Life Insurance: A Business of Risk Management

Motilal Oswal CEO track | Aug 24, 2020

Vibha Padalkar, MD & CEO, HDFC Life

SELECTED Superbrand INDIA Consumer Validated 2019

HDFC Life

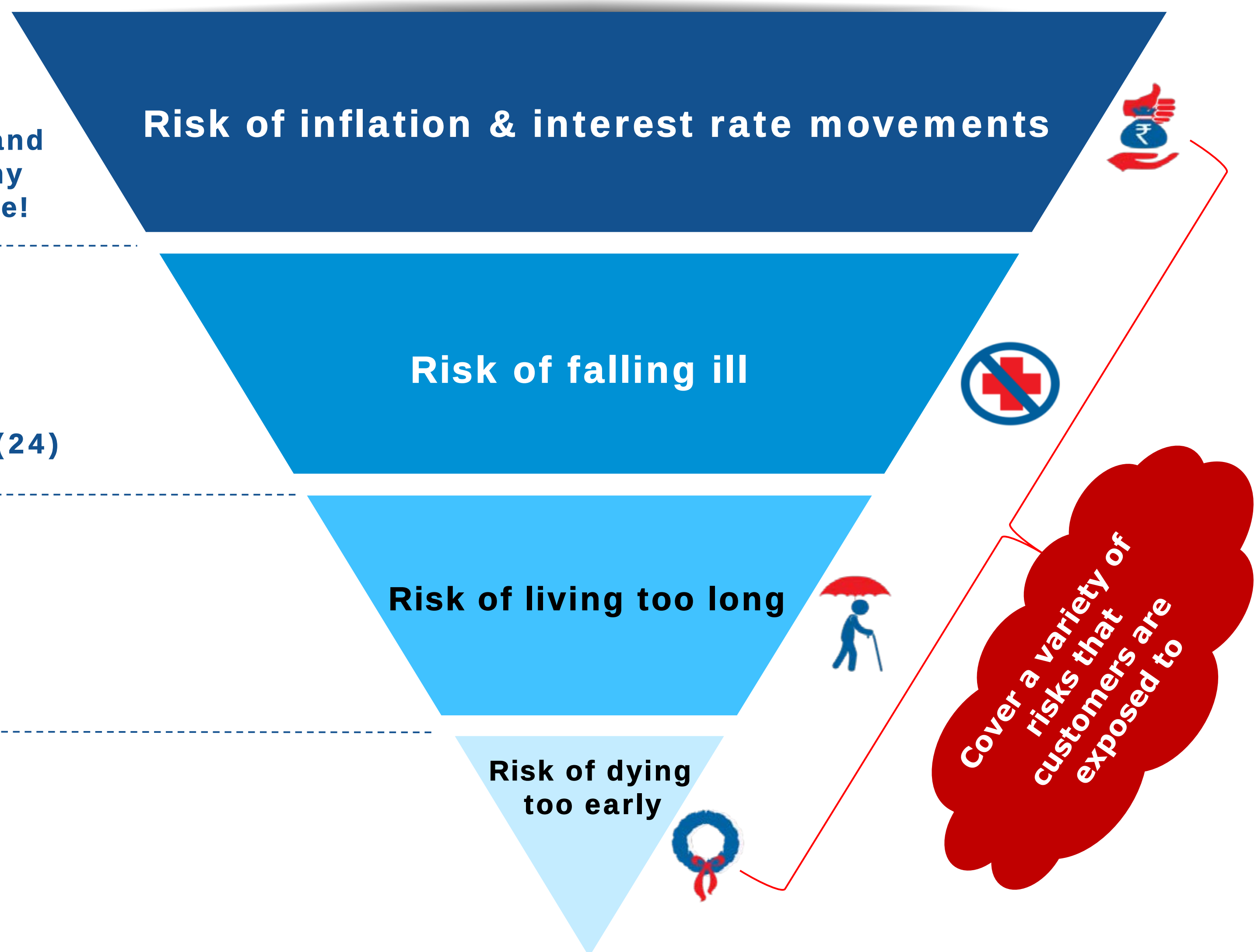
What are life insurance companies supposed to do for their customers?

