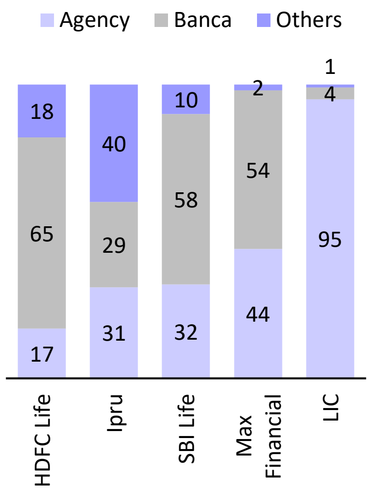
Life Insurance

Distribution mix (2QFY25)



Navigating the changes in surrender charges!

Revising commission structure and IRR to tackle the change

- **New surrender charges were implemented from 1st Oct'24, wherein key changes were: 1) implementation of charges from the first year itself (earlier it was effective from the second year), 2) a revision in the formula for guaranteed surrender value defined by the regulator, and 3) the discounting rate for calculation of surrender value has been linked to the 10-yr G-Sec yield.**
- **These changes are likely to impact VNB margins for listed companies in varied proportions based on their product mix (share of non-linked business), persistency assumptions in VNB calculations, and actual persistency. HDFCLIFE/SBILIFE/MAXFIN have indicated 100/50/100-200 bps impact, while LIC/IPRU have cited minimal impact.**
- **To counter the impact, some corrections have been made in commissions – 1) LIC has lowered upfront commissions and raised commissions in future years, and 2) private players have altered commission structures based on agent cohorts in terms of premium size and persistency.**
- **Further, the IRRs in the non-par segment over the past three months have been reduced by ~15-43bp to pass on some impact to the customers. During this period, the 10-yr G-Sec yield has declined by just 15bp.**
- **With insurance as a savings product becoming more liquid and agents needing to increase their business to meet their club membership targets (based on commissions), the ticket sizes are expected to increase.**
- **With all the noise and media reports (https://tinyurl.com/4y6zp26k) surrounding the bancassurance channel, which the regulator is considering in relation to the parent bank's share in the overall bancassurance distribution of an insurance company, we believe that companies with a higher proportion of non-bancassurance channels in their distribution mix will outperform. IPRU and LIC have a significantly higher share of the non-bancassurance channel.**

Various commission structures adopted by insurance companies for brokers

- Base commissions have been cut 3-5% by the majority of the companies.
- About 85-90% of the revised base commission will be paid out immediately, and 10-15% would be retained by the insurer and will be paid based on 13-month persistency.
- Some insurance companies have not altered commissions or implemented this delayed payment structure but have cited that based on 13-month persistency clawbacks would be implemented.
- Some fringe players have, in certain cases, taken this as an opportunity to increase their commissions to garner market share.

LIC cuts FY commission for agents; others adopt cohort-based approach

- LIC has cut its first-year commission from 35% to 28% and has increased the trail commission from 5% to 7.5%. The overall payout to the agents for the tenure of the product will broadly be unchanged in case the customer is persistent for the first five years.
- LIC has an enabling provision for implementing a clawback for commissions as well, but the same has not been implemented. The persistency performance of the new products launched under the new surrender norms will be monitored for implementing any clawback clauses.

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- Within the private sector, cohort-level segmentation has been done wherein business size and persistency track record are the key parameters. Agents with higher size and better persistency have better commissions and vice versa.
- For agents, the cut in upfront commissions can be detrimental to their MDRT/COT/TOT qualifications. These qualifications are based on commissions earned during a calendar year. Given that the first-year commissions have been cut, agents will have to focus on increasing the ticket sizes as well as widening their customer base.

No major cuts for the bancassurance channel

- Banks being the largest partner, have a strong bargaining power. As a result, no major cuts in commissions have been carried out. However, persistency-based clawback clauses have been negotiated with these partners.
- The critical element is the 13th month persistency, as beyond this, the persistency is managed by the insurance company itself.

