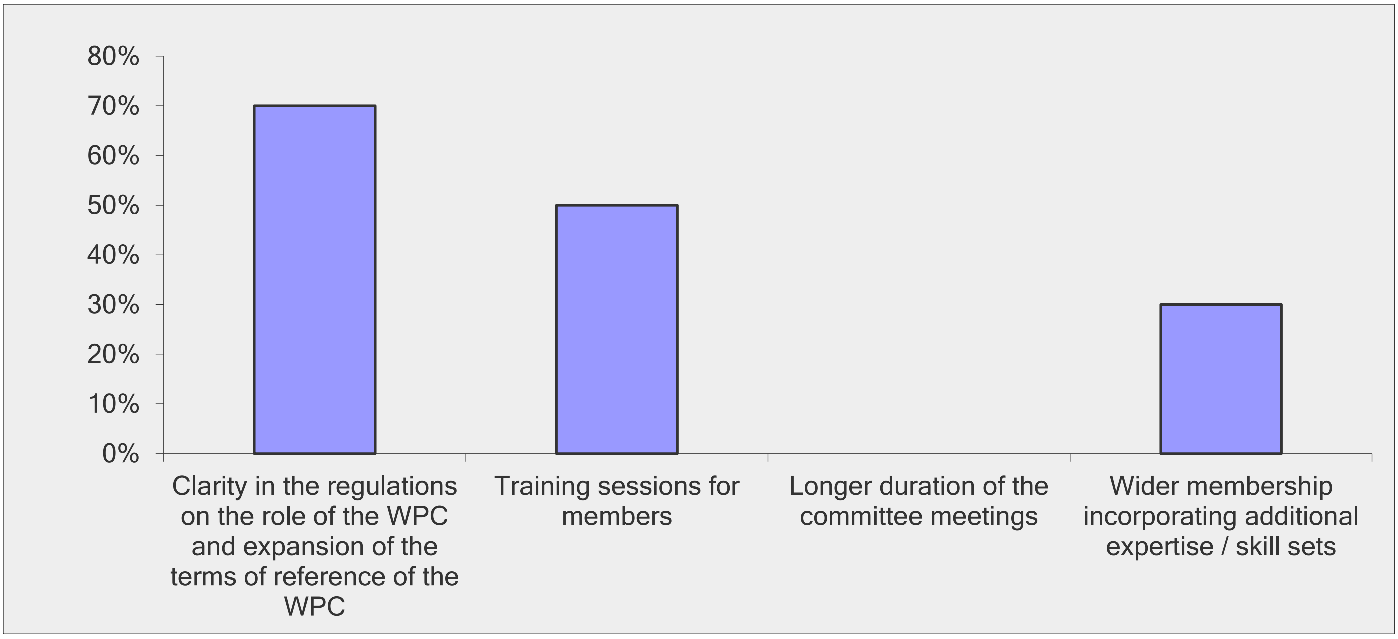
Responses under 'Yes' are set out below:

- *"Products and principles of par business"*
- *"Overview of the company's par business and related guidance notes and regulations"*

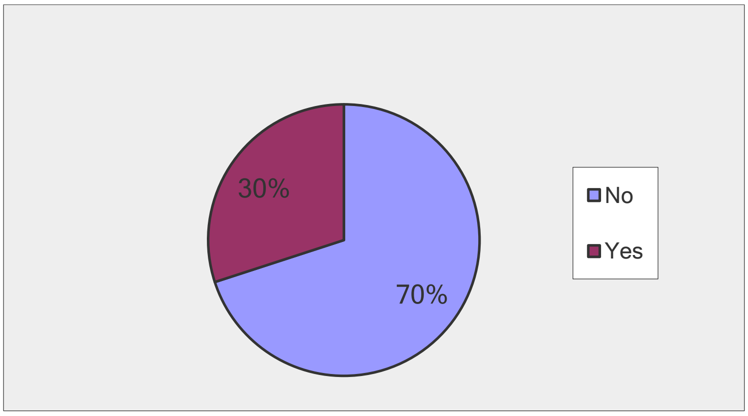
Q6. Do you believe that the WPC has sufficient resources (time, expertise/skill sets, access to company data, etc.) to perform its role effectively? [Select only 1]



Q7. Which of the following would help improve the effectiveness of the WPC? [Select multiple]



Q8. Do you foresee any potential conflict for the Appointed Actuary to be a signatory to the WPC report? [Select only 1]



Milliman comments

- Based on the responses, it is evident that the duration of WPC meetings varies widely across companies. The shortest time given in the survey was one hour per year, and the longest was more than four hours per year. Although this is not surprising given that it has only been one complete year since the constitution of the WPC, it does indicate that the level of detail in which participating business is discussed is unlikely to be uniform across WPCs.

