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IPO's Relevance to Enhancing Embedded Value

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Meeting the Challenges of Change

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My Plans for 22 ½ Minutes

- Context
 - History
 - The Act of 1999
 - The IPO Regulations
 - The IAI guidance note on EV methodology
- Will EV mislead investors?
- IPO & EV experience from other countries
- Enhancing Embedded Value

History of Life Insurance

- 1818 Oriental Life Insurance Company of Calcutta
- 1870 British Insurance Act
- 1912 Indian Life Assurance Companies Act
- 1938 Insurance Act
- 1956 LIC Absorbs 245 Companies
- 1999 IRDA Act
- 2011 “Issuance of Capital by Life Insurance Companies” Regulations

1999 IRDA Act

- “Insurance Regulatory and Development Act”
- Also amended 1938 and 1956 Acts
- Foresaw dilution after 10 years
- 26% was not just the foreign limit
- Details “shall be specified by regulations made by the Authority”
- First new company started selling in 2000

“IPO Regulations” Nov 2011

- IRDA (Issuance of Capital by Life Insurance Companies) Regulations 2011
- Sounds like an option...
- ...or is it actually a requirement?
- ...at or after 10 years?
- 12-18 months or what?
- Regulations include two tests:
 - Adequate solvency for last six quarters
 - $EV \geq 2x$ Paid-up Equity

EV Basics

- For long-term insurance (i.e. life)
- Recognizes accounting value not helpful
- Therefore $EV = PV$ of distributable earnings
- $EV =$
 - Free Surplus
 - + Required Surplus
 - + Value in Force (ViF)
- Ignores future new business
- Very theoretical

EV History

- 1959 – James Anderson (Canada) used discounted “cash flows” to measure profitability
- 1980s – Traditional Embedded Value (TEV) started by a group of European insurers
- 1990s – Embedded values are disclosed in European financial reports
- 2004 – European CFO Forum published “European Embedded Value (EEV)” Principles
- 2008 – CFO Forum published its “Market Consistent Embedded Value (MCEV)” Principles

IAI GN10 from Dec 2011

- Released very soon after IPO regulations
- Defines Indian Embedded Value (“IEV”)
- Sounds like MCEV...
- ...but allows freedom to be anything.
- Also defines New Business Value (NBV)!



Will IEV Mislead Investors?

- Common discussion:
 - Appraisal value = $IEV + n \times NBV$
- But...
 - Company will sell new business
 - Sponsor will have different return expectations
 - Distributability of profits in India?
- Theory versus practice
 - Spurious precision?

Countries' Experiences

- Canada
- Australia
- China
- India?



Enhancing Embedded Value

- Improve operations:
 - Claims, persistency, expenses, etc
- Improve your financial situation
 - Increase free surplus
- Improve the mathematical result
- Reinsurance helps in all three:
 - Underwriting, claims, and other procedures
 - Move VIF and RS to free surplus
 - Lock-in optimistic future assumptions