Products survey in Indonesia: Life post-PAYDI regulations

Introduction

Nearly two years have passed since the publication of our previous e-Alert covering OJK Circular Letter Number 5/SEOJK.05/2022 (SEOJK 5), which was released by the Indonesian Financial Services Authority (OJK) to cover unit-linked (PAYDI) business. SEOJK 5 sets more stringent restrictions for unit-linked business, covering critical areas such as product design, capital requirements, and investment guidelines. In addition, the new regulation introduces additional requirements on distributor compensation and sales processes, which has impacted the sales of these products.

Milliman has observed varying interpretations of the PAYDI regulations from the perspective of industry participants, even two years after their issue date and one year after their effective date. While Indonesian life insurers are adopting varied product strategies to navigate these changes, many have encountered challenges in the speed of developing and launching new products given the new regulatory landscape and heightened pressure from their distribution channels.

In response to these market dynamics, in the third quarter of 2023, Milliman conducted a market survey focusing on unit-linked product changes, the future outlook of the product mix, and the overall product development processes. We collected responses from 31 distinct life insurance companies in Indonesia. The survey findings offer a clearer understanding of the current market conditions and highlight potential areas for improvement. This e-Alert presents a summary of our findings and strategic insights, categorised under the following headings:

- Notable shift in portfolio mix
- Future product development
- Outlook and strategies

Data collected from the survey was also corroborated by our understanding that the proportion of actual new business sales, in terms of Annualised Premium Equivalent (APE), contributed by unit-linked products in the market has declined in the past two years.

Notable shift in portfolio mix

The survey results indicate an expected future market shift away from unit-linked products. Before the announcement of SEOJK 5, Figure 1 shows that 60% of the respondents attributed at least 25% of the new business APE to unit-linked products. In contrast, Figure 2 shows the reverse, with 60% of survey respondents expecting unit-linked products to contribute less than 25% of 2024 new business.

FIGURE 1: PROPORTION OF NEW BUSINESS APE ATTRIBUTABLE TO UNIT-LINKED PRODUCTS BY APE (PRE-SEOJK 5)

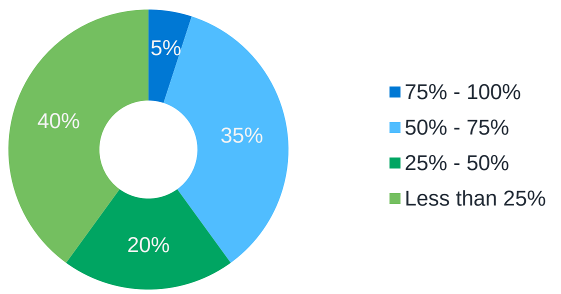
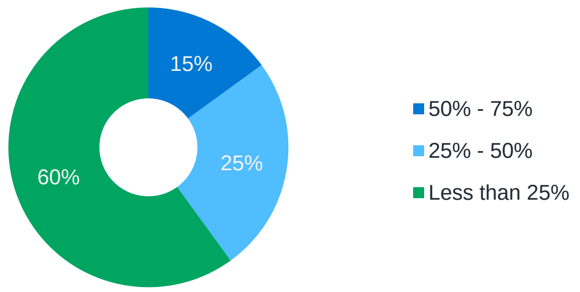
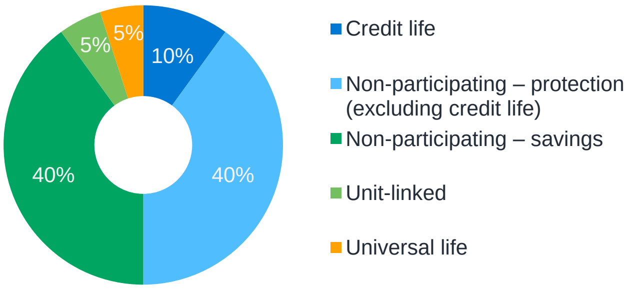


FIGURE 2: EXPECTED PROPORTION OF NEW BUSINESS APE ATTRIBUTABLE TO UNIT-LINKED PRODUCTS IN 2024



Furthermore, most respondents expect their most significant APE contributor for new business in 2024 to be non-participating products (with a broadly equal split between protection and savings business), as shown on Figure 3.

