24th February 2020

Performance of Life Insurance Corporation of India – Part II (Expenses)

1) The Management Expenses of a life insurance company can be divided into two parts: Expenses in respect of agency commission and Operating Expenses. The agency commission will be directly related to premium income. Higher the premium income, higher will be the commission. In the case of single premium policies, the commission cannot exceed 2% of single premium. The commission rates under unit linked policies will generally be less than that under traditional policies. The total expenses on agency commission will therefore depend on the nature and volume of business procured by a company and will not in any way be a measure of administrative efficiency of the company. On the other hand, the operational expenses will give an indication of the administrative efficiency. The profitability of a company will also depend on the extent of control exercised on the operational expenses. **The "Employees' Remuneration & Benefits" is a part of operational expenses.**

2) Is there any restriction on the amount of expenses that a life insurance company can incur? Originally, Rule 17D of Insurance Rules, 1939, dealt with Limitation of Expenses of Management of a life insurance organisation. The "Expenses of Management" has two components, Agency Commission and Operational Expenses. This Rule came into operation from 1st January 1951. In those days, the financial year was the same as the calendar year. **A broad outline** of this Rule is given below.

3) As per this Rule, No insurer shall, in respect of the life insurance business transacted by him in India, spend as expenses of management in any calendar year an amount exceeding the aggregate sum of –

- Five percent of all premiums received during the year on policies granting an Immediate annuity or a deferred annuity in consideration of a single premium, and five percent of all premiums received on other single premium policies during the year ;
- Ten percent of all first year's premiums and four percent of all renewal premiums received during the year on policies granting deferred annuity in consideration of more than one premium ;
- One twentieth of one percent of the average of the total sums assured by policies on which no further premiums are payable (less reinsurances) at the beginning and end of the year ;
- One percent of all annuities paid during he year ;
- Ninety percent of first year's premiums ; (if the premium paying term under the policy is not more than eleven years this percentage is to be reduced to a number equal to seven and a half times the number of whole years in that period.

It is to be noted that this ceiling is for total expenses of management. That is, total agency commission paid and operational expenses put together cannot exceed the above ceiling. Limitation of expenses on commission was given in Sec.40B of the Insurance Act, 1938.

4) At the time the Insurance Act, 1938 and Insurance Rules, 1939, came into force, Group Insurance, Unit Linked Insurance and Health Insurance were not present. The LIC started developing Group Insurance business in a big way only in the Seventies. The driving force behind that was the then Chairman, Shri.T.A.Pai. Unit Linked Insurance and Health Insurance

were introduced only after the Insurance Sector was opened to Private insurers.

5) After the opening of the Insurance Sector, Rule 17D of Insurance Rules, 1939, was replaced by "Expenses of Management of Insurers transacting life insurance business Regulations, 2016". As per these Regulations, No insurer shall, in respect of the life insurance business transacted by him in India, spend as expenses of management in any financial year an amount exceeding the aggregate sum of—

(i) Five percent of all single premiums received during the year on policies granting:

a. An immediate annuity; or

b. A deferred annuity;

(ii) Five per cent of all premiums received on other single premium policies during the year excluding:

a. Group fund based policies;

b. Individual Pure Risk policies;

c. Group Pure Risk policies; and

d. Policies covered under clause (i) above;

(iii) Ten percent of all single premiums received during the year on Group Pure Risk policies;

(iv) Ten percent of all single premiums received during the year on Individual pure risk policies;

(v) Fifteen percent of all premiums received on One year renewable group policies, other than group fund based policies.

(vi) **Group Fund based policies:** Allowance shall be based on the average of Assets under Management of Group Fund based policies at the beginning and at the end of the financial year as under:

Up to Rs. 10,000 crore 1 percent

In excess of Rs. 10,000 crore 0.80 percent

(Note: In the public domain "Assets Under Management" of Group Fund Based policies is not available directly. Even in the case of premium income under Group policies, the classification will be either,

Group Single Premium, Group Non-Single Premium, Group Yearly Renewal Premium or Group Insurance Premium, Group Superannuation Premium;

So, the Maximum Permissible Expenses under Group Schemes can be arrived at only by very approximate methods)

(vii) Ten per cent of all first year's premiums and four per cent of all renewal premiums, received during the year on policies granting deferred annuity in consideration of more than one premium;

(viii) One half of one per cent of all annuities paid during the year;

(ix) one-twentieth of one per cent of the average of the total sums assured of paid up policies on which no further premiums are payable at the beginning and end of the year;

(x) One-hundredth of one per cent of the total sums assured of lapsed policies under the revival period at the beginning of the year;

(In the case of items ix and x, no data will be available in the public domain. One twentieth of one percent is 0.0005 and One hundredth of one percent means 0.0001. These amounts will be quite small and can be ignored)

(xi) In the case of regular premiums pure risk business, with premium paying term not less than 10 years, 100% of first year premium and 40% of renewal premiums. Where the premium paying term is less than ten years, the percentage to be applied to first year's premium is to be reduced to a number equal to seven and half times the number of whole years in that period.

(xii) An amount computed on the basis of the percentages for the time being appropriate to the duration of the insurer's life insurance business specified. The allowance shall be on the basis of the percentage of premium received other than premiums referred to in clause (i) to (xi) during the year, as specified in Part-B of Schedule-I (as per this schedule, assuming that the duration of insurer's life insurance business is more than 10 years,

Premium paying term 5,6,7 years	60% of first year's and 15% of renewal premiums
Premium paying term 8 or 9 years	70% of first year's and 15% of renewal premiums
Premium paying term greater than 9 years	80% of first year's and 15% of renewal premiums

Note : Group insurance business with Regular Premium plans with limited premium payment term and/or pre-determined policy term shall be treated as regular business with due classification into first year premium and renewal premium. Plans other than those mentioned above shall be treated as Single Premium plans.

