

## No Cover For The Aged

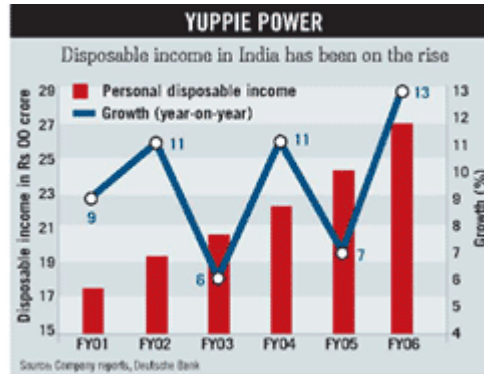
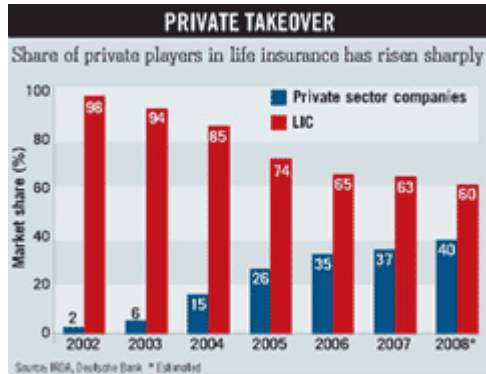
Avalamma is 58 years old; she lives alone on the outskirts of Bangalore with her 62-year-old husband. Their only source of income is a two-acre rice farm and a traditional LIC (Life Insurance Corporation) policy, which matured last year. “I paid Rs 6,000 for 15 years and received Rs 75,000 at the end of that period,” says Avalamma. “This policy was a savings instrument that I thought would take care of my husband and me when we got older. But this money is not enough at a time when food and medical expenses are going up.”

Talk to insurance companies and they will tell you that the market for term insurance products as savings vehicles is underserved. At the same time, the market for unit-linked insurance products (Ulips) is booming, thanks to the higher returns on premiums paid that the stockmarket promises. For Avalamma, the stockmarket has risks she doesn't understand — we haven't been tested by a prolonged bear phase yet — and neither does she have the option of investing in an annuities product because she knows that they would not meet her everyday expenses.

For Avalamma and others like her, social protection is absent when it is most needed — in their sunset years. “India has a weak pension system and it lacks a social security system,” says Rahul Chhapparwal, an analyst at Crisil. “Insurance is their only form of social security. But its penetration is low, and accounts for just 4 per cent of GDP.” And the problem can only be addressed by attending to the systemic issues the market faces.

Both annuities — an annuity is a deferred investment contract that will make regular payments (say, on a monthly, quarterly or annual basis) to a person for a period over one or more specified individuals' lifetimes, or over a combination of life and a period — and term life products — those that offer protection on death— offered by insurance companies depend on two sets of tables: annuity tables and mortality tables. For instance, annuity tables are used for estimating the pension you could get from your retirement till your death based on what you pay into your pension fund while you are working. Mortality tables show, at each age, the probability of your dying before your next birthday.

From these tables, several sets of statistics can be derived, from what age you are likely to survive until, the remaining life expectancy of people at different ages to estimates of longevity of people in your demographic segment. Both annuity and mortality tables are essential for creating and marketing savings products by life insurance companies. The tables are a product of a discipline that applies mathematical and statistical methods to assess risk in the life insurance industry, and the experts who apply them are actuaries.



(Graphics: Puja Rai)

## The System Creaks

Currently, life insurance companies are dependent on the two tables provided by the Life Insurance Corporation (LIC): the mortality tables of 1994-96 and the annuity tables of 1996-98, to assess the market. “These tables are old and they do not present the right picture of the current longevity of life,” says G.L.N. Sarma, chief actuary at Bharati Axa Life in Mumbai. That makes it difficult for private insurance companies to create pure protection products, when they have to base them on 10-year-old assumptions implicit in the tables.

This also underscores the challenges faced by life insurance companies. First, the tables they have to use are outdated, and demographics and life expectancy have changed, changing the risk profile. Second, the old tables — which have lower estimates of life expectancy — will require companies to retain higher solvency margins (a capital charge for life insurance companies that can affect profitability). Third, this limits the range of products that insurance companies can offer: pure life insurance that are risk-based, or annuities that are savings-based, or combinations of the two.

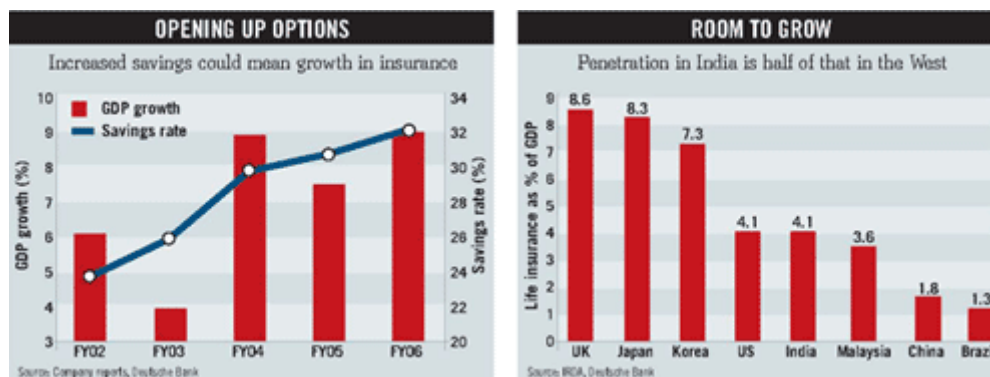
## Staying Solvent

Experts in the life insurance industry say that LIC will release its 2004-06 mortality tables soon, which will give private players a chance to create better term products. But LIC believes that any new data — on changing demographics and life expectancy — should henceforth be provided by the Life Insurance Council, which is a body entrusted by the Insurance Regulation and Development Authority (IRDA), India’s insurance sector regulator, to mine data for Indian life insurers. The problem is it could take another two years for this data to be available.

