India: New product regulations

New product regulations issued by the Insurance Regulatory and Development Authority of India (IRDAI) became effective on 1 April 2024. Following this, a Master Circular was issued in June 2024 providing a detailed elaboration of the regulatory requirements. Insurers have until 30 September 2024 to modify their existing products to comply with the new regulations.

The key changes introduced by these regulations include revisions to surrender values for non-linked insurance products and an explicit reference to variable annuities which have not previously been launched by Indian insurers.

This e-Alert summarises some of the key changes brought about by the new regulations and Master Circular and discusses their potential impact on the life insurance sector.

Non-linked products

The surrender value payable under non-linked contracts is the higher of the guaranteed surrender value (GSV) and the special surrender value (SSV). The GSV is the minimum surrender value stipulated by regulations, while the SSV, which can be higher, is defined by insurers and subject to change. Insurers must define their approaches to calculating SSVs during product filing.

The regulations make no change to the core principles underlying the computation of GSVs for non-linked products.

However, SSVs must now align with the ”notional asset share,” or asset share, as applicable (asset shares are normally calculated only for participating products), with a floor based on a prospective valuation of the expected present value of paid-up benefits at the time of surrender.

Additionally, surrender values are now payable after the completion of the first policy year, provided one full year’s premium has been paid. For policies with premium payment terms of less than five years, surrender values are payable immediately after one year’s premium payment, and for single policies, immediately after the premium is paid.

Asset shares, which are a widely used financial measure in life insurance, represent the accumulated value of the savings component of the premiums.

The notional asset share is to be computed in line with the prevailing Guidance Note (GN6) issued by the Institute of Actuaries of India (IAI). The interest rate assumed in the notional asset share calculation (for non-participating products) cannot be lower than the pricing interest rate assumed less 0.5%. Additionally, the expenses deducted as part of the notional asset share calculations should be consistent with the pricing expense assumptions, without exceeding the expense limits set out in the IRDAI (Expenses of Management, including Commission, of Insurers), Regulations 2024.

Regarding the prospective floor for SSVs, they must be at least equal to the expected present value of the

Paid-up sum assured on all contingencies covered

plus

Paid-up future benefits (such as income benefits)

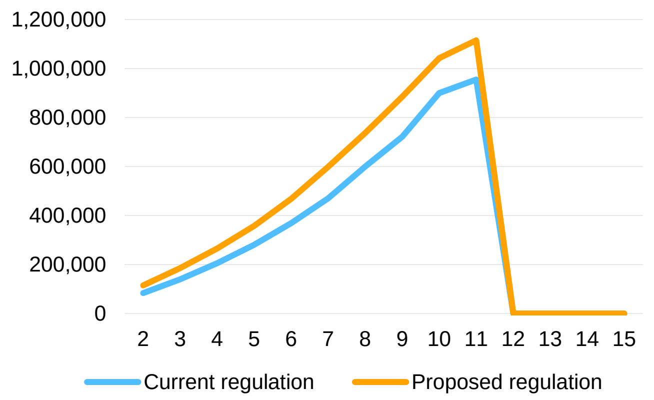
plus

Accrued/vested benefits, duly allowing for survival benefits already paid

The interest rate used to calculate the present value cannot exceed the prevailing yield on the 10-year government bond, plus a spread of 50 basis points (bps). The prospective floor for SSVs is to be reviewed annually based on the prevailing 10-year government bond yield.

We set out, in Figure 1, a graphical comparison of the existing and proposed surrender values (i.e., the greater of the GSV and the SSV) throughout the policy term for a sample non-participating savings product sold to a male aged 45 with an annualised premium of INR 100,000, a premium payment term of 10 years, and a policy term of 11 years, with an income payout period of 25 years starting thereafter. The SSVs have been computed based on certain actuarial assumptions and techniques. The results would differ if different assumptions or techniques are adopted and would vary for other product types.