Competition reduces as we approach the core

Banks (>2100) | AMCs (>45) | Life Insurers (24) | Gold | …..and many more!

Health / General Insurers (34) | Life Insurers (24)

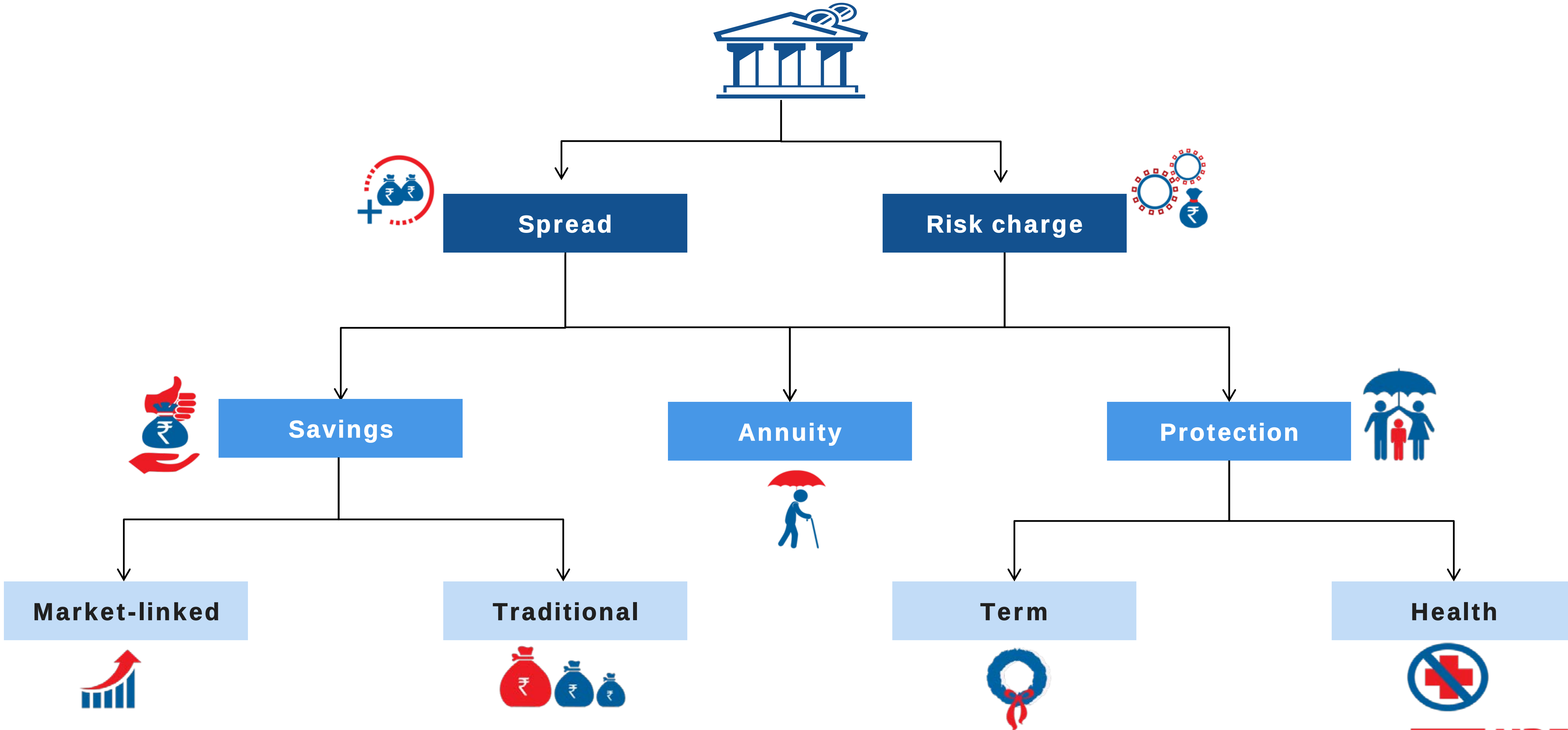
Life Insurers (24)