The solvency of an insurance company or its financial strength, depends chiefly on whether sufficient reserves have been set up for the obligations entered into and whether the company has adequate capital as security. To meet its payment

obligations, an insurance company needs to set aside a certain portion of premiums paid into creating a solvency reserve.

In other words, the solvency margin or reserve is the amount by which the assets of an insurance company should exceed its liabilities. This solvency margin for term life insurance products is 4 per cent, a rather high number. “This poses a large risk for an insurance company,” says I. Sambasiva Rao, actuary at SBI Life in Mumbai. “A high solvency margin for private insurance companies makes it difficult for them to be able to make money.”



(Graphics: Puja Rai)

By comparison, the solvency margin for Ulips, at 1.5 per cent, is less than half that for term products. Premiums for term insurance products are relatively low, and high solvency margins reduce the potential profitability for insurance companies. Analysts at Crisil say that only two — SBI Life and Bajaj Allianz — make profits in the life insurance business out of the 17 private players in the industry. This makes Ulips the preferred product for life insurance companies, and accounts for 90 per cent of new business income for them.

### A Single Product Industry?

Ulips are favoured for two simple reasons: lower solvency margins and the growth story of the stockmarket. But how long is the stockmarket’s rise likely to continue? Already, we have seen a significant cooling off. “It is true that the markets are going through a bear phase and the public would not like their renewal premium units to start at lower rates,” says Sanket Kawatkar, head of life insurance consulting with Waston Wyatt Consulting in Mumbai. “But markets will always bounce back and people should stay longer.”

But Kawatkar acknowledges that insurance here is not protection oriented, but rather oriented towards savings and investment. He adds that the life insurance industry needs a balanced portfolio in products, but this would only be possible by renewing the old tables available to actuaries. Other analysts, however, say that assumptions such as investment returns, expenses, surrenders, future

inflation, commission to agents and bonuses are the main concern for actuaries, not just mortality tables.

“While selling Ulips, insurance companies have not segregated the market based on a life cycle,” says Samir Bali, partner of business advisory services at Ernst & Young. This, he feels, is the reason why the older population has not been sold protection products.

Some actuaries point out that for protection policies to take off, a deeper and more active domestic bond market is a necessity. And that is nowhere close to happening soon, despite several policy measures and incentives provided by regulators and government to develop bond markets. A look at the numbers is instructive.

In December 2007, the market capitalisation of the bond market was Rs 13,86,493 crore; compare that to the market capitalisation of the Bombay Stock Exchange Sensitive Index (BSE Sensex), at Rs 28,00,000 crore at that time. “The depth and liquidity of the stockmarket allows actuaries to manage the liabilities better in case of Ulips and traditional policies,” says Bryce Johns, development actuary at Kotak Mahindra Life in Mumbai. “It also ensures better returns for those who are dependent on annuities.”

All actuaries say that a balance of protection and investment products is an imperative if life insurance is to be a significant part of the financial services industry. The average life expectancy of an Indian had gone up to 63 years from 58 years stated in the 1995 estimates of the Population Reference Board. Subsequent estimates could be even higher. “Therefore, while companies strive for profitability and depend on the stockmarket to achieve it, it is also necessary to cater to the population that is getting older by offering a mix of investment and protection oriented products,” says Crisil’s Chhapparwal.

### **An Update Is Sorely Needed**

But the most important starting point is having an updated set of mortality and annuity tables. Avijit Chatterjee, chief actuary of ICICI Prudential, believes that India needs to step up using data to benefit the insurance industry. “In Britain, the Continuous Mortality Investigation Bureau issued what it calls improvement projection tables in 2002,” he points out. “This it did because mortality rates were changing fast with scientific improvements in the UK.”

So, data was culled out to create new experiences for insurers. Statistical models are used continuously to predict future improvements in mortality in the UK. Chatterjee says that such expertise will be urgently needed as the Indian insurance market matures. The UK will soon be looking at its 2006 experience, while in India the industry stumbles along with 14-year-old data. Currently, LIC is the only player selling term products to the public.

But even the state-owned and oldest insurance company has moved towards launching Ulip products as they bring in more money. "The traditional products are not in favour because bond yields are low and when you bring in rising inflation, returns are very low," says G.N. Agarwal, chief actuary at LIC in Mumbai. "This is why Ulips are popular." But, he says, LIC's traditional products offered better returns even today.

Avalamma and her family are likely to disagree with that assessment. And she will not be alone. According to a study by Deutsche Bank, the Indian population is rapidly ageing. Census Bureau estimates suggest that the percentage of people aged over 55 will increase from 11 per cent to 26 per cent between 2005 and 2050, translating to approximately 423 million people. Given an already weak pension system in the country, the demand for pension products may possibly expand exponentially. And relying on Ulips for social protection may just not cut it.

**By Vishal Krishna**

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