CARE Ratings
Professional Risk Opinion

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Indian Life Insurance Industry – Navigating a Choppy 2020

Contact:
Sanjay Agarwal
Senior Director
sanjay.agarwal@careratings.com
+91-22- 6754 3582
Mob No: + 91 810 800 7676

Saurabh Bhalerao
Associate Director
saurabh.bhalerao@careratings.com
+91-22-6754 3519
Mob:+91-900 495 2514

Mradul Mishra (Media Contact)
mradul.mishra@careratings.com
+91-22-6754 3573

Introduction

The Indian insurance sector has been growing substantially over the past few years. To provide context, over a decade, the global industry grew at a CAGR of around 2%, while the Indian market grew at a CAGR of close to 12%.

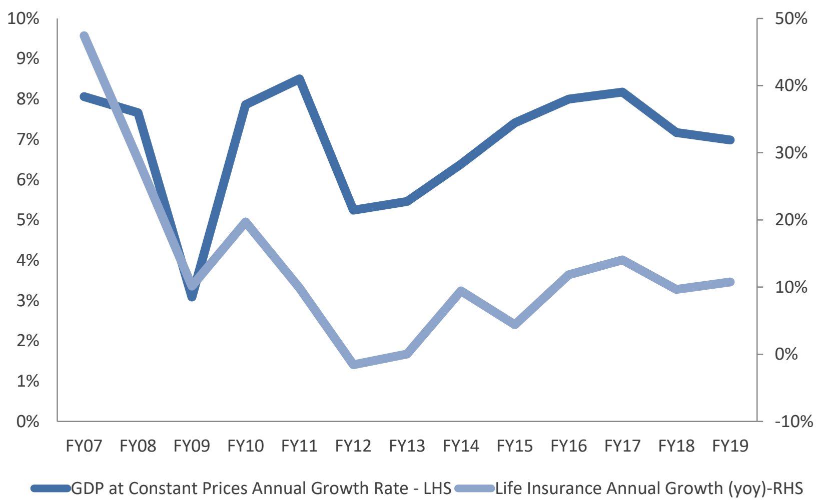
India accounts for approximately 2% of global premium volume. The Indian insurance industry's growth has been driven by product innovations and customization along with the development of strong distribution channels. The gap between India's insurance density and penetration levels and the average for Asian economies indicates a substantial growth opportunity.

Life insurance continues to dominate domestic insurance premium. Globally, share of life insurance in total premium was approximately 50%, while the same for India was nearly 75%.

Covid-19 affected the entire economy but life insurance companies suffered on two accounts namely loss of sales and outgo in terms of claims settlement. However, a silver lining is that the more consumers have realized the importance of insurance.

CARE expects the domestic industry to grow driven by pension products, life cover products, supportive regulations, effective distribution and improving customer services. However frauds and high lapse-ratio are some of the key challenges.

Figure 1: YoY Growth: Life Insurance Total Premium vs GDP

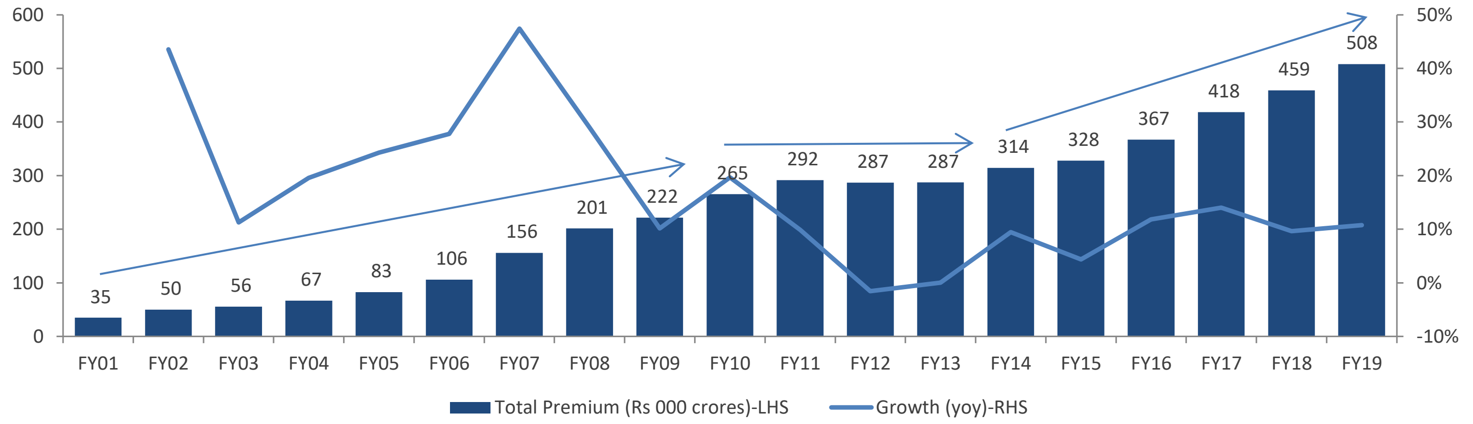


As can be seen in the Figure 1, insurance Premium volume is positively correlated with economic growth and visibly grows at a multiple to the GDP.