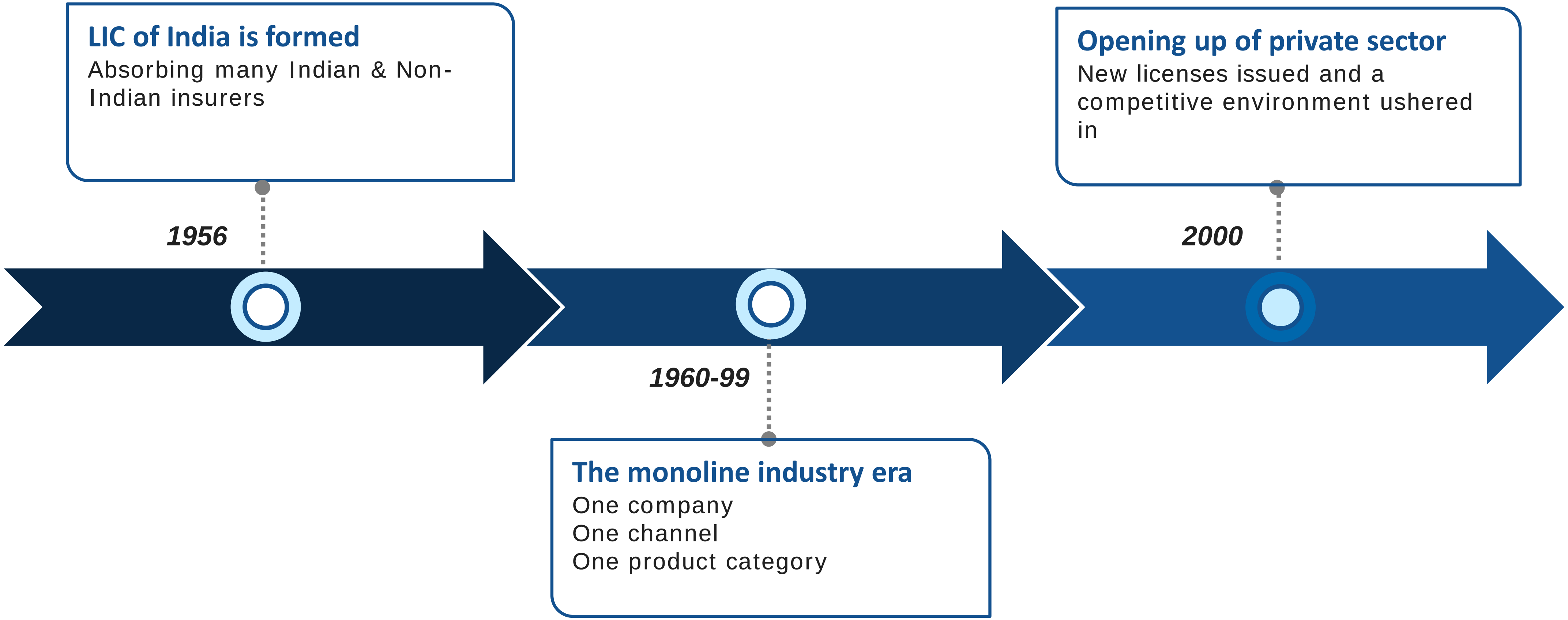
Sources: www.rbi.org.in; www.sebi.gov.in; www.irdai.gov.in

HDFC Life

And how are they expected to generate value?