- 70% of the respondents suggest that more clarity in the regulations in terms of the WPC scope may help in enhancing its effectiveness. This may also explain why WPC meetings vary so much in duration.

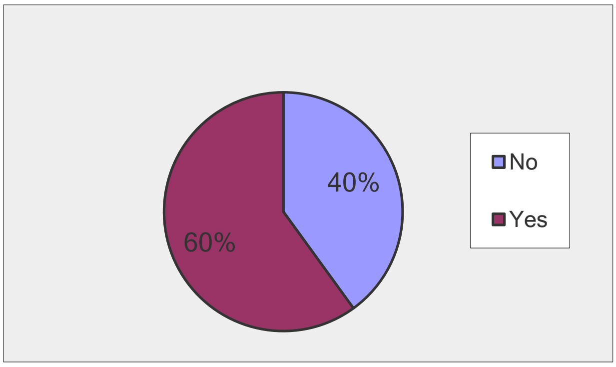
- Although 80% of the respondents state that the non-actuarial members of the WPC have not gone through any formal/informal training to prepare them for their role on the committee, more than 60% of those who have not conducted training believe it would enhance the effectiveness of the WPC.

- Overall, more than 70% of the respondents believe that the WPC has sufficient resources (time/skill sets/access to information, etc.) to perform its roles effectively. However, in our opinion, as practices evolve, there may be a need to either restructure the WPC (e.g., by adding members with specific skill sets) or to carry out training (especially to independent directors) on specific areas of the managment of participating business.

- It is interesting to note that only 30% of respondents believe that there may be a potential conflict in the Appointed Actuary signing the report of the WPC (which currently is expected to approve the asset shares calculated by the Appointed Actuary), as it may be seen as the Appointed Actuary approving his or her own work. Perhaps this can be addressed through changes in the regulations whereby the WPC is structured as a truly independent body consisting of people with relevant expertise and the Appointed Actuary (and indeed other members of the senior management team of the life insurance company) provides the necessary information to the WPC.

Documentation

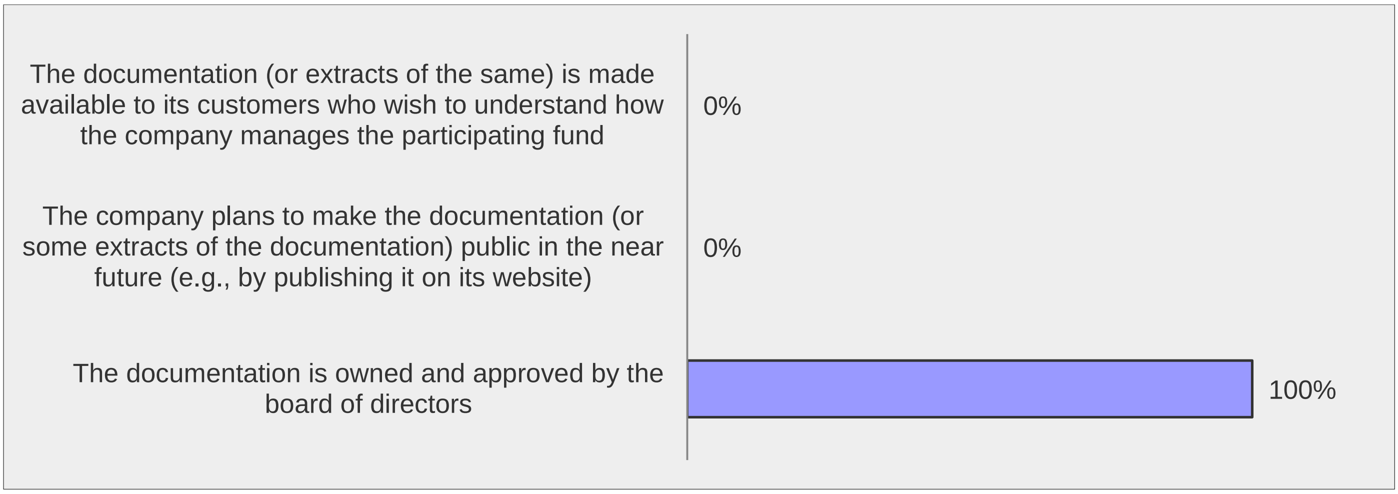
Q9. Has your company developed detailed documentation specifying how participating business will be managed? [Select only 1]