Growth trajectory of Indian Life Insurance

Since the industry was opened to private sector in 2001, it has witnessed several changes (regulatory and structural) and has undergone significant transformation. India's total life insurance premium reached Rs. 508,132. crore in FY19 from Rs. 156,076 crore in FY07 at a CAGR of 10.3% during FY07-19 due to 1) rising household savings/ income levels, 2) increasing education/ awareness level, 3) rise of middle class, 4) tax benefits, 5) product innovations/ customization by insurance companies, and 6) entry of multiple distribution channels such as bancassurance.

Figure 2: Life Insurance Total Premium



Source: IRDAI

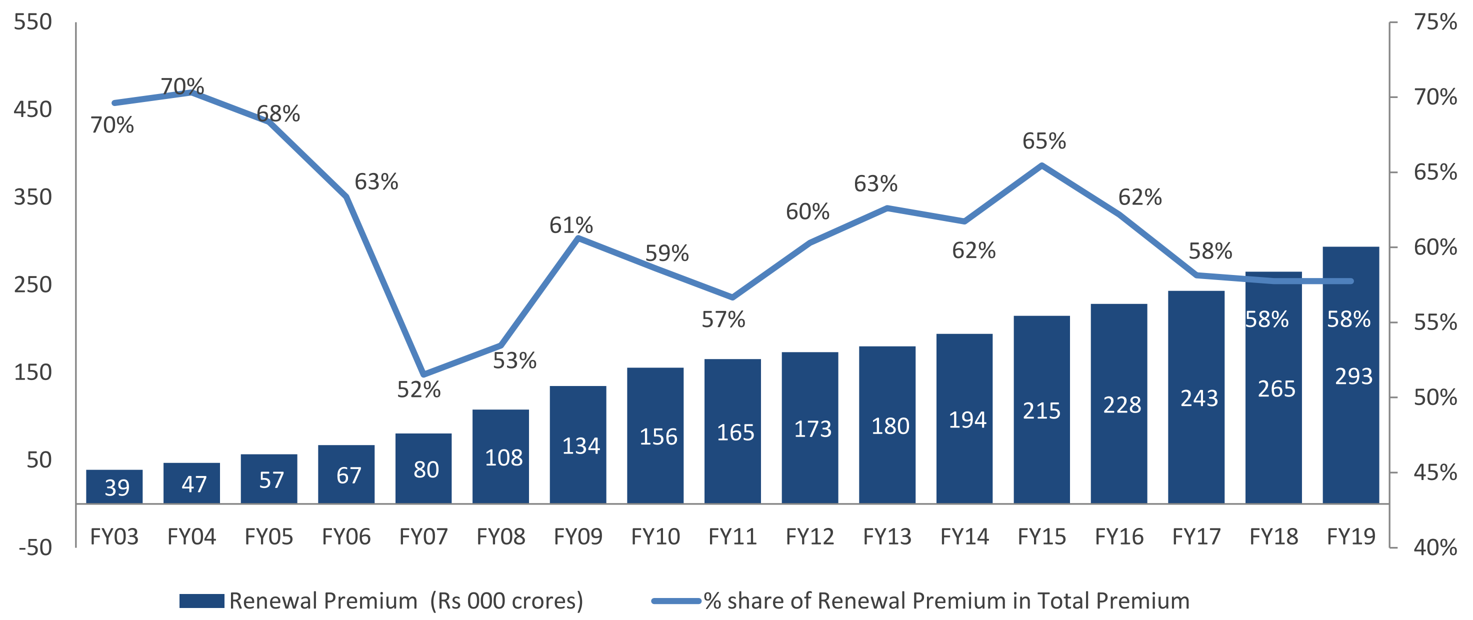
The above growth can be broken into three phases,