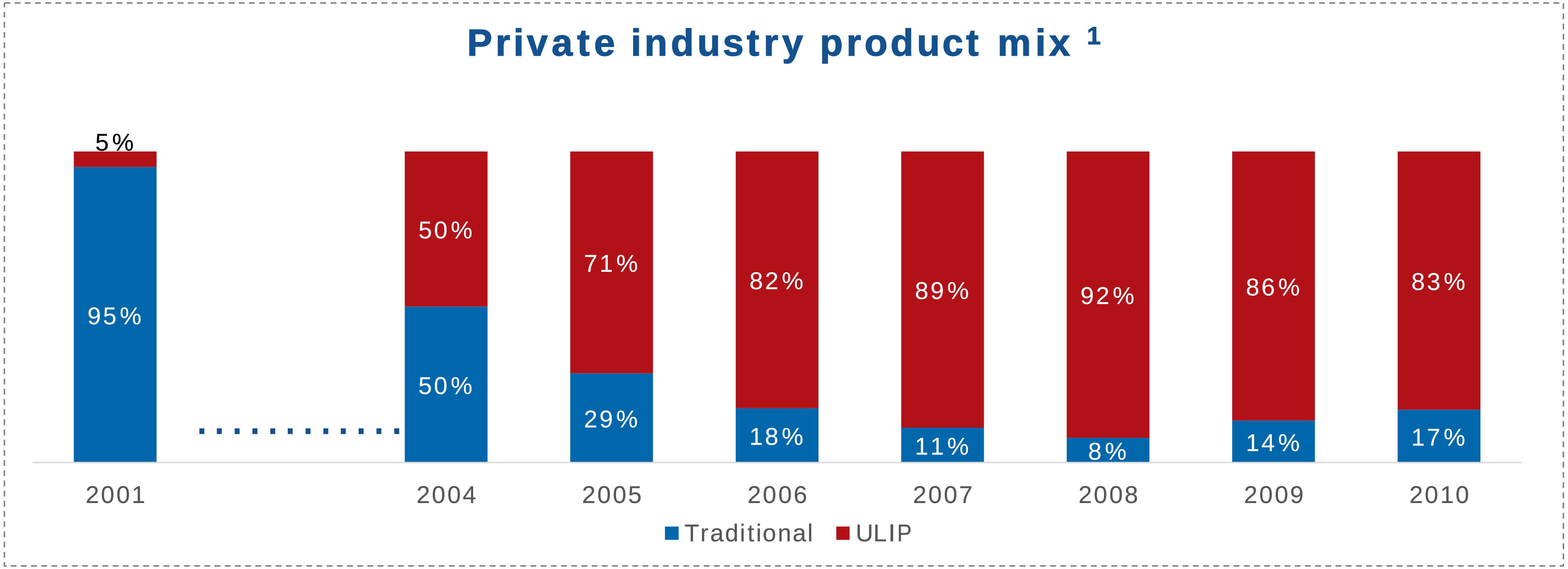


However, what we've seen in India till the early 2000s was mainly focused on mobilising savings



The end result being that a lot of savings were mobilised, but **without adequate risk transfer!**

After trying to emulate LIC for a while, private insurers decided to find their own path… with ULIP



The new product category mobilised even more savings, while continuing to compete with other financial and non-financial products…

But with no material risk transfer yet!

(While Total premium grew at a CAGR of ~26%, In-force sum assured grew slower by ~21% between FY06 and FY10)

Note: 1. Based on New business premium, Source: IRDAI Handbook and Annual report, Internal estimate

At HDFC Life, we charted our independent, unique path introducing innovative products that helped address customer concerns

2006

Retirement ✓
Early commitment to the category

2011-14

Online sale of protection ✓
Popularized with our flagship *Click2Protect*

Low charge ULIP
Pioneered with *Click2Invest* *

2015

Niche health concerns ✓
Addressed with products like *Cancer Care* *

2017-18

Annuity deferment ✓
Introduced concept with *Pension Guaranteed Plan* *

2019

Credit Life ✓
Leveraged a prominent white space

Children's plans ✓
Expanded the category with our *Youngstar* brand

Women as a category
Introduced concept with *Smart Woman* *

Long term guarantees ✓
Advanced risk management with *Sanchay Plus* *

Cost effective ULIP, even at higher ages
Joint life concept innovatively used in *Classic One* *

