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# Understanding the LIC IPO

The Russian- Ukrainian conflict looms large over the fate of the LIC IPO. Yet, the size of the IPO is set to surpass all the preceding public sector and private sector IPOs with *Paytm* raising the highest amount of Rs 18,300 crore in November 2021. With the listing of LIC, almost 84% of the market would be in the listed space.

LIC is the largest life insurer with a dominant market share in terms of:

- 64.1% in premiums (or Gross Written Premium),
- 66.2% in New Business Premium (or NBP),
- 74.6% in number of individual policies issued,
- 81.1% in number of group policies issued for Fiscal 2021.

Also, LIC's investments in listed equity represented around 4% of the total market capitalisation of NSE as of Sep 2021.

Internationally also LIC ranks fifth in terms of net premium earned, with premium of USD 56 billion in Fiscal 2021. Over a period of 12 months ending in CY 2020, AXA S.A. (USD 113 billion), Ping An Insurance (USD 110 billion), Allianz SE (USD 909 billion), China Life Insurance Company (USD 88 billion) are the only global peers having a net premium higher than LIC.

With this IPO, the Government would divest 5% of its holding and LIC is to achieve the benefits of listing, which is, enhancing its visibility and brand image. The Offer for Sale is for up to 316,249,885 Equity Shares for Government of India.

**Insurance Sector**

Life insurance sector has a long history with the establishment of LIC in 1956 which was followed by the opening of the sector to private participants in 2000. Currently, there are 23 private life insurance companies besides LIC. Over the years, the market share of LIC has fallen while that of private insurance companies has increased. Within the private sector insurers, the top three listed insurance companies have a share of 55% as of FY21.

By international standards, the penetration (premium as a per cent of GDP) and density (premium per capita in USD) of life insurance remains below the Asian and developed countries. India's life insurance penetration stood at 3.2% in CY 2020 compared to the global average of 3.3%. Among Asian countries, life insurance penetration in Thailand, South Korea and Singapore were at 3.4%, 6.4%, and 7.6%, respectively, in CY 2020. At $59 in CY 2020, insurance density, which is premium per capita, in India remains very low compared with other developed and emerging market economies. The insurance density for US stands at $1,918 and for Singapore its $4,528, South Korea at $2,050 and Thailand $244.

However, growth potential is immense given the favourable demographics, urbanisation, growing financial literacy and awareness about insurance.

**Peer Analysis**

On a comparative basis, LIC dominates the insurance space in terms of AUM, total premium and profitability.

| Parameters (H1 FY22) (INR billion) | Net Profit/ Profit after tax | AUM | Net worth | Total Premium |
|---|---|---|---|---|
| LIC | 14.3 | 39,558.90 | 78.2 | 4032.9 |
| SBI Life | 4.7 | 2,442.00 | 109.1 | 502.5 |
| HDFC Life | 5.8 | 1,912.10 | 89.2 | 385.8 |
| ICICI Prudential Life | 2.6 | 1,814.90 | 87.6 | 357.3 |

*Source: LIC draft red herring prospectus, Feb 13, 2022*

Asset under management (AUM) is defined as comprising policyholders' investment, shareholders' investment and assets held to cover linked liabilities

However, in terms of performance parameters, the private sector entities have fared better in terms of persistency ratio, solvency ratio and claim settlement ratio.

| Parameters (H1 FY22) | Solvency Ratio (times) | Claims Settlement Ratio | Surrender Ratio | Persistency Ratio (13th Month) | Persistency Ratio (61st Month) |
|---|---|---|---|---|---|
| LIC | 1.83 | 94.20% | 22.20% | 78.80% | 60.60% |
| SBI Life | 2.12 | 86.50% | 13.90% | 84.50% | 49.70% |
| HDFC Life | 1.90 | 98.00% | 21.80% | 85.90% | 52.30% |
| ICICI Prudential Life | 2.00 | 91.00% | 57.70% | 85.00% | 51.80% |

**Source: LIC DRAFT RED HERRING PROSPECTUS, Feb 13, 2022**

The solvency ratio gives insight into the company's cash flow as well as whether the cash flow is capable of meeting the company's liabilities - both long-term and short-term. As per IRDA, every insurer at all times has to have a solvency ratio of 150% (Which means 150% of Assets over Liabilities). Technically, Solvency Ratio is defined as ratio of the amount of the available solvency margin to the amount of Required Solvency Margin, wherein Solvency margin is excess of value of assets over the value of life insurance liabilities and other liabilities of policyholders' fund and shareholders' funds.

The entire objective of buying life insurance is ensuring financial protection against unforeseen circumstances. However, the purpose will be defeated if the insurer does not homer your claim. The Claim settlement ratio (CSR) acts as an indicator of their credibility and is defined as the per cent of claims that an insurance provider settles in a year out of the total claims. As a general rule, the higher the ratio, the more reliable the insurer.