FIGURE 3: EXPECTED LARGEST CONTRIBUTOR FOR NEW BUSINESS IN 2024



Our survey findings reveal several key concerns and possible causes for the shift away from unit-linked products, as outlined below.

FIGURE 4: TOP CONCERNS REGARDING THE SEOJK 5 PAYDI REGULATION (MULTIPLE RESPONSES ALLOWED)

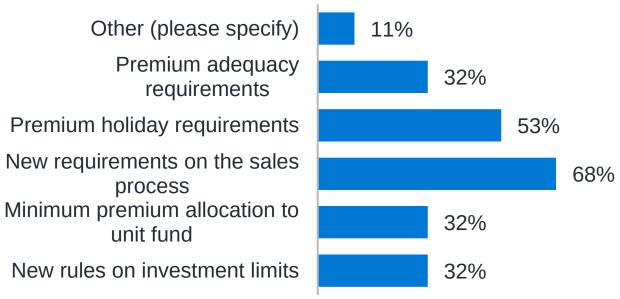


Figure 4 shows several key concerns from the survey respondents that have possibly affected their outlook on unit-linked products. The new requirement on the sales process is a top concern, expressed by 68% of our respondents, followed by premium holidays requirements (53%), premium adequacy requirements (32%), minimum premium allocation to unit fund (32%), and new rules on investment limits (32%). Other concerns include the absence of waiting periods for health rider products and less attractive distributor compensation.

Companies also indicated in the survey that the new regulation will impact their expected profit margins. Eighty percent of the respondents expected the profit margins for unit-linked products to reduce, with most expecting a 5% to 10% reduction (as a % of APE). In addition, the survey respondents also expected an increase in new business strain due to the new regulation, with 40% of respondents expecting a slight increase in new business strain by an additional one to two years and another 40% expecting an increase in strain by three to five years. Lower expected margins, higher new business strain, and increased compliance requirements are all leading insurers to expect a significant decline in the attractiveness of unit-linked products.

Recent industry insights suggest that industry performance over the past year is consistent with these survey results, with unit-linked new business APE declining across the market. Since the introduction of the new regulations, we have not observed any immediate reduction in unit-linked margins across the industry, but this could be attributed to companies redesigning the products in a way to meet the new regulations while maintaining their target profit margins.

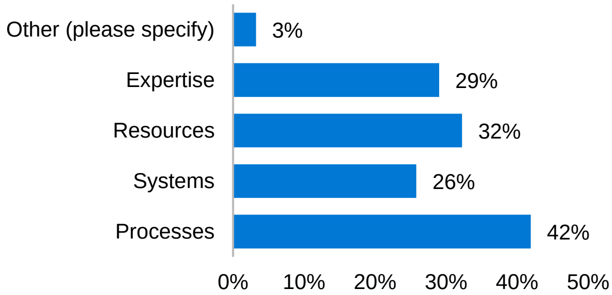
Future product development

The declining appeal of unit-linked business has left a white space for new product development, with 47% of respondents considering an expansion into universal life products, 40% into participating products, and 13% into both lines of business. Both product solutions would enhance the risk profile for shareholders while offering higher potential returns to policyholders. The speed and robustness of the insurer's product development process and technical expertise have become an essential competitive advantage in this new market environment. To remain competitive, companies should enhance these core competencies relative to their competitors to maintain or enhance market share, as product innovation has become a crucial differentiator.

The product development cycle time has become especially relevant. According to our survey, 70% of respondents stated that their average product development process takes three to six months. In comparison, 20% of respondents noted a more protracted process over six months, with only a minority (10%) stating that their product development process averages less than three months. Companies' views on their product development process could be seen as moderate at best, with nearly half (45%) of the respondents mentioning the need for improvement in their processes.

The survey results, as shown in Figure 5, indicate multiple areas for development, with the highest being process developments, followed by resources, expertise, and systems. A small number of insurers set their focus on innovation.

FIGURE 5: CRITICAL AREAS FOR DEVELOPMENT (MULTIPLE RESPONSES ALLOWED)



Note: "Other" includes innovation.

Outlook and strategies

Amidst the industry-wide shift away from unit-linked products, several issues largely specific to traditional products have recently emerged at the forefront of life insurers' attention.

