Current Issues in Life Assurance
Hotel Sea Princess, Mumbai
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Alternate Sources of Capital for Life Insurers

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Agenda

- Sources of Capital
- Regulatory Milestones
- Subordinated Debt and Preference Shares
- Financial Reinsurance
- Comparison of sources of capital

Sources of Capital

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- **Equity**
- **Sub debt**
- **Structured Reinsurance**
- **Capital Injection**
- **Preference Share**

Regulatory Milestones

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Nov 2015

- IRDAI released "Other Forms of Capital Regulations, 2015" vide notification dated 13th November 2015
- It prescribes the procedure for issue of Preference share capital and Subordinated debt by Indian insurers; lists conditions for approval from the Authority

Dec 2015

- IRDAI released "Issuance of Capital by Indian Insurance Companies transacting Life Insurance Business Regulations 2015" in supersession of 2011 regulations on the subject vide notification date 17th December 2015
- These regulations are applicable to the applicant company to raise funds through divestment of equity or issue of capital or both
- The regulation outlines the procedure for the application for issuance of capital and factors related to consideration of application by IRDAI

May 2017

- IRDAI constituted a Reinsurance Expert committee (REC), to carry out a review of reinsurance regulatory framework and make suitable recommendations
- Mandated to study international regulatory framework and practices relating to Reinsurance pool, Alternate Risk Transfer (ART) and make appropriate recommendations for India

Nov 2017

- REC report recommended Financial reinsurance may be permitted on a case by case basis provided there is significant risk transfer and the type of financing is cash arrangement. *REC further recommended that:*
- Such financial reinsurance will be permitted only with Indian reinsurance companies including FRBs (Foreign reinsurance branch) and other registered entities
- Every transaction will need to be discussed with and prior approval obtained from the Authority

Dec 2018

- IRDAI released the IRDAI Re-insurance Regulations 2018 vide notification dated 30th November 2018, effective from 1st January 2019
- Regulations state that an Indian insurer intending to adopt financial reinsurance solutions shall submit such proposal to the IRDAI
- IRDAI, after necessary examination and on being satisfied with the type of FinRe solution may allow the proposals on a case to case basis

Subordinated Debt and Preference Shares

Item	Description
Subordinated debt / Preference shares	• Indian Insurers can issue preference shares and/or subordinated debt subject to approval from IRDAI
Approval requirements	• All instruments shall be fully paid up and unsecured • Compliance with term and conditions stipulated by SEBI/other regulatory authorities and FEMA regulations (where applicable) in regard to issue of such instruments • IRDAI approval needed for payment of interest / dividend in case it may result in net loss or increase the net loss
Balance sheet classification	• Preference share under the head "Share Capital" • Subordinated debt under the head "Borrowings"
Limit on Subordinated debt/ Preference share	• The total quantum of subordinated debt and preference shares, in total, shall not exceed: ○ 25% of total of Paid up Equity Share Capital and Securities premium of an Insurer at any point in time ○ 50% of the Net worth of an insurer
Call option (subordinated debt)	• May be exercised after the instrument has run for at least a period of five completed years • Subject to prior approval from IRDAI
Amortization	• Subject to progressive hair cut for the purpose of computation of ASM on straight line basis in the final five years prior to maturity
Issue till date (subordinated debt)	• Only three life insurance companies have issued subordinated debt to raise capital with total issue size of INR 230 Cr and maximum issue size of INR 100 cr

Financial Reinsurance

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Financial Reinsurance is **specifically designed** to help an insurer **manage its capital and statutory solvency**

Example: in the simplest form of cash financing against an in-force portfolio:

- Financial Reinsurance allows to **upfront a part of embedded value** contained in the selected insurance portfolio
- To achieve this, reinsurer pays an **upfront commission** to the company in exchange of a share of **future profits**
- The reinsurer assumes the **risk** that, having paid the upfront commission, **the expected future profits do not emerge** due to adverse claim, lapse, investment and/or expense experiences

Comparison of Sources of Capital

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Category	Equity	Subordinated Debt	Reinsurance
Size	Medium - Large	Medium	Small – Large
Capital treatment	Tier 1	Tier 1-2	Tier 1 (cash)
Required capital	Neutral	Neutral	May reduce required capital
Cash provided	Yes	Yes	Optional
Duration	Permanent	Minimum ten years	Short - Long
Cost	High	Medium	Low - Medium
Issuance charges	Yes / No	Yes	No
Collateral	Last call on value of company	Unsecured	Block of business
Time to execute	Medium	Medium	Short - Medium
Commit to future capital at fixed terms	No	No	Yes (for limited time horizons)
Trigger	-	-	Can be at insurer's option
Rating	-	Rating generally required	Not necessary

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Thank you for your attention.