FIGURE 1: SURRENDER VALUES



As can be seen there are material increases to the surrender value throughout the policy term. The implications of such a change are unclear, given that each insurer prices its products differently, offering varying surrender value scales. However potential implications include the following:

- A likely **reduction in insurers' margins** if increases in surrender values cannot be offset by adjustments in other benefits or cost structures or through product innovation or more active management of product mix
- A possible **increase in capital requirements** given the surrender value floor on actuarial reserves
- A possible **reduction of maturity payments or income benefits** as insurers may reduce benefits for policyholders to mitigate margin impacts from increased surrender benefits
- **Deteriorating persistency** as a result of a better return on surrender and also possible anti-selective surrenders by those having higher premium policies in the event of sharp movements in interest rates. For customers who value the enhanced liquidity of these provisions, this may however be a benefit
- **A restructuring of distributor commissions**, to mitigate the impact on new business margins and capital requirements

Variable payout annuities

Insurers are now permitted to offer both immediate and deferred annuities, where annuity payments can be linked to a publicly available benchmark, subject to a guaranteed minimum payout. The minimum guaranteed annuity rate throughout the policy term shall not be less than 60% of the annuity rate at the policy's inception.

This variable payout option can be attached to individual life and joint life annuities with a return of the purchase price on the death of the annuitant or the last survivor, respectively. Given that the Indian annuity market is dominated by return of purchase price annuities, the variable payout option can be widely offered.

The projected variable annuity payouts shown in the benefit illustration must be realistic and based on expected movement of the benchmark. This expected movement should reflect the inherent volatility and risk of adverse benchmark movements.

This development is expected to facilitate a new suite of life insurance products with variable payout options that better address the needs of the older segment of the Indian population.

There are, however, some hurdles to be crossed to turn this enabling regulation into a thriving new product segment. In particular, insurers will need to tackle the challenge of providing index-linked payouts while managing the guarantee and the management of surrender values, which as noted above need to be reviewed in line with movements in bond yields. This may demand more creativity from insurers as the challenge is heightened in India, where insurers are currently unable to invest in equity derivatives or engage in short selling. However, product innovation in this space could lead to retirees being able to enjoy the upside from participation in an index along with a measure of stability, creating a potentially attractive alternative to the existing fixed annuity market.

Others

The minimum sum assured for regular premium and limited premium life contracts has been lowered for policies where the entry age is over 50 years. Previously, the 2019 product regulations required a life cover of at least seven times the annualised premium, which has now been reduced to five times. Similarly, for single premium products, the minimum sum assured has been reduced from 1.25 times the single premium to 1.10 times for policies with an entry age of 50 years or more.

Given the higher mortality costs for this older group, these changes should enable insurers to offer more attractive returns to these policyholders. However, as current tax regulations require life cover to be at least 10 times the annualised premium for benefits to be tax-exempt (except for whole life policies, where death benefits are always tax-exempt), the impact on boosting insurance sales may be limited.

Linked products are now explicitly classified as either unit-linked or index-linked. The net asset value (NAV) for index-linked products must be tied to publicly available indices.

Although this represents no significant change—because index-linked products in their current form are not prohibited—creating a distinct category might facilitate the future launch of such products. Further investment liberalisation may also allow insurers to launch products linked to commodity indices such as gold. However, the charge restrictions applicable to unit-linked products (which continue unamended) also apply to index-linked products.

The regulations seek to facilitate the launch of innovative products by allowing insurers to approach the IRDAI directly with the proposed design concept.

The free look period during which policyholders can cancel their policies has been extended from 15 to 30 days. All non-linked savings products offering surrender values are required to offer policy loans.

Insurers are required to have board-approved policies in respect of underwriting, product management and pricing and advertising.

The IRDAI is committed to keep its regulations and circulars up to date with emerging market requirements. Therefore, product regulations will be reviewed at least once every three years and the circular (containing more detailed provisions) at least once a year. This requirement is not present in the current 2019 product regulations, meaning insurers can expect regular reviews.

Conclusion

Quantifying the impact of the improved surrender values for non-linked products on new business profitability is challenging, although it could be moderate, especially with insurers implementing measures such as adjusting commission structures, lowering policyholder internal rates of return (IRRs), revising product combinations and advancing product development.

The increase in surrender values and their earlier payout (after the first policy year) may lead to decreased policyholder persistency.