2020

Long term solution with cash payouts ✓
Creatively structured via *Sanchay Par Advantage*

✓ **Risk transfer solutions**   * **Industry firsts**

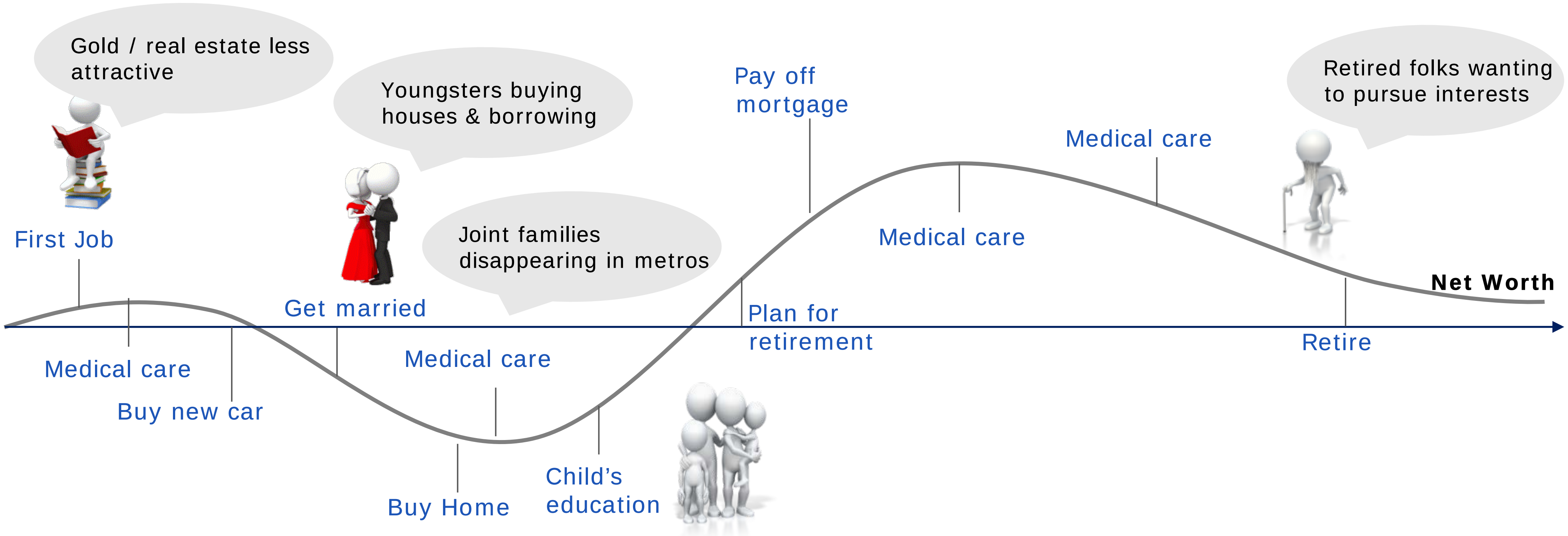
HDFC Life

These propositions were directed at real customer needs across their lifespans

	20 – 30 years	30 – 40 years	40 – 50 years	50+ years
Objective	Simple Savings	Borrowing	Investments	Asset Drawdown

Responding to customer needs and socio-economic changes

(Addressing mortality, morbidity, longevity, interest rate risks)



And our approach was validated with a **number of our propositions becoming the industry norm!**

Our propositions over the years were all centered around the core of risk management

Mortality

(Risk of dying early)

Longevity

(Risk of living too long)

