WEDAPT
INSURANCE NEWSLETTER

September'23

Some interesting Facts

- Income Tax exemption for life insurance policies in India is available only for policies where the death benefit is at least 10 times the annualised premium.

- Pure protection life insurance products (like Term Assurance) attract a GST of 18% on the premium. On the other hand, Traditional life insurance policies bundle investment and insurance elements, a GST of 4.5% is imposed on the first-year premiums, while the subsequent premiums will attract a 2.25% GST.

Impact of Union Budget 2023 on Indian Life Insurance Industry

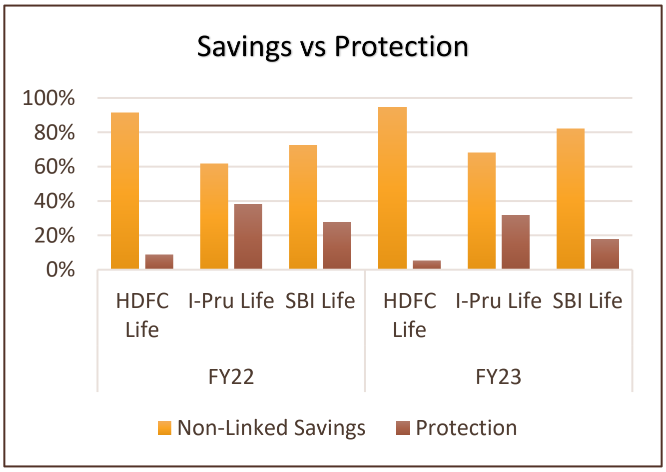
The performance of the Life Insurance Industry is heavily linked to the fiscal policies, especially tax norms, of the country. The Union Finance Minister, Nirmala Sitharaman presented the Union Budget for FY 2023-24 about six months ago which sought to address key issues while promoting economic growth, inclusivity, and fiscal discipline. This article focuses on the impact of Budget 2023 on the Indian Life Insurance Industry. There were two major announcements which could have an impact on the industry. These changes and their potential impacts have been further discussed here.

Major Announcements pertaining to Life Insurance Industry

I. Removal of Tax Exemption on the maturity proceeds of policies (non–linked Products) with an aggregate annual premium above five lakhs

Before the announcement of Budget earlier this year, maturity proceeds from non-linked products were not subject to taxation. This tax exemption, however, was removed this year for individuals who pay an aggregate annual premium of more than five lakhs.

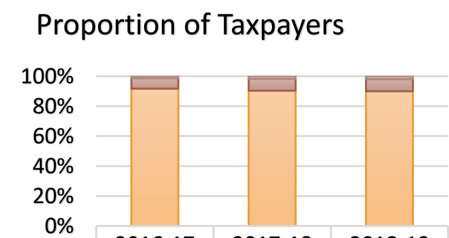
In India, people generally prefer non-linked savings products to protection products (*refer chart*). This measure has seemingly been taken by the government to promote the original purpose of life insurance – protection and financial security for the household from untimely or unforeseen death of an individual. This change will ensure that people are not using life insurance to attain tax-free returns on large investments (greater than five lakhs p.a.).



This change will be applicable on any policy issued on or after 1st April 2023. Although, it is important to note that the exemption on death benefit stays unaffected.

Impact on Life Insurance Industry

From a consumer perspective, this change is expected to mainly impact high net-worth individuals, who have the funds to invest more than five lakhs p.a. in life insurance.



	2016-17	2017-18	2018-19
Above 25 L	1%	2%	2%
10 L - 25 L	7%	8%	8%
<= 10 Lakhs	92%	90%	90%

The chart here shows the proportion of taxpayers based on gross total income. There is a minimal proportion of around 1% - 2% of taxpayers who have a gross total income of more than 25 lakhs.

From the insurers' perspective, this would primarily impact companies which have a higher proportion of policyholders paying more than five lakhs annual premium. Although Companies might not have a very high percentage of policies in this segment (refer below table). However, since the tax is applicable basis aggregate premium, business volume for less than five lakhs premium could also be impacted since potential investors who plan to buy multiple policies with different Companies would also be affected.