6) The above mentioned limitations are based on the provision made for expenses in the determination of premium rates under various Plans and Schemes. The parameters used for determining premium rates are, Interest rate, Commission and Operating Expenses and Rates of Risk. If the actual yield on investments is less than the rate of interest assumed or, if the actual expenses are higher than those assumed or, if the actual rates of risk are higher than the rates assumed, the Insurance Company will start incurring losses. With the margin between the actual yield on investments and the assumed rates continuously decreasing, it has become very important to ensure that the actual Management Expenses do not exceed the assumed expenses. So, the Regulator has to

continuously monitor the Ratio of (Actual Expenses incurred) and (Maximum Expense that can be incurred as per the portfolio of policies held by the insurer) and ensure that sufficient margin is maintained. In my opinion, in the present scenario of falling interest rates the value of this ratio should not exceed 80%.

7) One thing may be noticed. Nothing is said about Unit linked portfolio. ***It can therefore be assumed that, the ceiling on expenses in the case of Linked policies will be the same as that under Non-Linked policies.*** However, vide circular No. **IRDA**/ACT/CIR/ULIP/**102/06/2010 dated 28th June 2010, it is stated that, "Hence to encourage long term business and enable policyholders to earn additional returns thereby and taking into account the product features and the current cost structure, it is mandated that the cap on charges will be based on the difference between the gross and net yields of any product. The net yield is the gross yield adjusted for all charges. For insurance products which are of a tenor of less than or equal to 10 years duration, the difference between gross and net yields shall not exceed 300 basis points, of which fund management charge shall not exceed 150 basis points. For other contracts, i.e. those whose contract period is above 10 years, the difference between gross and net yields shall not exceed 225 basis points, of which the fund management charges shall not exceed 125 basis points.**

This is an additional condition. But, it is not possible to incorporate the above condition while determining Maximum Permissible Expense. So, unit linked policies are treated in the same way as non-linked policies (see condition xii above).

In the case of LIC of India however, a peculiar situation arises. LIC is virtually not doing any new business under unit linked insurance and is, at present, only receiving some renewal premiums. But, it has got some significant amount of fund pertaining to policies sold earlier. So, in the case of LIC, 5% of renewal premium plus 1.25% of the linked fund has been taken for Maximum Permissible expenses.

8) Generally, three kinds of deductions are made in the case of unit linked policies.

a) Agency commission: As and when a premium is received, commission at the appropriate rate will be deducted from the amount received. The balance amount will be divided by the Net Asset Value (NAV) at the time the premium is received, giving the number of units (generally to four decimal places) to be credited to the policy. The commission rate may differ from company to company.

b) Per policy expenses for servicing the policy. First year expense will be much higher than the expenses for the second and subsequent years. At the beginning of each month, corresponding to the per policy expense for the month, appropriate number of units will be cancelled for recovering the expense for the month. The assumptions regarding per policy expense will also differ from company to company.

c) Fund Management Charges: This can be taken as 1.25% of the fund per year or (1.25% /12) per month or (1.25% / 365) per day.

d) Besides the above three deductions, one more deduction has to be made, for recovering the charges for providing risk cover. This will generally be made at the beginning of each month.

9) The operational expense of each company has to be obtained from the Public Disclosure of that company. For each company, the link to the public disclosure is given in the IRDAI's website. For HDFC Standard Life and ICICI Prudential, I could get the required information through this link. In the case of LIC of India, there appears to be some defect in the Link given. But, the public disclosure could be accessed by entering **"LIC**

Public Disclosure" in Google Search. In the case of SBI Life, neither the Link nor the Google Search worked. So, while comparing operational expenses, I replaced SBI Life by Max Life. Why Max Life? One may ask. While HDFC, ICICI and LIC have their headquarters in Mumbai, I wanted to choose a company from another part of the country and so, chose a company with headquarters in Delhi. Let us first take up the case of LIC of India.

10) In the case of LIC, if we enter "LIC Public Disclosure and choose the year as March 2019, data for the full year 2018 – 19 will become available. First choose "L-1 Revenue Account". It gives the premium income, but gives only total premium income and does not give first year premium, single premium and renewal premium separately. Next try, "L-4 Premium schedule". This gives first year, single and renewal premiums separately; But does not give premium income under Assurances, Pension/Annuity, Group and Linked business separately. So, I have taken the data for LIC from its Annual Report, and it is easier to read the printed material than reading the display screen of the P.C Monitor.

11) In the Annual Report as at 31st March 2019, in pages 120 to 122, Summarised Results are given. These are copied in TABLE – 1A. Under Individual Pension Schemes, "Consideration for Annuities Granted" has been omitted since the premium income is negligible. (But, it is added to Total Premium Income in TABLE-8, towards the end). All the amounts in TABLE – 1A, are in millions. In the Annual Report, some amounts are in crores, some in Lakhs and some in thousands. The item "Annuities Paid" has been taken from "Schedule 4, Benefits Paid" in Page 210.