- **Phase I FY01–FY08:** Prior to 2000, LIC was the only player operating in the industry. Post liberalization several private companies entered the industry and all companies witnessed a significant growth. Total premium rose sharply driven by ULIPs coupled with a sustained capital-market appreciation, and high upfront commission especially for linked products.
- **Phase II FY09-FY14:** Private insurers face larger impact of regulatory changes On the basis of total individual first year premium income, the market share of LIC witnessed an increasing trend from FY10 to FY14, while private players witnessed a declining market share trend during the same period (refer chart 3). Bulk of the decline happened during the years of major regulatory changes, which necessitated significant effort on the part of the insurers to adapt. Several products (predominantly ULIPs) were rendered ineligible and insurers had to re-design them to comply with the new regulations, resulting in a sharp decline in product offerings. Subdued stock markets also reduced the appetite for linked products among customers
- **Phase III FY15 onwards:** After the slowdown in the earlier period, from FY15, the industry began showing signs of revival, primarily due to the improvement in performance of private players. LIC's first year premium growth has been marginally lower at 17.8% vs 18.4% for the private companies for the FY15-FY20 period primarily due to the rise in distribution channels of private players.

Over 85% is non-linked premium, while balance is linked premium. Non-linked premium is dominated by LIC, while the private sector holds a larger share in Linked premium (due to ULIP products). The shift in the premium market share can be attributed to several structural and regulatory changes. The private players underwent transformation leading to increased penetration, higher coverage, rise of multiple channels (including agency, bancassurance, broking, direct, corporate agency), superior reach, and intensifying competitiveness in the market. The overall industry has also witnessed trends such as increased digital presence, emergence of InsureTech for innovations around customer education & service/ products/ technology/ delivery systems for access.

Renewal premium accounts for approximately three fifth share of the total premium

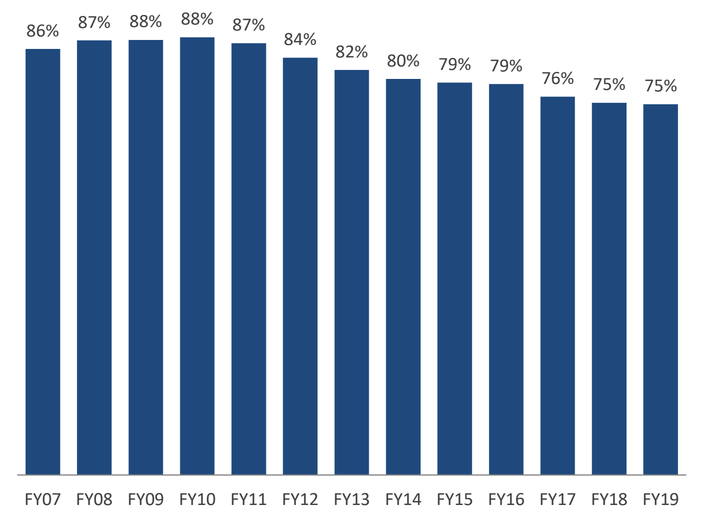
Figure 3: Share of Renewal Premium in Total Premium



Life Insurance continues to dominate the domestic Insurance sector

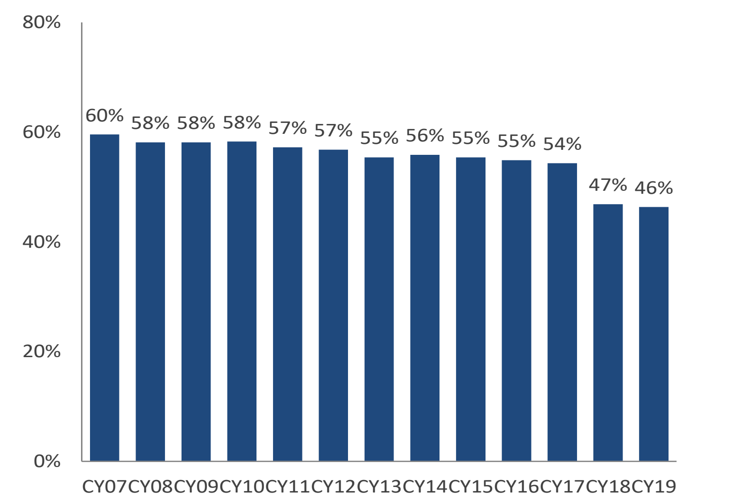
Life insurance segment continues to dominate the domestic insurance industry premiums. Globally, the share of life insurance business in total premium was around 50%, while the same for India was 75%. However, its share has been declining gradually from 85.8% in FY07.