In general, this could lead to a fall in volume of such policies for non-linked savings products. The impact of this change on profit margins for companies would depend on the margins targeted at the time of pricing of such high-ticket policies. However, these policies do have a major contribution in the expense recoveries through premium linked expenses which might impact the expense management for companies.

Company	% Policies with APE greater than 5 Lacs
ICICI-Pru Life	6%
Max Life	9%
HDFC Life	10%
SBI Life	1%

Next Steps

It is important to note that although the change in taxation currently only affects a smaller cohort of the business, this could also be an indication of what could be expected in coming times in terms of tax laws. The potency of the below mentioned steps also hinges on insurer's expectation about the dynamic economic environment.

- If the Government plans to push life insurance as a protection first business, the companies could go in two directions. One is to focus on the investment returns, to bring the savings product at par with other savings instruments. Other is to focus on the pure-risk contracts.
- To focus on savings products, the Companies might have to offer higher investment returns to compete with other popular investment options which offer a similar risk profile. Although, this might require an additional support from IRDAI in terms of ease of investment regulations.
- To attain and secure higher returns, investment in slightly unconventional assets like derivatives, FRAs etc. might increase as an industry.
- Companies could also attempt to cut down on the death benefit component to provide better maturity proceeds. However, this is currently restricted by the minimum prescribed limit of 7 times the annualized premium by IRDAI's regulation.

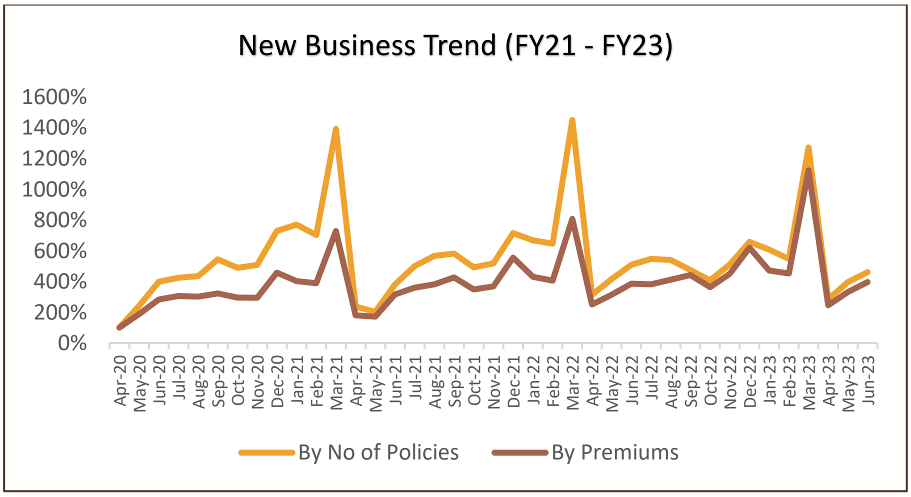
- Pure-risk products would mean term/TROP products, whole-life products, and riders. These are low premium products and offer higher profit margins than savings product generally. Notably, the demand for such pure-risk products has also improved post COVID-19.

- However, this would also lead to a magnified mortality/morbidity risk. This would enhance the importance of efficient reinsurance arrangements and effective underwriting processes.

- This makes assessment of accurate mortality risk a more significant issue for insurers across the industry. These companies could make use of wearable technology and cloud-based data storage to evaluate the risk more accurately, thereby charging appropriate premium for the same, as can be seen being adopted extensively in the Health Insurance sector.

II. Push Towards New 'exemption-less' Tax Regime with lower tax rates.

The old tax regime offered numerous exemptions to taxpayers, one of which was the tax exemption under Section 80C, on the premiums paid by an individual for life insurance products. Such exemptions have been a major driver of investments in life insurance and other such savings instruments. For the same reason, there has been a seasonal trend of business for life insurance companies, which is usually skewed towards the last three months of the financial year – January, February, and March.