TABLE – 1A

LIC of India Data Extracted from Annual Reports

All amounts are in Rs.Million

	Items	2016 - 17	2017 - 18	2018 – 19
a	First Year Premium	221,761	250,984	265,870
b	Single Premium and Consideration for annuities	234,979	266,551	244,705
c	Renewal	1,667,297	1,752,695	1,865,051
d	Individual Pension First Year Premium	436	299	222
e	Individual Pension Renewal Premium	7,486	7,127	6,767
f	Group Insurance Premium	281,923	310,103	422,156
g	Group Superannuation Premium	577,884	581,815	558,987
h	Linked business	10,005	8,771	8,008
i	Annuities paid	68,827	87,645	109,143
j	Average Fund under Group Fund based policies	2,078,814	2,541,066	2,882,951
k	Linked Fund	605,123	509,203	416,080

The Annual Report for March 2019 contains also the data for March 2018. The Annual Report for March 2018 contains the data for March 2018 and March 2017. So, the data for March 2017 can be taken from the Annual Report of March 2018.

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12) From the above data, let us estimate the Maximum expense that can be incurred by LIC. The data available in the public domain, as given in TABLE – 1A, is not sufficient to make this estimate and so, only a very rough estimate could be made.

13) Non-linked Business

a) 80% of first year's premium (assuming that the premium paying term is always greater than 9 years and that none of the policies are pure term assurance policies)

80% of Rs.221,761 million = 177,409 m
80% of Rs.250,984 million = 200.787 m
80% of Rs.265,870 million = 212,696 m

b) 5% of single premium
5% of Rs.234,979 million = 11,749 m
5% of Rs.266,551 million = 13,328 m
5% of Rs.244,705 million = 12,235 m

c) 15% of Renewal premium
15% of Rs.1,667,297 million = 250,095 m
15% of Rs.1,752,695 million = 262,904 m
15% of Rs.1,865,051 million = 279,758 m

d) Individual pension (on the assumption that these are deferred annuities)

10% of fist year premium and 4% of renewal premium
10% of Rs.436 million = 44 million
10 % of Rs.299 million = 30 million
10% of Rs.222 million = 22 million

4% of Rs.7,488 m = 299 m
4% of Rs.7,127 m = 285 m
4% of Rs.6,787 m = 271 m

e) Group Insurance
10% of Group Insurance premium
10% of Rs.281,923 m = Rs.28,192 m
10% of Rs.310,103 m = 31,010 m
10% of Rs.422,156 m = 42,216 m

f) Group Superannuation

In the case of Group Superannuation premium, ***provision for expenses is based only on Assets under Management and the premium income is not to be considered.*** But the AUM is not directly available in the Annual Report. The Consideration for Annuities, given under Business in Force (Group), given in Page 129 of Annual Report, March 2019, and Page 107 of the Annual Report of March 2018 have been taken as the AUM. In

each Annual Report, Consideration for Annuities for three years is given. These are,

Year	Consideration for Annuities (Millions)	Average AUM (Millions)
2015 – 2016	Rs.1,841,994	
2016 – 2017	Rs.2,315,634	Rs.2,078,814
2017 – 2018	Rs.2,766,497	Rs.2,541,066
2018 – 2019	Rs.2,999,405	Rs.2,882,951

The average AUM arrived at here is only an approximation.

The Maximum Permissible Expense is,

1% of first Rs.100,000 million + 0.8% of the balance AUM
1% of Rs.100,000 m + 0.8% of Rs.1,978,814m = 16,831 m
1% of Rs.100,000 m + 0.8% of Rs.2,441,066m = 20,529 m
1% of Rs.100,000 m + 0.8% of Rs.2,782,951m = 23,264 m

14) Linked Business

g) All the premiums are taken only as renewal premium. The Maximum amount available for expense will be, 15% of premium income PLUS 1.25% of the Unit Lined Fund. The value of this Fund has been taken from the Balance Sheet.
5% of Rs.10,005 m + 1.25% of Rs.605,123 m = 8,065 m
5% of Rs.8,771 m + 1.25% of 509,203 m = 6,804 m
5% of Rs.8,008 m + 1.25% of 416,080 m = 5,601 m

15) Annuities paid

h) The maximum available for expense will be 0.5% of annuities paid. The amount of annuities paid will be available under “Benefits Paid” in the Schedules under Revenue Account.
0.5% of 88,827 m = 444 m
0.5% of 87,645 m = 438 m
0.5% of 109,143 m = 546 m

16) Management Expense

i) Management Expense = Commission Paid + Operating Expenses

These are available in the Revenue Account given in the Annual Report.

In the Annual Report for March 2019, figures for both 2018 – 2019 and

2017 – 2018 are available. In the Annual Report for March 2018, figures for both 2017 – 2018 and 2016 – 2017 are available

2016 – 2017 165,901 m + 289,447 m = Rs.455,348 million

2017 – 2018 182,268 m + 301,424 m = Rs.483,692 million

2018 – 2019 193,112 m + 291,820 m = Rs.484,932 million

These values are copied in TABLE – 1B

"Employees' Remuneration and Benefits" is a part of Operating Expenses. Its value was,

In 2015 – 2016 Rs.146,593 million
In 2016 – 2017 Rs.206,294 million
In 2017 – 2018 Rs.210,820 million
In 2018 – 2019 Rs.198,719 million

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17) In TABLE – 1B, the Rows (a) to (i) give the Maximum Expense Permissible under each item. Row (j) gives the Total maximum Expense Permissible. Row (k) gives the Actual Management Expense. Row (l) gives the ratio of the Actual Expenses to Maximum Permissible Expenses. This ratio was 92.3% for the year 2016 – 2017 and was very high. It came down to 90.1% for the year 2017 – 2018. In the year 2018 – 2019, the ratio has come down to a comfortable level of 84.1%.