Figure 4: Share of Life Insurance of Insurance Premiums in India



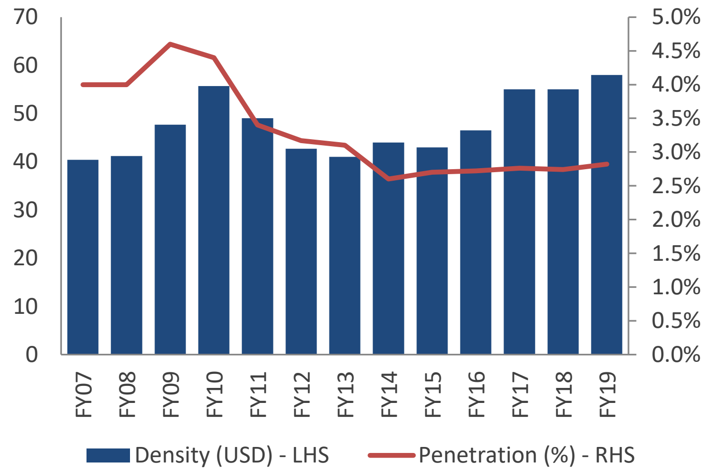
Source: IRDAI

Figure 5: Global Share of Life Insurance Premiums in Insurance Premiums



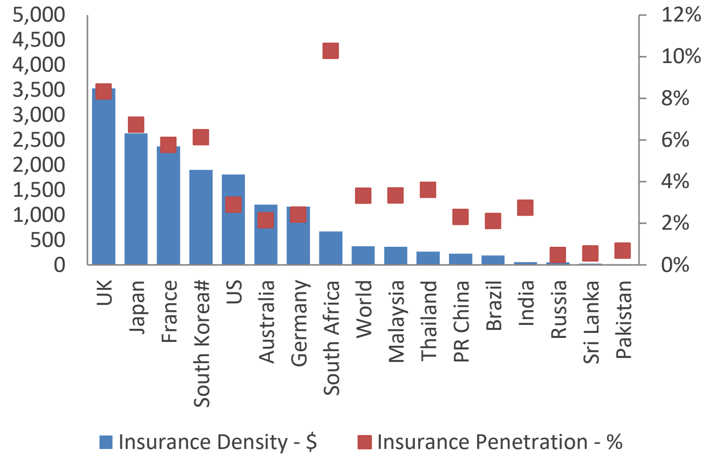
Source: IRDAI

Figure 6: Life Insurance: Density and Penetration



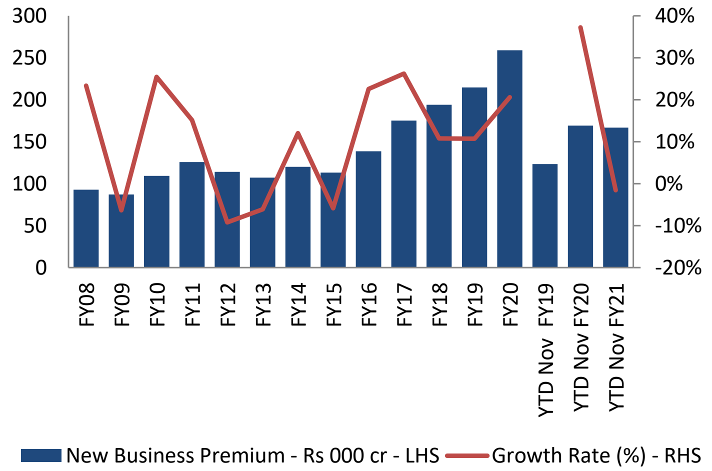
Life insurance penetration (premium as percentage of GDP) in India declined from a peak of 4.6% in CY09 to 2.5% in CY13 and recovered marginally later. Bulk of the decline happened during the years of major regulatory changes, which necessitated significant effort on the part of the insurers to adapt. Several products (predominantly ULIPs) were rendered ineligible and insurers had to re-design them to comply with the new regulations, resulting in a sharp decline in product offerings. However, the insurance industry in India has staged a smart recovery after multiple regulatory actions had significantly impacted the operations.