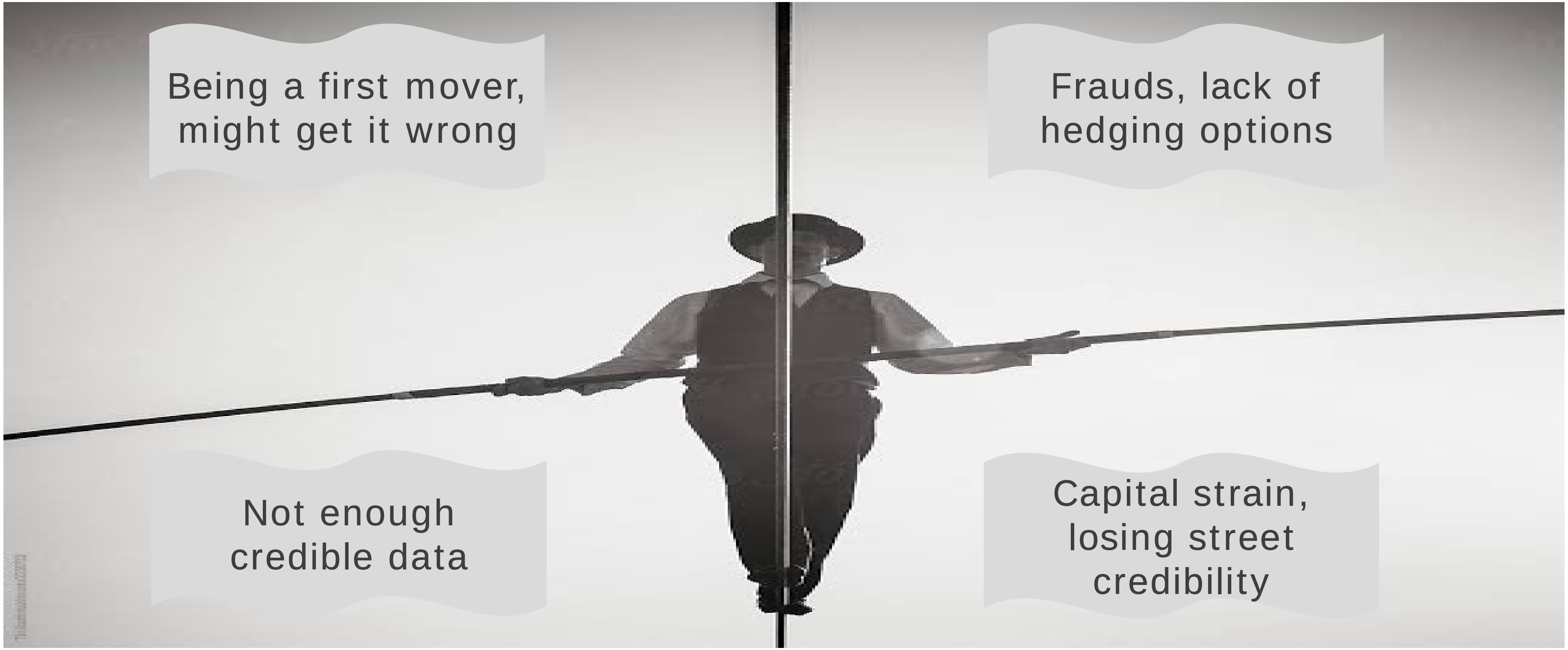
Morbidity

(Related to illness / disease)

Interest rate

(Related to investments, managing guarantees)

But risk management can be tricky…



So, what is the science behind our risk management that helps HDFC Life stay balanced on the rope?

1

Risks we cover for our customers

- **Mortality** (Risk of dying early)
- **Longevity** (Risk of living too long)
- **Morbidity** (Related to illness / disease)
- **Interest rate** (Related to investments, managing guarantees)

2

Risks intrinsic to our business

- **Operational risks** (Persistency, Mortality, Expense)
- **Economic risks** (Equity markets, Interest rates, Credit risk)

Risk management measures: Mortality & Morbidity

1 Reducing incidence of fraud & early claims

Analytics and Data Enrichment

Risk+

AI-ML based risk models, rule engines, credit bureaus etc.