In the year 2016 – 2017, the ratio rose to 92.3% due mainly to a steep increase in "Employee Remuneration and Other Benefits", which is a component of "Operating Expenses", from Rs.146,593 million to Rs.206,294 million. In the year 2018 – 2019, the ratio decreased to 84.1% due mainly to decrease in "Employee Remuneration & Other Benefits" from Rs.210,820 million to Rs.198,719 million. The increase in 2016 – 2017 may be due to wage revision and payment of arrears. The reason for the decrease in 2018 – 19 is not known.

TABLE – 1B
Maximum Permissible Expense

LIC of India **All amounts are in Rs.Million**

	Maximum Expense Permissible in respect of	2016 – 17	2017 – 18	2018 – 19
a	First Year Premium	177,409	200,787	212,896
b	Single Premium and Consideration for annuities	11,749	13,328	12,235
c	Renewal	250,095	262,904	279,758
d	Individual Pension First Year Premium	44	30	22
e	Individual Pension Renewal Premium	299	285	271
f	Group Insurance Premium	28,192	31,010	42,216
g	Group Superannuation Premium	16,831	20,529	23,264
h	Linked business	8,065	6,804	5,601
i	Annuities paid	444	438	546
j	**Total Maximum Expense Permissible**	**493,128**	**536,115**	**576,809**
k	Actual Management Expense	455,348	483.692	484,932
l	**Actual / Maximum Permissible**	**92.3%**	**90.0%**	**84.1%**

Private Insurers

18) Let us next take up the case of private insurers. Since Annual Reports of these companies are not available, we have to depend only on public disclosures. In the Public Disclosure of HDFC, Individual and Group Premiums have been combined together and not given separately. The public disclosure statement of ICICI gives more information, but does not give group premium separately. The public disclosure statement of Max Life gives group premium separately. In order to adopt the same method for all three companies, I divided the premium into two major groups, Non-Linked and Linked and, each of these groups into three sub-groups, First year Premium, Single Premium and Renewal Premium.

19) In the case of Group Superannuation schemes, Maximum Permissible ***Expense is based only on Assets under Management and the premium income is not to be considered.*** Since premium incomes under individual and group policies are not given separately, premiums received under Group Fund Based Schemes have also got included under Non-Linked premium under Individual policies. ***This over estimates the Maximum Permissible Expenses.***

20) The AUM is also not directly available in the Disclosure Statements. The private insurers are concentrating mainly on Linked business and are not paying much attention to Group business since the profit margin under Group business is quite small. So, the mean fund under fund based Group Schemes cannot be high. Let us take it as Rs.50,000 million. The maximum permissible expense is 1% of mean fund and will be equal to Rs.500 million. We can take the same amount for all the three years for all the three companies.

21) The "Annuities Paid" is available in the Benefits Paid Schedule under the Revenue Account. The value of Linked Fund can be taken from the Balance Sheet.

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22) Let us begin with HDFC – Standard Life. The data extracted from Public Disclosure Statement is given in TABLE – 2A.

TABLE – 2A HDFC Standard Life

All amounts are in Rs.Million

		2016 – 17	2017 - 18	2018 – 19
a	First Year Premium	16,731	20,166	23,017
b	Single Premium and Consideration for annuities	39,587	54,379	89,786
c	Renewal	47,256	58,408	65,840
d	Linked First Year Premium	18,997	27,197	27,563
e	Linked Single Premium and Consideration for annuities	11,648	11,739	9,347
f	Linked Renewal	60,236	63,742	76,306
g	Annuities paid	640	837	1,632
h	Linked Fund	508,065	545,982	605,213

23) TABLE – 2B gives the maximum permissible expense in respect of each item. In respect of Non-Linked items, the Maximum Permissible Expense has been taken as,

- 80% of First Year Premium,
- 5% of Single Premium and
- 15% of Renewal Premium

Since premium incomes under individual and group policies are not given separately, the same percentages get applied also in the case of group policies. This will over estimate the Maximum Permissible Expense. The working is shown below.

24) Non-Linked

a) 80% of first year's premium (assuming that the premium paying term is always greater than 9 years and that none of the policies are pure term assurance policies)

80% of Rs.16,731 million = 13,385 m

80% of Rs.20,166 million = 16,133 m

80% of Rs.23,017 million = 18,414 m

b) 5% of single premium

5% of Rs.39,587 million = 1,979 m

5% of Rs.54,379 million = 2,719 m

5% of Rs.89,788 million = 4,489 m

c) 15% of Renewal premium

15% of Rs.47,256 million = 7,088 m

15% of Rs.58,408 million = 8,761 m

15% of Rs.65,840 million = 9,876 m

25) Fund based Schemes

In the case of Group Superannuation premium, ***provision for expenses is based only on Assets under Management and the premium income is not to be considered.*** Since premium incomes under individual and group policies are not given separately, premiums received under Group Fund Based Schemes have also got included under Non-Linked premium under Individual policies. This over estimates the Maximum Permissible Expenses. The AUM is also not directly available in the Disclosure Statements. So, as mentioned in paragraph (20) the maximum permissible expense has been taken as Rs.500 million for all the three years. This is in addition to the maximum permissible expense based on premium income under fund based schemes.

26) Linked

a) 80% of first year premium

80% of Rs.18,997 million = 15,198 m

80% of Rs.27,197 million = 21,758 m

80% of Rs.27,563 million = 22,050 m

b) 5% of Single premium

5% of Rs.11,648 million = 582 m

5% of Rs. 11,739 million = 587 m

5% of Rs.9,347 million = 467 m

c) 15% of Renewal premium

15% of Rs.60,236 million = 9,035 m

15% of Rs.63,742 million = 9,561 m

15% of Rs.76,306 million = 11,446 m

27) Annuities paid

The maximum available for expense will be 0.5% of annuities paid. The amount of annuities paid will be available under “Benefits Paid” in the Schedules under Revenue Account.