Figure 7: Global Life Insurance Penetration and Density



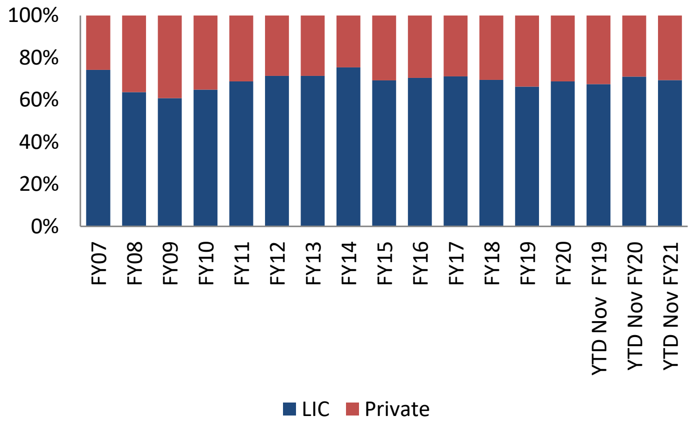
India's insurance penetration is lower than global average and significantly lower than quite a few developed countries. India continues to be an underpenetrated insurance market with an insurance penetration of 2.82% in fiscal 2017, as compared to other countries and a global average of 3.33%. At $55 in fiscal 2016, the insurance density in India also remains very low as compared to other developed and emerging market economies as well as the global average. Both these indicators highlight the immense untapped development potential within the Indian insurance industry.

Figure 8: New Business Performance



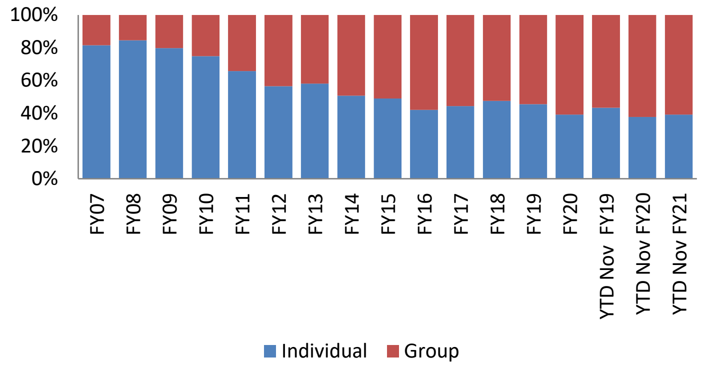
New business performance had witnessed robust growth; however, the life insurance sector reported a drop in November 2020 after witnessing a growth for four continuous months in FY21. First Year Premium of life insurers fell by 26.9% in the month of November 2020 to Rs 19,159 crore, compared to Rs 26,221 crore in November 2019 due a fall in group non-single premiums, however, the individual segment muted the fall. Single premium policies (primarily investment oriented) accounted for a significant portion of the policies sold in November 2020 but declined compared to yoy levels; however, non-single policies witnessed a sharper fall. The life insurance sector reverted to negative growth in their first year premium collection. The sector reported a dip of 1.5% in first year premium to Rs. 1,66,663.0 crore in YTD November FY21 from Rs. 1,69,251.2 crore in YTD November FY20 (compared to an increase of 37.2% reported in YTD November FY20).

Figure 9: New Business Premium Growth- LIC vs. private insurance companies



LIC's first year premium income grew at a CAGR of around 15%, while the private sector premium income grew at a CAGR of 30%. The share of public sector life insurer in first year life insurance premium though fell from 94% in FY03 to 74% in FY07 and further to 66% in FY19, however remains very formidable. LIC's first year premium decreased by 3.8% in YTD November FY21 compared to growth of 44.5% in YTD November FY20. While private companies reported a growth of 3.9% in YTD November FY21 versus growth of 22.1% in YTD November FY20. The increase in market share of private companies has been more in the insurance premium (value) compared to the quantum of the policies sold annually (volume). -

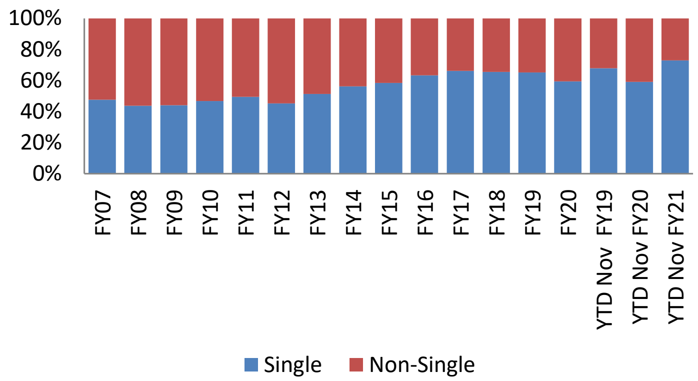
Figure 10: New Business Performance – Individual vs. Group



Source: IRDAI

In the earlier part of the period, individuals accounted for a substantial portion of the new business premium. Studying the chart, it can be observed that group insurance's share rose with a corresponding rise in the share of the direct selling channel. Individual as well as group premiums dropped sharply in November 2020 vs. the positive growth witnessed in November 2019. On the other hand, growth turned negative for group premiums in YTD November FY21, but individual premiums reported muted growth of 2.4% in YTD November FY21 vs the growth of 19.3% in YTD November FY20. The group premium continues to be larger than the individual premium, but individual premium has been reducing its gap, year by year.