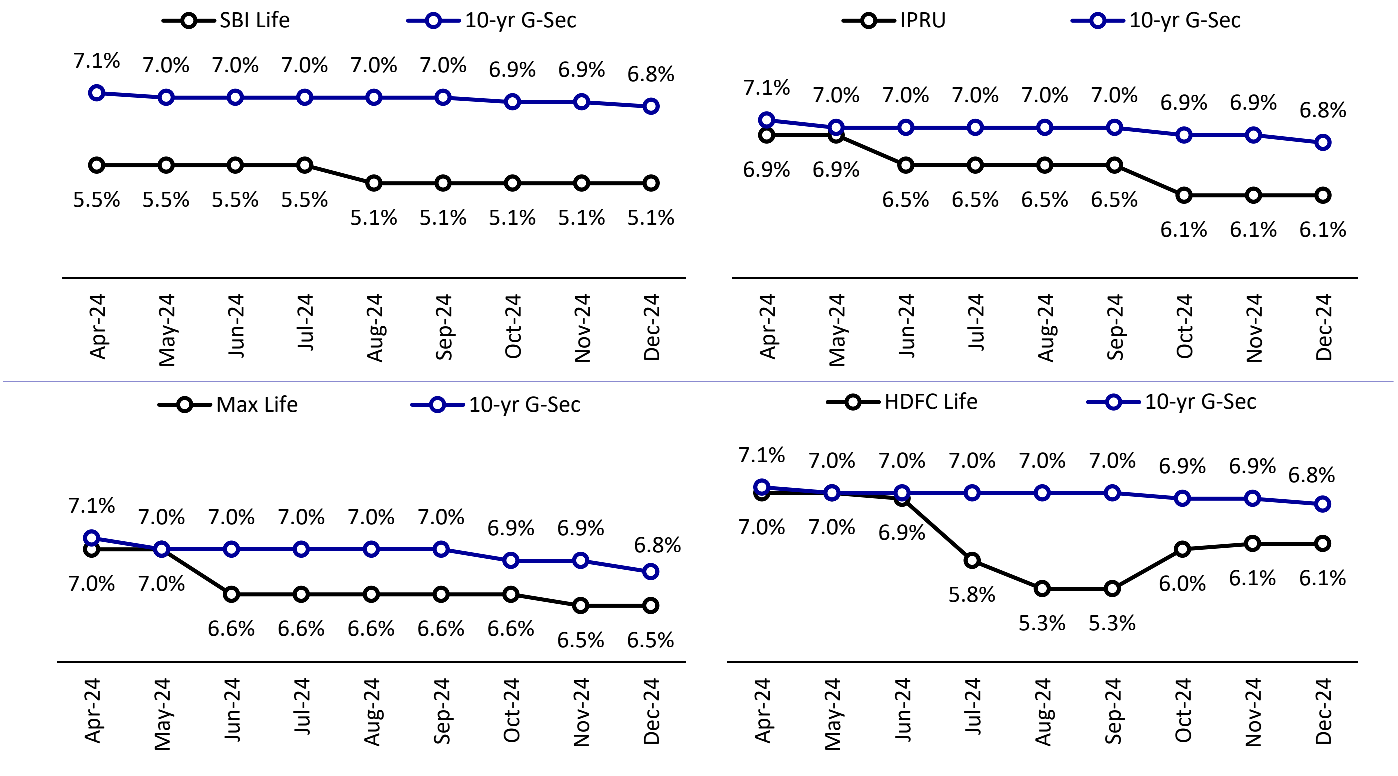
Selective adjustments to non-par IRRs

- The other way to offset the impact of surrender charges is to adjust the IRRs in the non-par segment and bonus rates in the par segment.
- Since the implementation of surrender charges, the 10-year G-Sec yield is down by about 15bp but the companies have adjusted the IRRs by 25-40bp, reflecting the passing on of some impact to customers as well.
- Bonus rates in the non-par segments are also expected to be pruned going forward.