0.5% of Rs.647 m = 3 m

0.5% of Rs.837 m = 4 m

0.5% of Rs.1,632 m = 8 m

28) Management Expense

i) Management Expense = Commission Paid + Operating Expenses

Commission Expense is given in Schedule L5 and Operating Expense is given in Schedule L6 under the Revenue Account. These can be taken from the Public Disclosure. In the Public Disclosure for March 2019, figures for both 2018 – 2019 and 2017 – 2018 are available. In the Public Disclosure for March 2018, figures for both 2017 – 2018 and 2016 – 2017 are available

2016 – 2017 7,920 m + 23,853 m = Rs.31,773 million

2017 – 2018 10,749 m + 31,593 m = Rs.42,342 million

2018 – 2019 11,177 m + 38,136 m = Rs.49,313 million

The “Employees’ Remuneration and Benefits” is a part of Operating Expenses and its values for the three years are,

2016 – 2017 Rs.11,042 million

2017 – 2018 Rs.12,918 million

2018 – 2019 Rs.14,082 million

These values have been copied in TABLE – 2B

TABLE – 2B
Maximum Permissible Expense

HDFC **All amounts are in Rs.Million**

		2016 – 17	2017 – 18	2018 – 19
.a	First Year Premium	13,385	16,133	18,414
.b	Single Premium and Consideration for annuities	1,979	2,719	4,489
.c	Renewal	7,088	8,761	9,876
.d	Fund based Schemes	500	500	500
.e	Linked First Year Premium	15,198	21,758	22,050
.f	Linked Single Premium and Consideration for annuities	582	587	467
.g	Linked Renewal	9,035	9,561	11,446
.h	Annuities paid	3	4	8
.i	**Total Maximum Expense Permissible**	**47,770**	**60,023**	**67,250**
.j	Actual Management Expense	31,773	42,342	49,311
.k	**Actual / Maximum Permissible**	**66.5%**	**70.5%**	**73.3%**

29) In TABLE – 2B, the Rows (a) to (h) give the Maximum Expense Permissible under each item. Row (i) gives the Total maximum Expense Permissible. Row (j) gives the Actual Management Expense. Row (k) gives the ratio of the Actual Expenses to Maximum Permissible Expenses. This ratio was 66.5% for the year 2016 – 2017, 70.5% in 2017 – 2018 and 73.3% in 2018 – 2019 and is consistently below 80%. However, the increasing trend in the ratio is not a good sign.

ICICI - Prudential

30) Let us next consider ICICI Prudential. The data given in TABLE – 3A has been taken from the Public Disclosure Statements.

TABLE – 3A ICICI Prudential

All amounts are in Rs.Million

		2016 – 17	2017 – 18	2018 – 19
a	First Year Premium	6,429	10,690	10,667
b	Single Premium and Consideration for annuities	5,938	11,095	24,938
c	Renewal	40,753	45,027	46,212
d	Linked First Year Premium	57,017	62,872	59,118
e	Linked Single Premium and Consideration for annuities	9,248	7,461	8,921
f	Linked Renewal	104,154	133,543	159,443
g	Annuities paid	1,390	1,822	1,769
h	Linked Fund	839,365	923,124	1,036,999

31) TABLE – 3B gives the maximum permissible expense in respect of each item. In respect of Non-Linked items, the Maximum Permissible Expense has been taken as,

- 80% of First Year Premium,
- 5% of Single Premium and
- 15% of Renewal Premium

Since Individual and Group premiums have been combined together in the data, the same percentages get applied also to Group premiums, including Group Fund based schemes. ***This results in over estimation of Maximum Permissible Expense.***

The working of Maximum Permissible Expense is shown below.

32) Non-Linked

a) 80% of first year's premium (assuming that the premium paying term is always greater than 9 years and that none of the policies are pure term assurance policies)

80% of Rs.6,429 million = 5,143 m

80% of Rs.10,690 million = 8,552 m

80% of Rs.10,667 million = 8,534 m

b) 5% of single premium

5% of Rs.5,938 million = 297 m

5% of Rs.11,095 million = 555 m

5% of Rs.24,938 million = 1,247 m

c) 15% of Renewal premium

15% of Rs.40,753 million = 6,113 m

15% of Rs.45,027 million = 6,754 m

15% of Rs.46,212 million = 6,932 m

33) Fund based Schemes

d) In the case of Group Superannuation premium, ***provision for expenses is based only on Assets under Management and the premium income is not to be considered.*** Since premium incomes under individual and group policies are not given separately, premiums received under Group Fund Based Schemes have also got included under Non-Linked premium under Individual policies. This over estimates the Maximum Permissible Expenses. The AUM is also not directly available in the Disclosure Statements. The private insurers are concentrating mainly on Linked business and are not paying much attention to Group business since the profit margin under Group business is quite small. So, the mean fund

under fund based Group Schemes cannot be high. Let us take it as Rs.50,000 million. The maximum permissible expense is 1% of mean fund and will be equal to Rs.500 million. We can take the same amount for all the three years..

34) Linked

a) 80% of first year premium

80% of Rs.57,017 million = 45,614 m

80% of Rs.62,872 million = 50,298 m

80% of Rs.59,118 million = 47,294 m

b) 5% of Single premium

5% of Rs.9,248 million = 462 m

5% of Rs. 7,461 million = 373 m

5% of Rs.8,921 million = 446 m

c) 15% of Renewal premium

15% of Rs.104,154 million = 15,623 m

15% of Rs.133,543 million = 20,031 m

15% of Rs.159,443 million = 23,916 m

35) Annuities paid

The maximum available for expense will be 0.5% of annuities paid. The amount of annuities paid will be available under “Benefits Paid” in the Schedules under Revenue Account.