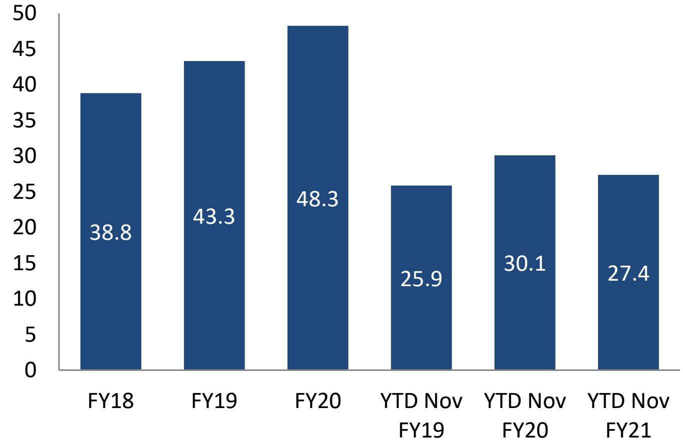
Figure 11: New Business Performance – Single vs. Non-single



Source: IRDAI

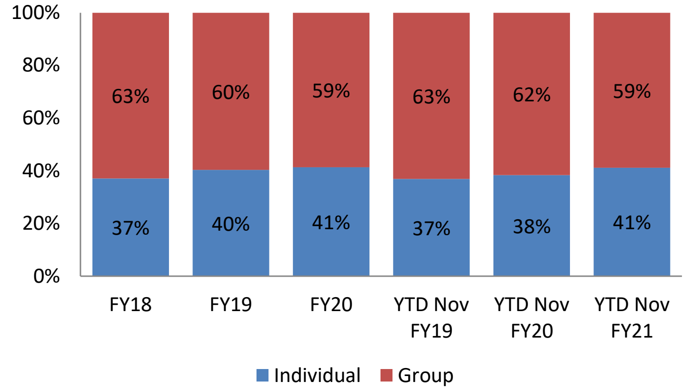
The share of single premium policies has been steadily increasing over the period and has reversed the earlier position when the non-single premium accounted for the larger share. A majority of the single premium policies are accounted by LIC.

Figure 12: New Business Performance – Movement in Sum Assured (Rs lakh cr)



Source: IRDAI

Figure 13: New Business Performance – Movement in Sum Assured: Individual vs Group



Source: IRDAI

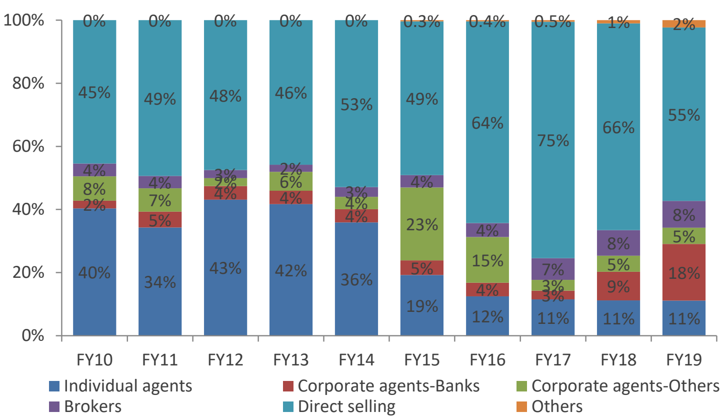
The sum assured was increasing till FY20, however, due to the pandemic; the sum assured has dipped in the current year. In Sum Assured, private companies have a share of 85.3% (vs 85.5% in YTD November FY20) due to their focus on pure protection plans and a strong digital presence.

The share of sum assured for the individual segment has shown an increase for the past three years which is also reflected in the YTD numbers for the current year. This has been driven by the rising interest for term plans which have been pushed by the private players.

Distribution Channel Analysis

Marketing of insurance service is critical and complex due to the periodicity, claims and brand switching costs that affect buying behavior. Consequently, distribution is one of the key determinants of success for insurance companies. A variety of distribution channels are currently used to sell insurance products. These channels can broadly be classified into internet-led channels, company-led channels, bank-led channels, and agent-led channels. There has been a shift in the channel mix from the earlier agency-focused model to a more diversified distribution mix.