PRODUCT DEVELOPMENT PROCESS

Speed to market is significantly more critical in developing traditional and universal life products, whose appeal and profitability can be more sensitive to market conditions, such as interest rates, asset-liability management (ALM) practices, and product design, compared to unit-linked products. Inefficiencies within the product development cycle will need to be minimised, and IT systems will need to be continually enhanced to keep pace with new requirements likely to arise from product innovation.

RESOURCES AND EXPERTISE

Accurate assumptions are pivotal in pricing traditional long-duration products, given the inherent level of guarantees provided. The importance of insights derived from industry benchmarking and utilising credible data cannot be overstated. Additionally, the presence of a resilient actuarial team with diverse specialisations, including product development, pricing, and valuation, is crucial for crafting competitive products that ensure profitability. This approach aligns with shareholder interests and enhances market appeal.

Product development teams should remain attuned to market trends and competitive landscapes inside and outside Indonesia. Insurers with robust technical teams are exploring innovative non-linked life insurance products from more developed markets, such as participating and universal life products. Implementing further system developments, such as creating stochastic projection models for participating and universal life products, may be essential to stay ahead in this dynamic landscape.

ASSET-LIABILITY MANAGEMENT (ALM) PRACTICES

Sound ALM practice is essential for these traditional products that exhibit long-duration liabilities. The strategy to optimise the mismatch between assets and liabilities is an important factor in mitigating interest rate risk, minimising capital requirements, and reducing potential volatility on capital. Considering how cash flows from new businesses offset liquidity from existing in-force policies will be crucial in a successful ALM practice. Before launching a new product, it is also essential to analyse the market for potential instruments to support the ALM, which are somewhat more limited in Indonesia. Some companies use higher Risk-based Capital (RBC) levels to absorb potential short- to medium-term ALM impacts. Lastly, developing effective investment (new business) and reinvestment (in-force) strategies to meet guarantees and fulfil obligations to policyholders is also vital in managing these products.

ECONOMIC ASSUMPTIONS

Interest rate assumptions and yield curve projections are essential to pricing traditional long-term products. Assumptions on the return of assets can significantly influence the value and cost of guaranteed benefits to policyholders. Insurers can analyse the sensitivity of their product profitability under various economic environments by considering a range of potential economic scenarios, including market downturns, interest rate fluctuations, and other scenarios.

NON-ECONOMIC ASSUMPTIONS

Pricing of traditional products relies heavily on non-economic assumptions. Most companies started selling these products only a few years ago and possibly have minimal credible experience with mortality, lapses, and policyholder behaviour assumptions. Insufficient margins within pricing assumptions might impact future shareholder expectations, while excessive margins compromise product attractiveness in a competitive environment. Sensitivity and scenario analysis can help companies better understand the profitability profile of the product, while competitiveness analysis and benchmarking against other companies can shed insights into market practices.

Conclusion

The life insurance landscape in Indonesia is undergoing rapid transformation, with expectations for ongoing evolution in the years ahead. Key catalysts for this evolution go beyond these unit-linked regulation changes but will include the initiation of IFRS 17[1] reporting, the requirement to spin off Syariah windows to standalone entities, and the new regulation on capital requirements. Senior management in Indonesian life insurance companies is shifting their focus beyond immediate operational concerns, strategically reshaping their portfolios to ensure sustained profitability and competitiveness in a market where industry players tend to have risk aversion and reactive responses to market changes.

Our survey findings indicate a proactive shift among life insurers as they explore new products that provide robust customer value and demonstrate competitiveness against traditional offerings, fostering a more favourable shareholder return profile.

[1] Also referred to as PSAK74 or PSAK117 in Indonesia.

Milliman is among the world's largest providers of actuarial, risk management, and technology solutions. Our consulting and advanced analytics capabilities encompass healthcare, property & casualty insurance, life insurance and financial services, and employee benefits. Founded in 1947, Milliman is an independent firm with offices in major cities around the globe.

milliman.com

CONTACT

Junaidi Amin
junaidi.amin@milliman.com

Farzana Ismail
farzana.ismail@milliman.com

Ouling Lu
ouling.lu@milliman.com

Joshua Winata
joshua.winata@milliman.com