0.5% of Rs.1,390 m = 7 m

0.5% of Rs.1,822 m = 9 m

0.5% of Rs.1,789 m = 9 m

36) Management Expense

i) Management Expense = Commission Paid + Operating Expenses

Commission Expense is given in Schedule L5 and Operating Expense is given in Schedule L6 under the Revenue Account. These can be taken from the Public Disclosure. In the Public Disclosure for March 2019, figures for both 2018 – 2019 and 2017 – 2018 are available. In the Public Disclosure for March 2018, figures for both 2017 – 2018 and 2016 – 2017 are available

2016 – 2017 7,589 m + 23,572 m = Rs.31,161 million

2017 – 2018 14,033 m + 20,299 m = Rs.34,332 million

2018 – 2019 15,513 m + 28,053 m = Rs.43,566 million

These values are copied in TABLE – 1B.

Emp. Remuneration for the three years: 8,036 9,653 9,731
This is a part of Operating Expenses

TABLE – 3B

ICICI **All amounts are in Rs.Million**

		2016 – 17	2017 – 18	2018 – 19
.a	First Year Premium	5,143	8,552	8,534
.b	Single Premium and Consideration for annuities	297	555	1,247
.c	Renewal	6,113	6,754	6,932
.d	Fund based schemes	500	500	500
.e	Linked First Year Premium	45,614	50,298	47,294
.f	Linked Single Premium and Consideration for annuities	462	373	446
.g	Linked Renewal	15,623	20,031	23,916
.h	Annuities paid	7	9	9
.i	**Total Maximum Expense Permissible**	**73,759**	**87,072**	**88,878**
.j	Actual Management Expense	31,161	34,332	43,566
.k	**Actual / Maximum Permissible**	**42.2%**	**39.4%**	**49.0%**

37) In TABLE – 3B, the Rows (a) to (h) give the Maximum Expense Permissible under each item. Row (i) gives the Total maximum Expense Permissible. Row (j) gives the Actual Management Expense. Row (k) gives the ratio of the Actual Expenses to Maximum Permissible Expenses. This ratio was 42.2% for the year 2016 – 2017. It has come down to 39.4% for the year 2017 – 2018 and increased to 49.0% in 2018 – 2019 and is consistently below 50%. The increase in 2018 – 19 is due to sharp increase in Management expenses in that year.

Let us next take up Max Life.

TABLE – 4A

Max Life **All amounts are in Rs.Million**

		2016 – 17	2017 – 18	2018 – 19
.a	First Year Premium	17,838	18,286	21,861
.b	Single Premium and Consideration for annuities	9,871	10,987	12,259
.c	Renewal	53,205	60,111	65,380
.d	Linked First Year Premium	8,627	13,629	16,870
.e	Linked Single Premium and Consideration for annuities	328	584	614
.f	Linked Renewal	17,936	21,412	28,769
.g	Annuities paid	45	68	73
.h	Linked Fund	152,204	163,050	186,738

38) TABLE – 4B gives the maximum permissible expense in respect of each item. In respect of Non-Linked items, the Maximum Permissible Expense has been taken as,

- 80% of First Year Premium,
- 5% of Single Premium and
- 15% of Renewal Premium

Since premium incomes under individual and group policies are not given separately, 80%, 5% and 15% respectively of first year, single and

renewal premium income under group policies too have been included in the Maximum permissible expense. This will over estimate the Maximum Permissible Expense.

The working of Maximum Permissible Expense is shown below.

39) Non-Linked

a) 80% of first year's premium (assuming that the premium paying term is always greater than 9 years and that none of the policies are pure term assurance policies)

80% of Rs.17,838 million = 14,270 m

80% of Rs.18,286 million = 14,629 m

80% of Rs.21,861 million = 17,489 m

b) 5% of single premium

5% of Rs.9,871 million = 494 m

5% of Rs.10,987 million = 549 m

5% of Rs.12,259 million = 613 m

c) 15% of Renewal premium

15% of Rs.53,205 million = 7,981 m

15% of Rs.60,111 million = 9,017 m

15% of Rs.65,380 million = 9,807 m

40) Since Individual and Group premiums have been combined together in the data, the same percentages get applied also to Group premiums. ***This results in over estimation of Maximum Permissible Expense.***

41) Fund based Schemes

The mean fund under the fund based group schemes is not available in the public domain. The mean fund under fund based Group Schemes

cannot be high. Let us take it as Rs.50,000 million. The maximum permissible expense is 1% of mean fund and will be equal to Rs.500 million. We can take the same amount for all the three years..

42) Linked

a) 80% of first year premium

80% of Rs.8,627 million = 6,902 m

80% of Rs.13,629 million = 10,903 m

80% of Rs.16,870 million = 15,096 m

b) 5% of Single premium

5% of Rs.328 million = 16 m

5% of Rs. 584 million = 29 m

5% of Rs.614 million = 32 m

c)15% of Renewal premium

15% of Rs.17,936 million = 2,690 m

15% of Rs.21,412 million = 3,212 m

15% of Rs.28,769 million = 4,315 m

43) Annuities paid

The maximum available for expense will be 0.5% of annuities paid. The amount of annuities paid will be available under “Benefits Paid” in the Schedules under Revenue Account.