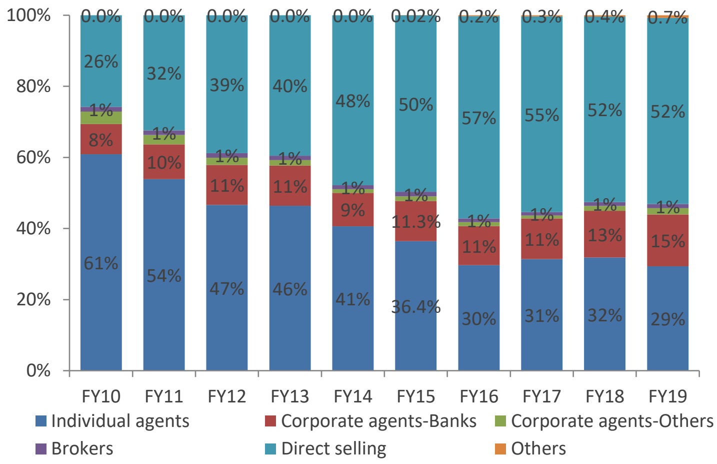
Figure 14: Distribution Channels – New Business by volume



Source: IRDAI

The contribution of the Agency channel to the new business volume decreased from 40% in FY10 to 11% % in FY19. On the other hand, the share of banks in new business has gone up from 2% in FY10 to 18% in FY19 and direct selling channel's share has increased from 45% in FY10 to 55% in FY19, primarily on the basis of group business being sourced directly by the companies.

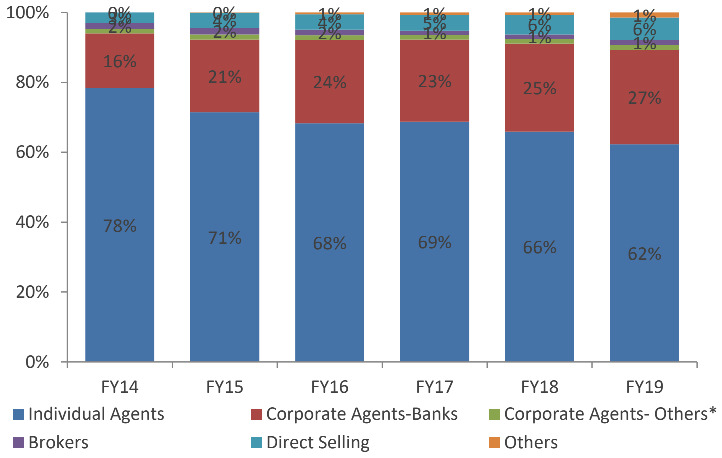
Figure 15: Distribution Channels – New Business by value



Source: IRDAI

The contribution of the Agency channel to the new business premium decreased from 61% in FY10 to 29% in FY19. On the other hand, the share of banks in new business has gone up from 8% in FY10 to 15% in FY19 and direct selling channel's share has increased from 26% in FY10 to 52% in FY19, primarily on the basis of group business being sourced directly by the companies. This is also indicative of an increasing share of private insurance companies in the new business premium as these companies have leveraged these channels more effectively as compared to the public sector firms. The cap on ULIP charges, introduced in 2010, led to a rationalisation of owned agency network and introduced a shift towards third-party channels. The well-developed banking sector in India and the nationwide presence of banks resulted in the increase of bancassurance's contribution to total insurance business.

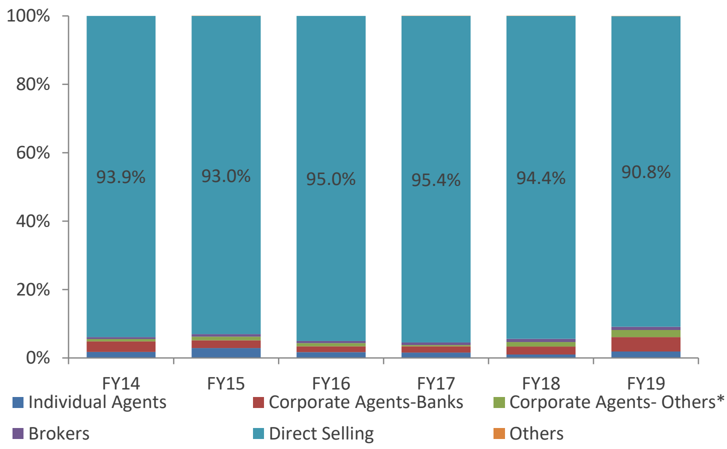
Figure 16: Distribution Channels for Individuals



Source: IRDAI

Agency channel continues to dominate the individual business, albeit which has reduced from 78% to 62%, while bancassurance has increased from 16% to 27% indicating both the rise of alternate distribution channels and growth of private insurance companies in the sector. LIC generated over 90% of its individual new business premium through Agency channel while the share of Agency channel was close to 30% for the private sector. The proportion of individual new business premium sourced by LIC through Agency channel has remained steady at a high of over 90% for more than the last decade indicating significant reliance on this distribution channel. While the share of Agency channel for private sector has reduced from a high of 66% in FY07 to 30% in FY19.