No 'one size fits all' underwriting

Dynamic classification depending on profile, detailed medical & financial underwriting

Regular portfolio review

To identify emerging trends, outliers and take corrective actions

Industry collaboration

Mitigation from organised cartels

2 Limiting impact on profitability & solvency

Reinsurance

Optimized reinsurance strategies for risk transfer

Catastrophe agreement

To protect excess loss

Proactive reserving

Well provisioned to prevent sudden shocks from current pandemic

3 Balancing price and risk

Active re-pricing

Ongoing wherever required (mostly applies for Group schemes)

Product boundary conditions

Gate criteria depending upon customer profile and sourcing channel

Product design

Exclusions - pre-existing conditions, age limitations, suicide clause etc

4 Strong governance & audits @Partners

TPAs & medical centers

Ensure process & quality adherence

Distribution partners

Adherence to best practices and continuous monitoring of risk

Mortality & Morbidity

HDFC Life

Risk management measures: Longevity & Interest rate

1 Natural hedges & Residual strategy

Naturally hedged product lines

Protection and longevity; Unit linked and Non-par savings

Limit quantum of AUM

Quantum of retail guaranteed products 14% of AUM

External hedging

Instruments such as FRAs, IRFs, Swaps, amongst others

Reinsurance

Natural offset to mortality risk exposure

2 Product design & mix monitoring

Prudent pricing assumptions

Interest rate and risk margins assumptions

High Annuity ROPP business

Return of premium annuity products (>95% of annuity)

Regular monitoring & repricing

Monitoring of interest rates and business mix; repricing to align benefits with prevailing rates

3 Prudent ALM approach

Target cash flow matching

For Non-par savings + Group protection portfolio to manage non-parallel shifts & convexity

Duration matching

Immunise overall portfolio to manage parallel shifts in yield curve

4 Validation

Stress test scenarios

W.r.t. interest rates and persistency to identify impact on net asset-liability position

External validation (by Milliman)

ALM strategy appropriate to meet policyholder liability cash flows & protect net asset-liability position

Longevity & Interest rate

HDFC Life

Risk management measures: Operational and Economic

1 Operational risks

Balanced product mix

To manage risk emerging from market volatility

Mortality assumptions

Regular, granular review of experience vs assumptions, with corrective actions

Digital renewals

~90% of renewal payments made digitally

Cost control measures

Continuous measures to reduce variable and discretionary costs

Conservative assumptions

To factor adverse market impact

Continue to invest in Tech

To stay ahead of the curve & invest in future cost-saving technologies

2 Economic risks

Conservative investment strategy

GSecs or AAA rated securities (~97%); Exposure to below AA assets 0.3% of AUM

Regular monitoring

Ongoing investment portfolio review

Calibrated approach to shareholders funds

Risk averse approach for investment in shareholders funds (~25% equity)

Business Risks

In conclusion

Sensitivity of key risk factors (FY20)	Scenario	Change in VNB Margin	% Change in EV
Reference rate	▲ 1%	-0.7%	-1.2%
	▼ 1%	0.2%	0.6%
Equity Market movement	▼ 10%	-0.1%	-1.1%
Persistency (Lapse rates)	▲ 10%	-0.5%	-0.7%
	▼ 10%	0.6%	0.8%
Acquisition Expenses	▲ 10%	-3.9%	NA
	▼ 10%	3.9%	NA
Mortality / Morbidity	▲ 5%	-0.6%	-0.9%
	▼ 5%	0.6%	0.9%

Non par

VNB Margin	EV
-2.0%	-1.3%
1.7%	0.0%

Key takeaways:

- We are in the business of risk transfer, which implies the need for strong risk management measures
- These measures, if executed in a calibrated manner, have the potential to generate significant value, while also meeting varied customer needs
- At HDFC Life, we follow a prudent approach along with regular assessment of assumptions vs actual experience
- As seen, this has resulted in lower sensitivity to EV and VNB, which is also validated by external agencies

Thank You