0.5% of Rs.45 m

0.5% of Rs.68 m

0.5% of Rs.73 m

These can be ignored

44) Management Expense

i) Management Expense = Commission Paid + Operating Expenses

Commission Expense is given in Schedule L5 and Operating Expense is given in Schedule L6 under the Revenue Account. These can be taken from the Public Disclosure. In the Public Disclosure for March 2019, figures for both 2018 – 2019 and 2017 – 2018 are available. In the Public Disclosure for March 2018, figures for both 2017 – 2018 and 2016 – 2017 are available

Emp. Remuneration 8,023 7,543 8,435

2016 – 2017 7,589 m + 15,912 m = Rs.23,501 million

2017 – 2018 8,929 m + 16,099 m = Rs.25,028 million

2018 – 2019 9,888 m + 19,274 m = Rs.29,162 million

These values are copied in TABLE – 4B

TABLE – 4B

Max Life **All amounts are in Rs.Million**

		2016 – 17	2017 – 18	2018 – 19
.a	First Year Premium	14,270	14,629	17,489
.b	Single Premium and Consideration for annuities	494	549	613
.c	Renewal	7,981	9,017	9,807
.d	Fund based schemes	500	500	500
.e	Linked First Year Premium	6,902	10,903	15,096
.f	Linked Single Premium and Consideration for annuities	16	29	32
.g	Linked Renewal	2,690	3,212	4,315
.h	Annuities paid	--	--	--
.i	**Total Maximum Expense Permissible**	**32,853**	**38,839**	**47,854**
.j	Actual Management Expense	23,501	25,028	29,162
.k	**Actual / Maximum Permissible**	**71.5%**	**64.4%**	**60.9%**

45) In TABLE – 4B, the Rows (a) to (h) give the Maximum Expense Permissible under each item. Row (i) gives the Total maximum Expense Permissible. Row (j) gives the Actual Management Expense. Row (k) gives the ratio of the Actual Expenses to Maximum Permissible Expenses. This ratio was 71.5% for the year 2016 – 2017. It has come down to 64.4% for the year 2017 – 2018 and further came down to 60.9% in 2018 – 2019. Its business performance is steadily increasing and the ratio of Actual Management Expenses to Maximum Permissible Expenses is continuously decreasing.

46) TABLE – 5 below gives the ratio of Actual to Maximum Permissible Expenses for the four companies for the three years. This Ratio is the highest in the case of LIC of India. But, it appears to be coming down. The performance of ICICI stands out.

TABLE - 5

Ratio of Actual Expenses to Maximum Permissible Expenses

	Company	2016 - 17	2017 - 18	2018 - 19
1	**HDFC Standard Life**	66.5%	70.5%	73.3%
2	**ICICI Prudential**	**42.2%**	**39.4%**	**49.0%**
3	**Max Life**	71.5%	64.4%	60.9%
4	**LIC of India**	92.3%	90.0%	84.1%

TABLE - 6

Growth Rate of First Year Premium, including Single Premium (Linked and Non-Linked)

All Amounts in (Rs.million)

	Company	2016 - 17	2017 - 18	2018 - 19
	HDFC Standard Life	86,963	113,483 30.5%	149,715 31.9%
	ICICI Prudential	64,232	92,138 43.4%	103,644 12.5%
	Max Life	36,664	43,038 17.4%	51,624 19.9%
	LIC of India	457,176	517,834 13.3%	510,787 **(-1.36%)**

47) TABLE – 6 above gives the rate of growth of first year premium income, including single premium income, of all the four companies. The rate of growth is the lowest in the case of LIC of India. But, it has to be noted that,

- In the case of Private Insurers,
  - A significant proportion of first year premium comes from Linked Business.
  - Further, since Individual and Group Premiums have been clubbed together in the disclosure Statement, the first year premium income under group policies has also got added to the first year premium income under individual policies.
- In the case of LIC,
  - The Corporation is not doing any Linked Business and premium income under Group Policies has been given separately.
  - So, the first year premium income given in the TABLE pertains purely to non-linked, individual policies.

48) TABLE – 7 on the following page gives the Rate of Growth of Total Premium Income and the Overall Expense Ratio. It can be seen that the Rate of Growth of Total Premium Income is the lowest in the case of LIC and highest in the case of HDFC. The Overall Cost Ratio can be defined as the Ratio of Management Expenses to the Total Premium Income. It is highest in the case of Max Life. The performance of LIC is quite good in this regard. With a little effort, it can bring this ratio to 12.5%. This is crucial for increasing the valuation surplus.

TABLE - 7

Rate of Growth of Total Premium Income and Overall Expense Ratio
All Amounts in (Rs.million)

			2016 - 17	2017 – 18	2018 - 19
	HDFC	Management Exp.	31,773	42,342	49,313
		Total Premium	194,457	235,631 **21.2%**	291,861 **23.9%**
		(Managmnt. Exp / Total Premium)	**16.3%**	**18.0%**	**14.8%**
	ICICI	Management Exp.	31,161	34,332	43,566
		Total Premium	223,539	270,688 **21.1%**	309,299 **14.3%**
		(Managmnt. Exp / Total Premium)	**13.9%**	**12.7%**	**14.1%**
	MAX LIFE	Management Exp.	23,501	25,028	29,162
		Total Premium	107,807	125,011 **16.0%**	145,753 **16.6%**
		(Managmnt. Exp / Total Premium)	**21.8%**	**20.0%**	**20.0%**
	LIC	Management Exp.	455,348	483,692	484,932
		Total Premium	3,001,967	3,178,510 **5.9%**	3,371,854 6.1**%**
		(Managmnt. Exp / Total Premium)	**15.2%**	**15.2%**	**14.4%**

49) TABLE – 8 on the following page gives for the three years 2016 – 2017, 2017 – 2018 and 2018 – 2019 the expenses in respect of Agency Commission, Employees' Remuneration & Benefits and Operating Expenses. Employees' Remuneration & Benefits is a part of Operating Expenses. The sum of Agency Commission and Operating Expenses gives the Management Expenses. Dividing Employees' Remuneration & Benefits by Operating Expenses, we can see what percentage of Operating Expenses goes towards Employees' Remuneration & Benefits.