Exhibit 1: Management commentary during 2QFY25 earnings call on surrender value regulations and commission structure changes

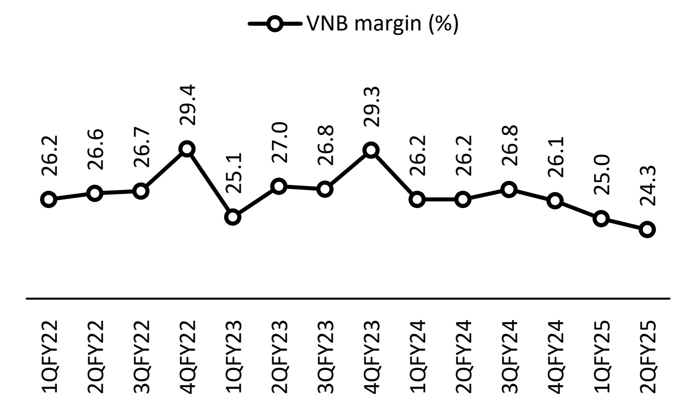
Commentary	HDFC Life	Ipru Life	SBI Life	Max Financial	LIC
❖ New surrender value regulations	❖ 100bp impact is expected on VNB margins from new surrender charges regulations. It is renegotiating with channel partners on multiple terms to reduce the impact.	❖ The company is in the discussion phase with channel partners to offset the impact of surrender value regulations through clawbacks of commission, reduction of commission in certain products, etc.	❖ VNB margin has not been affected by surrender guidelines, and the company started relaunching products from the middle of September. No change made in the commission structure due to minimal impact of new surrender guidelines as the product mix is skewed towards ULIP.	❖ The company has relaunched 98% of its products and is in the process of mitigating margins through discussions for compensation benefits. It expects a 100-200bp margin impact, the majority of which will be mitigated in the next few quarters.	❖ The company has relaunched 32 out of 54 products in the first tranche post revision in premium rates, along with design changes. Commission has been aligned to policy duration. The company is currently not implementing a clawback provision and may make a decision after seeing the experience on the new products. Rewards and benefits apart from commission can be introduced going forward to encourage business in areas with profitable customers.

Exhibit 2: IRR of non-par products has declined for players over the past few months in line with the decline in 10-yr G-Sec



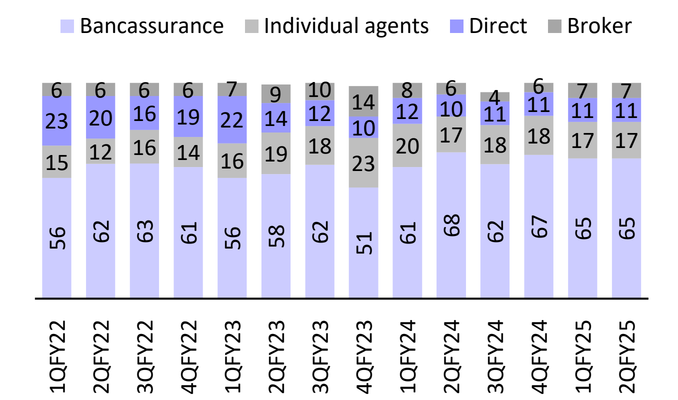
Source: Company, MOFSL

Exhibit 3: HDFC Life's VNB margin



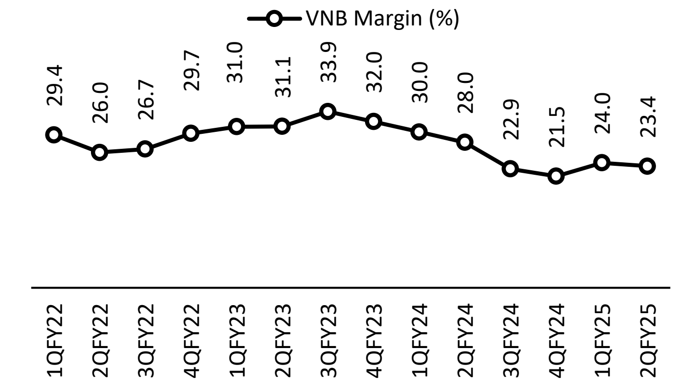
Source: Company, MOFSL

Exhibit 4: HDFC Life's distribution mix (%)