There could be advancements in the annuity sector with the introduction of variable annuities, which are permitted by the regulations but are yet to be launched in India.

FIGURE 2: SUMMARY OF KEY CHANGES

SUBJECT	DESCRIPTION/ TOPIC	NEW 2024 REGULATIONS	OLD 2019 REGULATIONS	COMMENTS
Surrender Value	Increase to SSV on non- linked products and earlier payment of surrender values.	SSV increased by the introduction of the requirement to have the SSV based on the notional asset share, subject to a floor set prospectively based on the value of paid-up benefits at the time of surrender. The interest rate assumed in the notional asset share calculation cannot be lower than the pricing interest rate assumed less 0.5%. Also, the expenses deducted as part of the notional asset share calculations should be consistent with the pricing expense assumptions and not exceed the expense limits set out in the IRDAI (Expenses of Management, including Commission, of Insurers) Regulations 2024. The interest rate used to calculate the present value of the paid-up benefits cannot exceed the prevailing yield on the 10-year government bond yield plus a spread of 50 basis points. The surrender value is to be reviewed annually based on the prevailing 10-year government bond yield. Additionally, surrender values are now payable after the completion of the first policy year provided one full year's premium has been paid. For policies with premium payment terms of less than five years, surrender values are payable immediately after one year's premium payment and for single policies immediately after the premium is paid.		Impact is difficult to forecast but may include a reduction in insurers' margins, an increase in capital requirements, a reduction in maturity payments, a deterioration in persistency and a restructuring of distributor commission.

<table>
<tr><th>SUBJECT</th><th>DESCRIPTION/ TOPIC</th><th>NEW 2024 REGULATIONS</th><th>OLD 2019 REGULATIONS</th><th>COMMENTS</th></tr>
<tr><td>Annuities</td><td>Variation in annuity payment levels</td><td>For both immediate and deferred annuities, annuity payments can vary based on a publicly available benchmark but with a guaranteed minimum payout. The minimum guaranteed annuity rate throughout the policy term shall not be less than 60% of the annuity rate at the policy’s inception.</td><td>No comments on the issue of variation in annuity payments.</td><td>Insurers may attach the variable payout option to existing annuities and also launch new categories of annuity contracts.</td></tr>
<tr><td>Product Cover Levels</td><td>Minimum cover levels</td><td>The minimum sums assured are set out below:
<table>
<tr><th colspan="3">MINIMUM SUM ASSURED</th></tr>
<tr><th>AGE AT ENTRY</th><th>SINGLE PREMIUM</th><th>REGULAR PREMIUM AND LIMITED PREMIUM</th></tr>
<tr><td>Less than 50 years</td><td>1.25 times of single premium</td><td>7 times the annualised premium</td></tr>
<tr><td>50 years and above</td><td>1.10 times of single premium</td><td>5 times the annualised premium</td></tr>
</table></td><td>The minimum sums assured are set out below:
<table>
<tr><th colspan="2">MINIMUM SUM ASSURED</th></tr>
<tr><th>SINGLE PREMIUM</th><th>REGULAR PREMIUM AND LIMITED PREMIUM</th></tr>
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</table></td><td>Given the higher mortality costs for this older group (i.e., those aged 50 and above), it should be possible for insurers to provide more attractive returns to these policyholders. However, given the current requirements to have life cover of at least 10 times the annualised premium for benefits to be tax-exempt (except in the case of whole life policies, where death benefits are always tax-exempt), this may have limited impact in terms of boosting insurance sales.</td></tr>
<tr><td>Index-Linked Products</td><td>Index-linked product under unit-linked platform</td><td>Index-linked products formally permitted under unit-linked platform.</td><td>No separate category for index-linked products.</td><td>Formally permits index-linked products, which may facilitate the launch of such products in the future.</td></tr>
<tr><td>Regulatory Review</td><td>Frequency of review of product regulation and Master Circular</td><td>The product regulations are to be reviewed within three years and the Master Circular is to be reviewed every year.</td><td>No mention of review.</td><td>Regular review should enable the regulations/circular to be responsive to emerging market needs.</td></tr>
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