Q10. Does the documentation on management of participating business cover the following items? [Select multiple]

Answer Options	Response Percent
How expenses of the company are allocated to different funds	80%
Investment policy of the participating fund	80%
Company's accepted definition and interpretation of 'Policyholders' Reasonable Expectations' (PRE)	100%
How asset shares are developed: The level of expenses that are allocated, how investment income is credited, and the treatment of lapse profits	100%
How asset shares are developed: Consideration for cost of capital charge, consideration for cost of guarantee charge and consideration for a charge for shareholder transfers and tax	100%
How asset shares are used for the purpose of calculation of bonus rates, the determination of policyholder payouts (maturity and surrender), and reserving	100%

Q11. With regard to the documentation of management of participating business, please specify which of the following statements reflect the company's practice [Please select multiple]

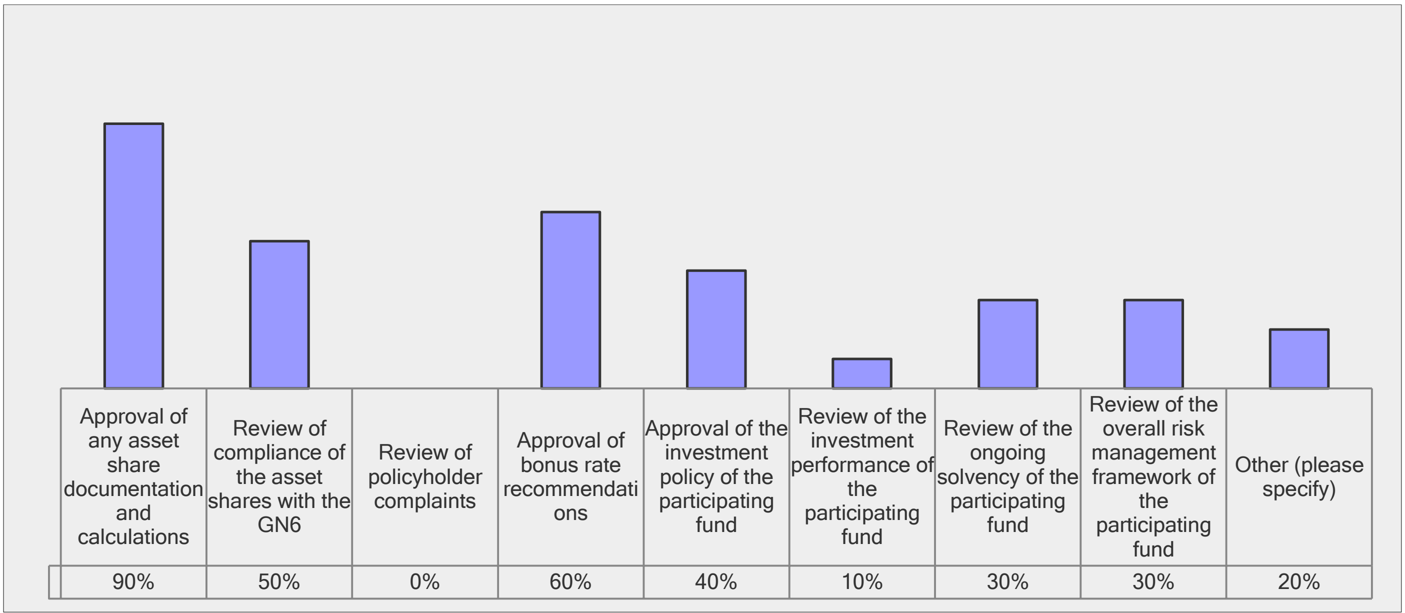


Milliman comments

- Those keeping detailed documentation on the management of with-profits business generally responded that this documentation has many best-practice features. Surprisingly, however, 40% suggest no documentation exists.
- This is an important area to address on a priority basis. In our opinion, the governance framework for participating business cannot be effective without insurers having documentation detailing how they would manage different aspects of the business.

<u>Working of the WPC</u>

Q12. What is covered in the terms of reference (ToR) of the WPC out of the following items? [Please select multiple]



Responses under 'Others' are set out below:

- *"Reinsurance arrangement for par business"*
- *"Review of reinsurance arrangements, any questions from regulators related to WP"*

Q13. Please specify the proportion of time spent (high/medium/low) discussing the following items at WPC meetings. Leave blank if any item is not discussed at WPC meetings.