TABLE – 8
Percentage of Operating Expenses going towards Employees' Remuneration & Benefits

All Amounts in (Rs.million)

			2016 - 17	2017 - 18	2018 – 19
	HDFC	Agency Commission	7,920	10,749	11,177
		Emp. Remuneration & Benefits	11,042	12,918	14,082
		Operating Expenses.	23,853	31,593	38,138
		(Emp. Remuneration / Operating Expenses)	**46.3%**	**40.9%**	**36.9%**
	ICICI	Agency Commission	8,036	9,653	9,731
		Emp. Remuneration & Benefits	7,589	14,033	15,513
		Operating Exp.	23,572	20,299	26,053
		(Emp. Remuneration / Operating Expenses)	**32.2%**	69.1**%**	59.5**%**
	MAX LIFE	Agency Commission	7,589	8,929	9,888
		Emp. Remuneration & Benefits	8,023	7,545	8,435
		Operating Exp.	15,912	16,099	19,274
		(Emp. Remuneration / Operating Expenses)	50.4**%**	46.9**%**	43.8**%**
	LIC	Agency Commission	165,901	182,258	193,112
		Emp. Remuneration & Benefits	206,294	210,820	198,719
		Operating Expenses	289,447	310,424	291,820
		(Emp. Remuneration / Operating Expenses)	**71.3%**	**67.9%**	**68.1%**

50) It can be seen from this TABLE that, in the case of LIC, a very high percentage of Operating Expenses goes towards Employees' Remuneration & Benefits. What is the significance of these percentages and how to interpret them?

51) In the case of LIC, very few functions are outsourced. In fact, only low level functions are outsourced. In the case of private insurers, many high level functions are outsourced. For example, many of the private insurers outsource I.T functions. Some are outsourcing even policy servicing functions. This results in reduction of number of employees and decreases Employee Remuneration & Benefits. But it does not reduce Operating Expenses since the cost of outsourcing will come under Operating Expenses. This results in reduction in the ratio (Employee Remuneration & Benefits / Operating Expenses).

Agency Commission

52) It can be seen that, except in the case of Max Life, the agency commission is less than Employee Remuneration & Benefits. In the case of LIC, in spite of the fact that the Employee Remuneration & Benefits constitutes more than two third of the Operating Expenses, the difference between agency commission and Employee Remuneration & Benefits is not very high. This is a good sign.

53) When an agency is discontinued before becoming eligible for future renewal commission under the policies procured by it, the commission does not get paid. About 10% of the commission payable does not get paid because of the discontinuance of agency. At present, this amount emerges as surplus in the valuation. About 20% of this amount goes to Government in the form of tax and dividend. The balance 80% gets distributed to with-profit policyholders as bonus.

54) Instead, if these amounts are taken to a separate fund and utilised for giving medical benefit to agents (and their families) provided, prescribed conditions (to be framed by the LIC) are satisfied, it would go a long way

in improving the quality and productivity of the agents. The Corporation may kindly consider this suggestion favourably.

Conclusion

55) The different deductions being made under unit linked policies was seen in paragraph (8). Of these, Fund Management Charge, @1.25% is the major source of profit for the insurer. Under a unit linked policy, the fund under the policy increases with duration and so, the deduction of 1.25% from the fund towards fund management charges will continuously increase. To understand the magnitude of such deduction, consider the case of LIC.

56) As at 3st March 2019, the Life Fund of the Corporation was Rs.28.3 trillion. This fund is being managed by the investment department of the Corporation. Suppose we assume that the cost of managing this fund is 1.25% of the value of the fund. The fund management cost will then be,

28,300,000,000,000 x 0.0125

= 2,830,000,000 x 125

= 353,750,000,000

= Rs.353.75 billion or Rs.35,375 crores.

But, the total Operating Expenses of the Corporation for the year 2018 – 19 was only Rs.29,182 crores. That is, total expenses, other than agency commission, was only Rs.29,182 crores and the expenses incurred for managing the Fund can only be a fraction of this. This can give one an idea of the profit margin available under Linked policies and also explain why the private insurers are concentrating on unit linked portfolio.

57) In the case of the LIC, the proportion of policies under the unit linked plans is negligible since its agents are reluctant to sell a product under

which maturity amount is not guaranteed. This can reduce the emergence of Surplus considerably and has to be kept in mind while comparing Valuation Surplus of LIC with other companies.

Dividend Paid to Government.

58) In the environment of falling interest rate and investment yield, control on expenses is crucial for profitability. Dividend paid to shareholder is a measure of this profitability. The first charge on the Valuation Surplus is Tax @14.1625%. Of the balance surplus, 95% is allotted to with-profit policyholders and 5% to the Government (sole shareholder) as dividend. The amount of dividend paid to the Government on 31st March 1990 was Rs.60 crores (600 million). The expected dividend as at 31st March 2020 will be Rs.3,000 crores (30 billion). The average annual rate of growth of dividend is thus 13.93%. This will give an idea of the control on expenses exercised by the LIC.

24th February 2020

R.Ramakrishnan
Chief Actuary (Retd.)
LIC of India