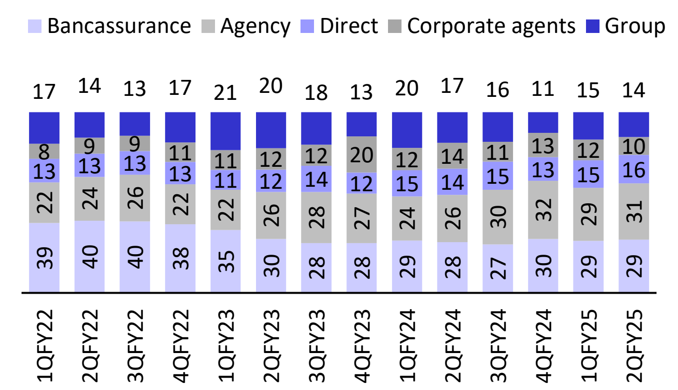
Source: Company, MOFSL

Exhibit 5: Ipru Life's VNB margin



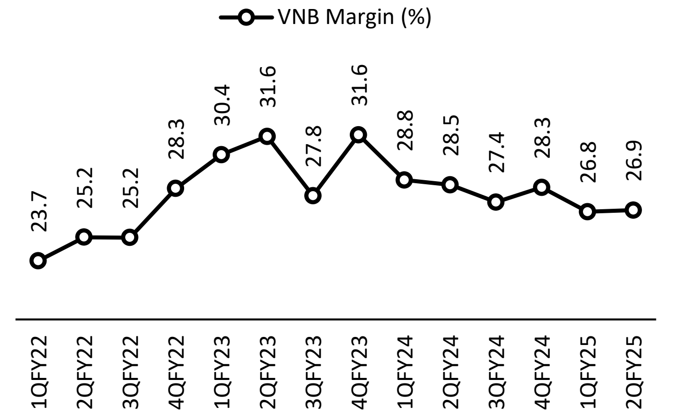
Source: Company, MOFSL

Exhibit 6: IPRU Life's distribution mix (%)



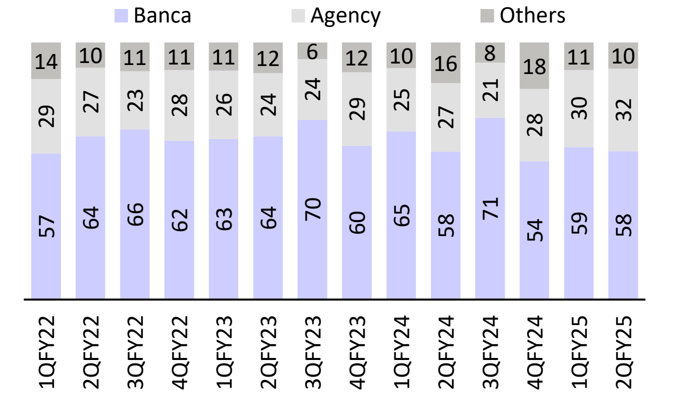
Source: Company, MOFSL

Exhibit 7: SBI Life's VNB margin



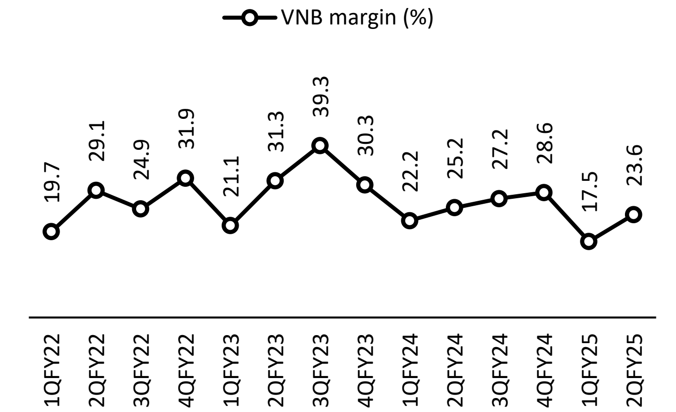
Source: Company, MOFSL

Exhibit 8: SBI Life's distribution mix (%)