The Government had introduced the new tax regime in the Finance Act, 2020 as an alternative to the old tax regime. The intention was to roll out a simplified tax structure, without any complications of the exemptions and with more straight-forward tax slabs. This year, the government significantly reduced tax rates under the new regime. Due to the reduced tax rates and a simplified tax structure, Central Board of Direct Taxes (CBDT) expects at least 50% to 66% of the taxpayers to switch over to the new tax regime in the coming financial year itself. This might lead to a reduced motivation to purchase new policies or pay renewal premiums for the life insurance consumer base. Although, it must be noted that people can still arrive at a lower tax liability under the old tax regime, if they have a certain level of savings/expenses which are allowed as deductible.

Impact on Life Insurance Industry

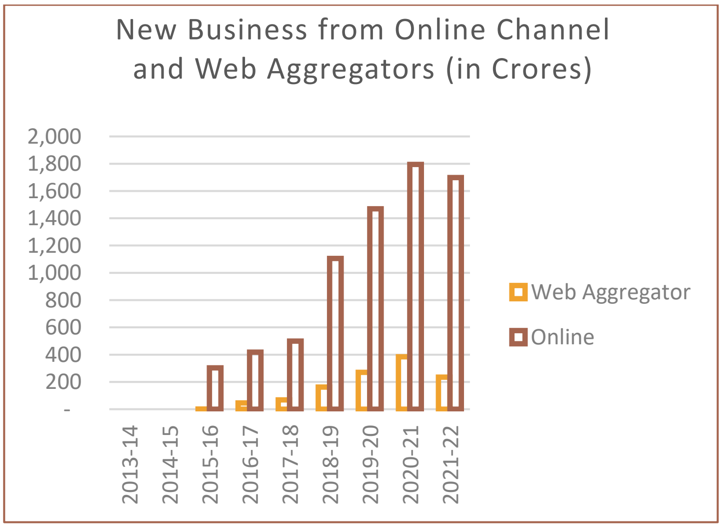
The tax savings on life insurance premiums under the old tax regime have been a major incentive for the public to purchase life insurance policies. The shift towards the new tax regime could result in a fall in premium collection for insurance companies, especially in the month of January, February and March.

As a result of people moving into the new tax regime, companies might observe lower persistency rates especially for policies that are in their early years. Under such circumstances, companies might have to find a way to hold on to the existing policyholders. There might not be a very significant impact on policies in their later years.

Lower tax rates under the new regime leaves the people with higher disposable income. There is a high chance that some of the financially sophisticated population may shift to term insurance or pure risk coverage to secure a reasonable death cover and invest their savings in other financial instruments promising better returns.

However, it is important to realise that tax saving, although an incentive, is not the foremost reason for buying insurance anymore. We have seen a widening reach of the life insurance industry through numerous initiatives by IRDAI to spread awareness about life insurance. The government has also launched multiple schemes through microinsurance products.

Further, the pandemic has triggered the awareness on insurance and demand for protection products. This combined with, expedited digital adoption where customers are more willing to use portals/apps post-COVID, has led to the development of a strong market base. The chart below shows the increase in new business sold through online channel and web aggregators in the past few years.



This increase in sales through digital channels might be an indication the industry is gradually shifting to stage wherein the customer is seeking insurance instead of agents and intermediaries pushing them to buy policies.

Next Steps

- The new tax regime takes away a major selling point from the life insurance companies. Therefore, there is a need to create new and innovative selling points to attract new business-like increased flexibility of withdrawals, higher surrender values etc. all of which will be substantially challenging for the industry and subject to certain regulatory requirements.

- The companies might have to do more intensive follow-ups at the time of policy renewal with existing policyholders to ensure high retention.

- Companies will have to make more efforts to increase customer awareness about life insurance. They will also have to notice the heightened awareness of pure risk covers and demand for easy-to-understand standardised products.

- Insurers might have to increase their usage of new-age marketing strategies like social media platforms etc. to capture the unacquired market in India.

Conclusion

Both the changes mentioned above can lead to a reduction in new business as well as existing business for the insurers. The removal of tax exemption on maturity proceeds is a more specific change which might have a slightly restricted impact given that the proportion of policyholders getting affected by this is not very high.

In a broader sense, the change in taxation also sends across a negative message. This might lead to a harmful effect on the perception of life insurance in general, especially due to low financial awareness and ignorance in certain sections of the society. This might lead to a reduction in new business volumes as well.