Figure 17: Distribution Channels for Group



Source: IRDAI

Direct selling dominates the group business which indicates that the life insurers' in-house teams are responsible for these sales. However, it can also be seen that banks are emerging as a channel for these types of sales.

Operational and technological changes have led to the development of multiple distribution channels in the insurance industry. Due to rising commissions in traditional channels such as agents and banks, insurance companies are developing alternate channels to drive growth at lower costs. This has led to the emergence of additional channels such as call centres, mobile, internet (web aggregators, Insurance Marketing Firms (IMF) and websites of insurance companies) and insurance marketing firms which are not tied to single insurance company but can sell policies of multiple insurance companies. Development of alternative channels is also being driven by changes in customer behavior, product preferences, and processes. Agency, direct selling, and bancassurance channels continue to remain the dominant distribution channels of the life insurance companies and are expected to contribute substantially going forward. However, the alternate distribution channels are just starting to contribute and are expected to increase their share of the distribution pie. Further, the pandemic has caused insurance companies to fast-track digital options for other channels to drive sales. The companies have also worked on automating and digitizing the insurance workflows e.g. LIC launched ANANDA for individual agents.

Challenges

We have examined the factors behind the industry' growth such as income tax benefits, product innovations and customization, multiple distribution channels, competitive pricing and adoption of technology and alliances; however, certain challenges such as Economic slowdown due to Covid 19, low persistency ratio, income thresholds for agents also need to be examined.

- Economic slowdown and the covid 19 has led to cessation of a few policies of people affect by the pandemic, while the pandemic itself has resulted in higher pay-outs
- The persistency ratio measures how long customers stay with their policies and is important as a high ratio contributes to profitability and helps in reducing costs through economies of scale. Domestically, this ratio is currently low as per international standards but is generally improving albeit slowly both at the 13th month and 61st month levels. Globally, the persistency ratio is around 90% in the 13th month and over 65% after 5 years.
- Low income of Individual agents: The average premium income per policy of individual agents grew at a CAGR of 6% over the last decade, even as average premium income per policy of corporate agents grew at a CAGR of 11% over the same period. The average premium income per policy of corporate agents was 2.5 times of individual agents highlighting the divide,
- Frauds which results in higher premium and lower underwriting profits

These challenges would have to be addressed to improve the vibrancy and industry growth as well as increase insurance penetration & density.

Outlook

The outlook for the insurance industry is not just a function of the economic growth but industry specific factors such as expansion in insurance penetration, evolution and change in the share of various distribution channels, enabling regulatory movement, also affect the premium growth. The life insurance business witnessed a fall in the earlier part of the year due to the lockdown and business disruption caused by the pandemic

CARE expects the life insurance segment to continue to grow in the high single digits for the year as compared to a double digit growth witnessed last year. The growth drivers include 1) Higher demand for retirement products such as pension/annuity coming from an aging population coupled with low availability of government sponsored social security mechanisms and rising awareness of retirement planning, 2) The prevailing interest rate scenario would continue to drive the interest in guaranteed return plans, 3) The pandemic has created a rise in the demand for protection plans, 4) ULIPs may witness some interest due to strong market performance, 5) Younger demographic opting for pure protection plans driving insurance coverage, 6) Intense push to increase insurance coverage especially in rural populace, 7) Product innovations/customization including the launch of standard life insurance policies across companies, 8) Rise of multiple channels, and 9) Continued tax benefits.

Companies are expected to incur significant investments into bundling digital into all the distribution channels while maintaining a razor-sharp focus on cost improvement to sustain margins. However, frauds, high lapse-ratio, any unfavourable changes in macro-economic factors such and uncertainties in the regulatory landscape could be characterized as key challenges to the industry growth. Overall, the outlook is expected to be stable in the medium term.

CARE Ratings Limited
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022.
Tel: +91-22-6754 3456 I Fax: +91-22-6754 3457
E-mail: care@careratings.com I Website: www.careratings.com