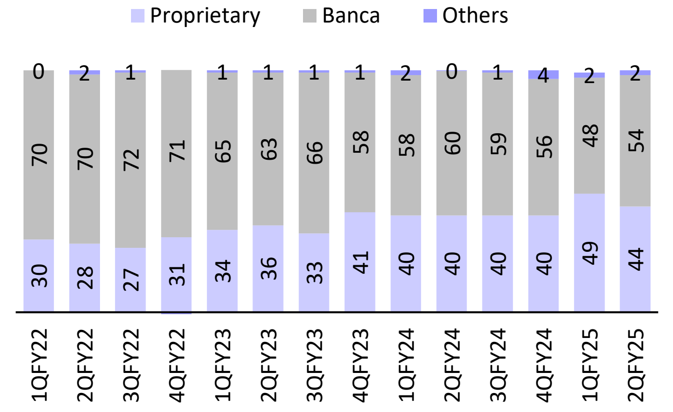
Source: Company, MOFSL

Exhibit 9: Max Financial's VNB margin



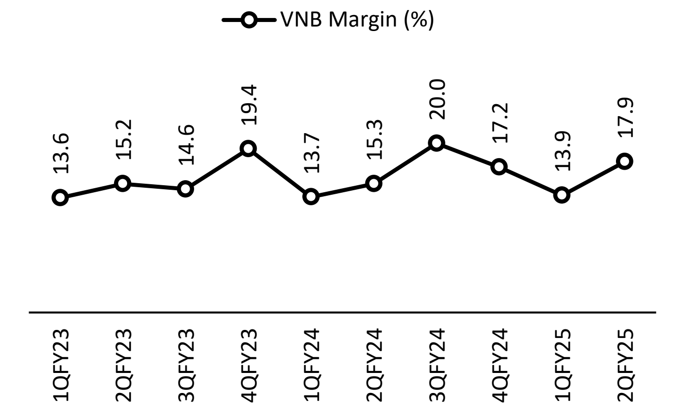
Source: Company, MOFSL

Exhibit 10: Max Financial's distribution mix (%)



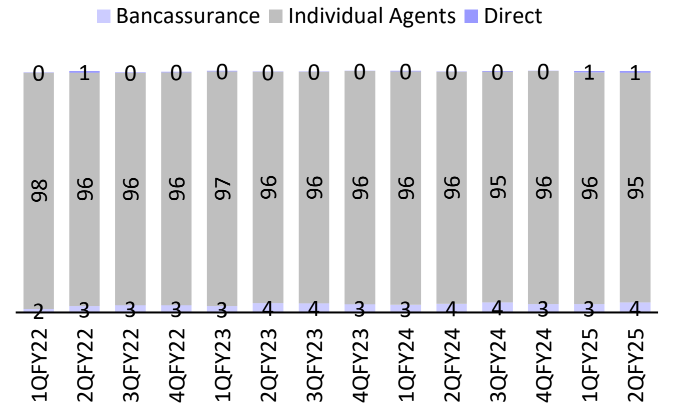
Source: Company, MOFSL

Exhibit 11: LIC's VNB margin



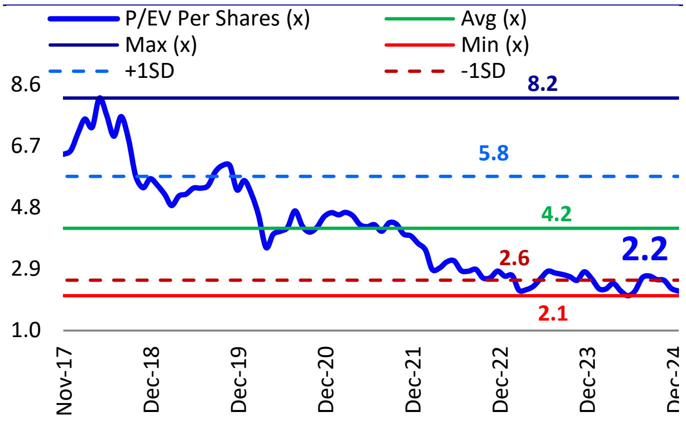
Source: Company, MOFSL

Exhibit 12: LIC's distribution mix (%)