The Life Insurance industry in India is still at a growing stage. The awareness around life insurance products is increasing at a steady pace. One of the major reasons for this lack of awareness is the information asymmetry between the insurance companies and the prospective customers. Due to this asymmetry, there is a huge communication gap wherein the real purpose of buying a particular life insurance product often gets lost.

The changes in the budget are a test of how well the Indian life insurance market has evolved in recent years. The impact might not be significant if people realise the actual value of life insurance.

Latest Industry Updates

IRDAI approves new life insurance companies.

Insurance Regulatory and Development Authority of India has granted three companies - Acko Life, Go Digit, and Credit Access - certificate of registration to commence life insurance business in India. This development brings the total number of life insurers in India to 26. This regulatory endorsement reflects the evolving landscape of the insurance industry under underlines the commitment to expand the array of financial services to the citizens of India.

Stay vacates from Sahara Life insurance business

The latest update reveals that the Supreme Court has removed the stay previously imposed by SAT on IRDAI's determination to transfer Sahara Life Insurance Business to SBI Life Insurance.

Bandhan Financial Holding Ltd (BFHL) to acquire Aegon life insurance

Bandhan Financial Holding Ltd (BFHL) is set to acquire Aegon Life Insurance, as part of an agreement to purchase the complete stakes held by Aegon India Holding BV (49%) and Bennet, Coleman, and Company Ltd (46.09%). This move represents a significant chance for BFHL, an established presence in banking and mutual funds, to expand its product offerings within the financial services sector and further diversify its portfolio.

NEW PRODUCTS

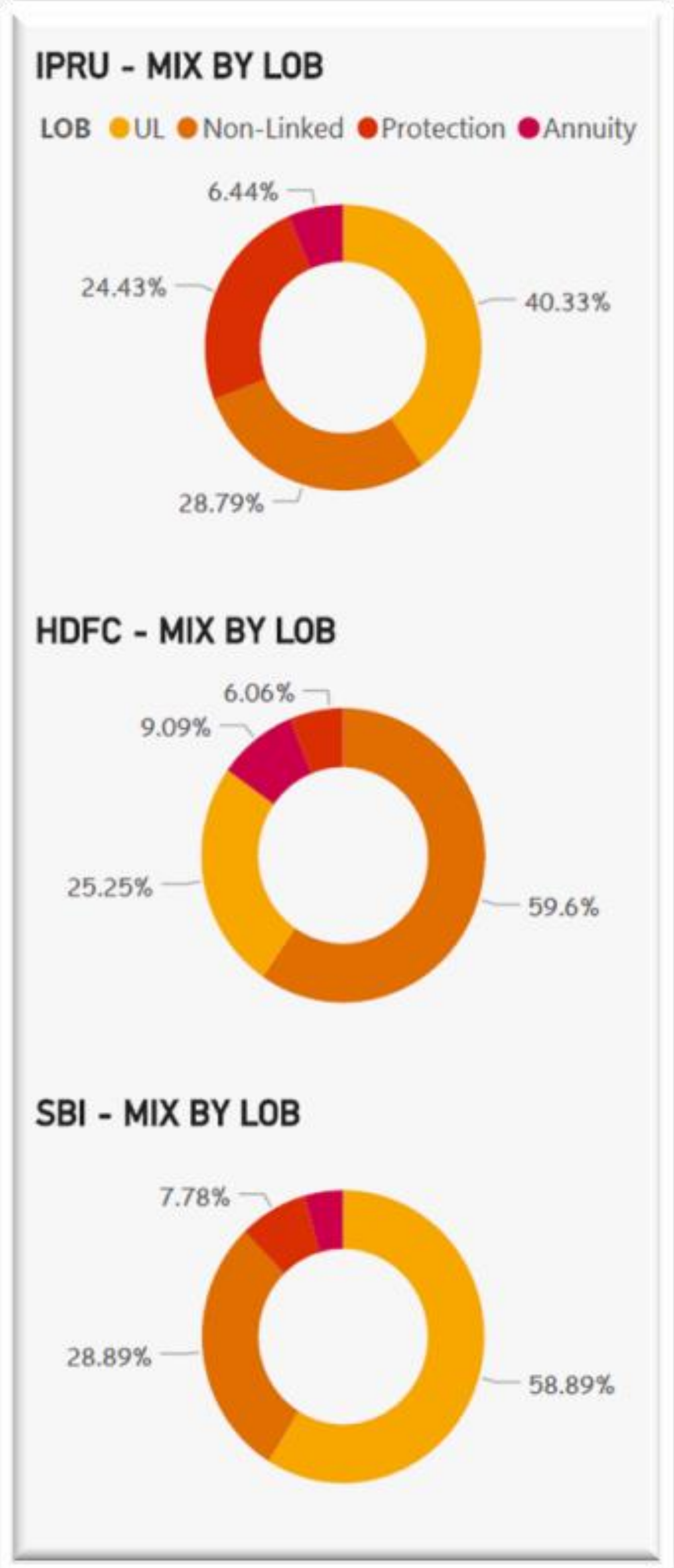
New insurance for egg donors and surrogate mothers