Answer Options	High	Medium	Low	Response Count
Expenses – Allocation to the participating fund	2	5	2	9
Expenses – Allocation to asset shares	5	2	2	9
Investments – Policy, performance and allocation to asset shares	1	3	4	8
Reinsurance – Policy and impact on the participating fund	0	2	6	8
Risk management and solvency of the participating fund	0	2	5	7
Policyholder protection and PRE	5	2	2	9
Usage of asset shares (policyholder benefit payout, determination of bonus rates, reserving)	3	4	2	9
answered				**9**
skipped				**1**

Milliman comments

- Responses to these questions indicate that the lack of clarity (and a narrow definition in the regulations around the ToR of the WPC) has resulted in companies adopting differing practices when specifying the ToRs.
- Only half of the respondents suggest that the WPC actually reviews the compliance by the Appointed Actuary to the requirements of GN6, whilst only 30% of the respondents suggest that the WPC looks at the overall risk management aspects of the participating business.
- The proportion of time spent by the WPC in reviewing the 'usage' of asset shares is stated to be 'high' by four and 'low' by two out of the nine who responded to this question. This again seems to suggest that the regulations, which currently require the WPC to approve the asset shares but do not go any further (e.g., in specifying how to use the asset shares so approved by the WPC in practice), may need to be revisited.
- In our opinion, it is important to have an enhanced role of the WPC in order to strengthen the governance framework, and the IRDA should clarify its regulations in that respect. However, we also believe that without waiting for the IRDA to amend its regulations, insurers may voluntarily adopt enhanced ToRs for their WPCs so as to ensure that there are effective checks and balances for the management of participating business.

Conclusions

The establishment of the WPC is a good step, but there is a need for greater clarity in the regulations: The absence of such clarity has resulted in the insurers adopting differing practices in terms of the structuring and scope of the WPC. Given the differing regulatory interpretations, benchmarking against peers may help to ensure that companies are not deviating significantly from general industry practice as it emerges.

Lack of detailed documentation is a significant area for enhancement: Insurers should take steps to enhance the level of documentation related to the management of participating business. The governance framework for participating business cannot be effective without insurers having such detailed documentation in place.

If not through regulations, insurers should aim to enhance the ToR of the WPC voluntarily: It is important for insurers not to look at the WPC as merely a 'tick box' exercise, carrying out duties that only satisfy specific regulations. Even if the regulations are not changed, insurers should look to voluntarily enhance the scope of the WPC in order to put in place checks and balances in the management of participating business and to strengthen the overall governance framework. This might include reviews and approvals of compliance against GN6, investment policy and performance of the fund, monitoring of the overall risk management framework, monitoring of the solvency position of the participating fund, etc. It may also include how the approved asset shares are getting utilised in bonus decisions, monitoring policyholder complaints, ensuring that policyholders' reasonable expectations (PRE) formed through the illustrations at the point of sale and subsequent communications are managed effectively, etc.

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Contact Details:

If you have any questions about this e-Alert, please contact any of the following consultants:

Sanket Kawatkar
Principal and Consulting Actuary
B712, 215 ATRIUM Chakala
Andheri-Kurla Road, Andheri (E)
Mumbai 400 059, India
Office: +91 22 6784 8410
Fax: +91 22 6784 8401
Mobile: +91 98201 81681
Email: sanket.kawatkar@milliman.com

Richard Holloway
Managing Director South East Asia & India Life
133 Cecil Street, #12-02 Keck Seng Tower
Singapore 069535
Office: +65 6327 2301
Fax: +65 6221 0642
Mobile: +65 9732 0150
Email: richard.holloway@milliman.com

Philip Jackson
Consulting Actuary
B712, 215 ATRIUM Chakala
Andheri-Kurla Road, Andheri (E)
Mumbai 400 059, India
Office: +91 22 6784 8413
Fax: +91 22 6784 8401
Mobile: +91 9619294144
Email: philip.jackson@milliman.com

Shamit Gupta
Consulting Actuary
Global Business Square
401, Fourth Floor, Plot No 32
Institutional Area, Sector-44
Gurgaon 122 002, India
Office: +91 124 464 1507
Fax: +91 124 408 8588
Mobile: +91 98330 31513
Email: shamit.gupta@milliman.com

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