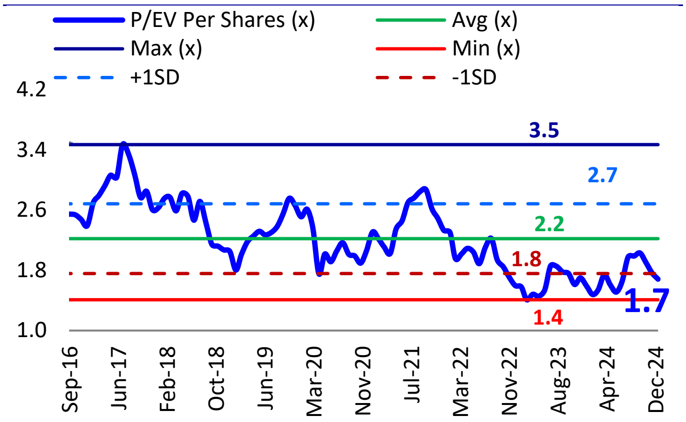
Source: Company, MOFSL

Exhibit 13: HDFC Life's P/EV Chart



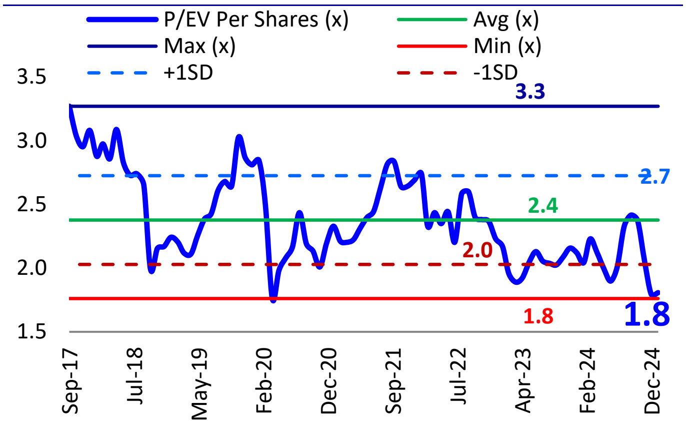
Source: Company, MOFSL

Exhibit 14: Ipru Life's P/EV Chart



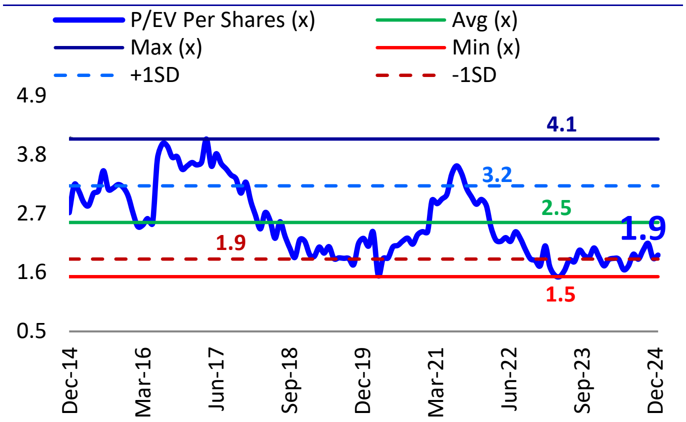
Source: Company, MOFSL

Exhibit 15: SBI Life's P/EV Chart



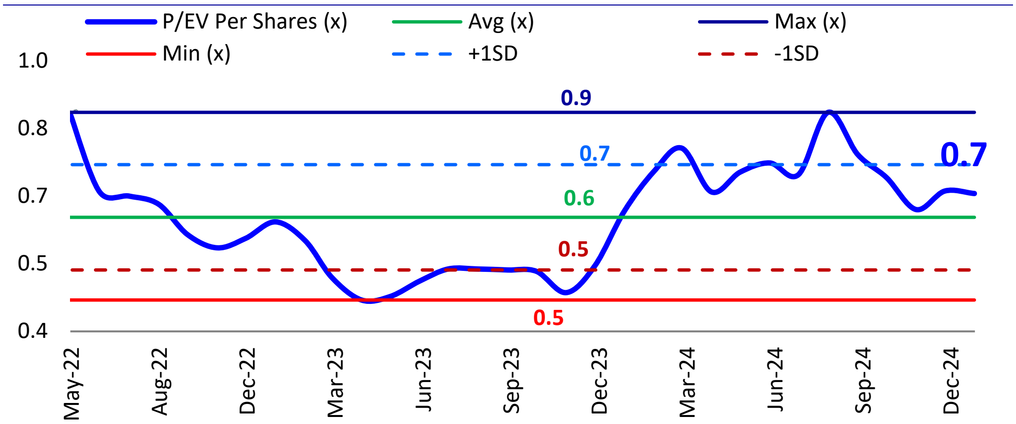
Source: Company, MOFSL

Exhibit 16: Max Financial's P/EV Chart



Source: Company, MOFSL

Exhibit 17: LIC's P/EV Chart



Source: Company, MOFSL

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