In response to IRDAI's encouragement, Aegon Life has initiated the sale of surrogacy group plans through facilities and clinics registered under ART (Assisted Reproductive Technology). The financial commitment is undertaken by couples pursuing this route. The insurance entails a three-year life cover for surrogate mothers and one year for egg donors, safeguarding against critical complications stemming from the procedures.

High premium Term insurance for diabetics

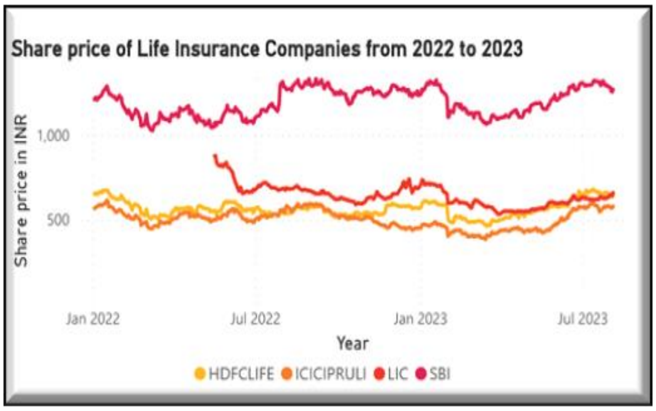
Bajaj Allianz's latest offering introduces a high-premium term insurance specifically tailored for individuals dealing with pre-existing conditions like pre-diabetes and type 2 diabetes. This product aims to simplify the process of obtaining term insurance for this demographic. Previously, these individuals faced challenges of exorbitant premiums or even rejection due to their perceived higher mortality risk.

Listed Companies Key Performance Indicators



Data pertaining to individual business only.

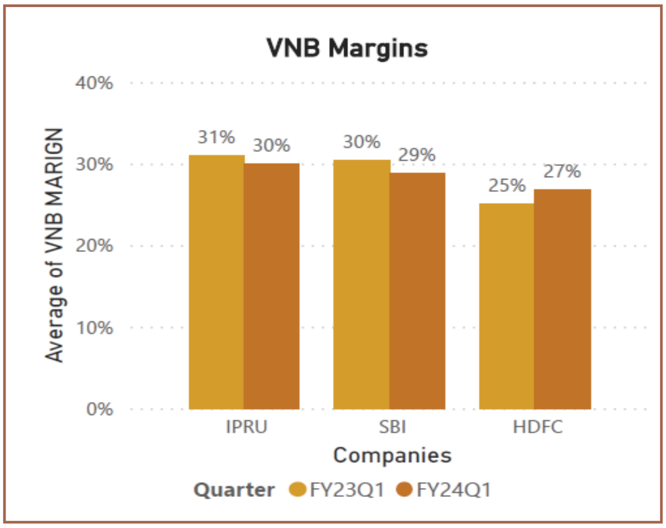
Movement in Share Prices of Listed Companies



Embedded Value and VNB Margins

The embedded value for the private sector increased by ~15% in the last financial year. The VNB Margins have been around 30% across the companies.

Embedded Value (in billions)	FY22	FY23
SBI	396.30	460.40
MAX	141.74	162.63
LIC	5,442.91	5,822.43
IPRU	316.25	356.34
HDFC	329.60	395.30
Total	**6,626.80**	**7,197.10**



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