Surrender ratio is defined as total surrender amount divided by total investments during the year/period. For instance, in case of participating products, a decline in interest rates may result in lower bonus rates for policyholders, which may lead to policyholder dissatisfaction and therefore, an increase in surrenders and a decrease in sales of new policies.

Persistency Ratio indicates how many policyholders are paying the due premiums regularly on the policies with the insurer. The number generally shows how long the customers stay with the insurer and indicates his/her satisfaction. The ratio is measured for the financial year or a combination of financial years starting 1 year to 5 years. 1st year's persistency ratio is estimated in the 1st month of the next year and so on. That's why the one-year persistency ratio is indicated as 13$^{th}$ month ratio and 5-year ratio would be called 61$^{th}$ month persistency ratio. Technically, it is defined as is defined as the proportion of business that is retained from the business underwritten and is measured in terms of the number of policies and premiums underwritten.

A high level of persistency is an important metric to assess the quality of sales because it is the first opportunity to assess the likelihood of premiums being paid beyond the first year, thereby reaffirming the policyholder's decision to buy the insurance policy and thus reflecting the quality of business written. A high level of 61st month Persistency Ratios reflects the success of products with a long-term horizon. A focus on this metric helps in averting high surrenders and retaining customers by reaffirming the insurance decision made at the time of sale of policy.

The table throws some interesting insights. LIC has a higher level of persistency ratio over 13 months and 61 months. But this ratio comes down post 5 years to a level of around 60%. This is a challenge in the insurance industry.

Further the expense ratio of LIC remains lower than private institutions. It is defined as operating expenses as a percentage of total premium. LIC's expense ratio is considerably lower than that of private players on account of it being a mature business. For private players in the industry as well, the operating costs are coming down on account of higher dependence on technology and fintech tie-ups for multiple operations.

| Operating expense ratio (% of total premium) | | |
|---|---|---|
| Year | LIC | Private players |
| FY16 | 8.5 | 16.0 |
| FY17 | 9.6 | 14.6 |
| FY18 | 9.5 | 13.3 |
| FY19 | 8.4 | 12.9 |
| FY20 | 9.0 | 13.4 |
| FY21 | 8.7 | 12.6 |

**Source: LIC DRAFT RED HERRING PROSPECTUS, Feb 13, 2022**

In terms of mis-selling of products, LIC ranks lowest and has the lowest share. Mis-selling complaints refers to the grievances reported by the policyholders under 'unfair business practices'.

| Parameters (H1 FY22) | Policies mis- selling complaints per 10,000 policies |
|---|---|
| LIC | 2.4 |
| SBI Life | 7.6 |
| HDFC Life | 18.3 |
| ICICI Prudential Life | 34.4 |

**Source: LIC DRAFT RED HERRING PROSPECTUS, Feb 13, 2022**

Even so, the performance of LIC has to be viewed in light of the role played by it in the furtherance of government goals such as taking over of stake in IDBI Bank and others.

**Significant policy changes for LIC IPO**

The major changes in the policy dominating LIC's operations is pertaining to segregation of its life fund. Through the Amendment to Section 24 of the LIC Act, the segregation of the Life Fund into participatory and non-participatory funds, depending on the nature of the policies they support has been effected. While the surplus from the Life Fund was historically divided in the 95:5 ratio, as far as the participatory fund is concerned this ratio would change to 90:10, "in a phased manner". This is in line with how surplus is distributed in the private sector. The change, especially the one that has enabled 100% of the surplus in non-participatory funds to flow to the shareholder, has led to a massive jump in the value of a key metric called the Indian Embedded Value, or IEV. Indian Embedded Value consists of Adjusted Net Worth ("ANW") (consisting of free surplus and required capital) and the value of in-force business ("VIF").

The IEV figure has jumped more than five-and-a-half times to approximately Rs 5.4 lakh crore on September 30, 2021 from just Rs 95,605 crore as on March 31, 2021.

**Savings Space**

The Incremental savings allocation has increased to insurance and mutual funds segment and they are undertaking efforts to increase their share. The competition for savings is set to get intense going forward. The share of life insurance in incremental household financial savings was at 16.8% in FY20 which fell to 15.0% in FY21 and as of 9MY FY21, the ratio has increased to 19.4%.

| Share of life insurance in incremental household financial savings | | | |
|---|---|---|---|
| | FY19 | FY20 | 9MFY21 |
| Bank deposits | 36.50% | 36.60% | 29.40% |
| Provident and pension funds | 18.70% | 19.30% | 16.70% |
| Mutual funds | 2.70% | 1.90% | 6.60% |
| Life insurance funds | 16.80% | 15.00% | 19.40% |
| Currency | 13.00% | 12.40% | 14.50% |
| Others | 12.30% | 14.70% | 13.40% |

**Source: LIC DRAFT RED HERRING PROSPECTUS, Feb 13, 2022**

**To conclude:**

- LIC IPO is set to surpass the largest mobilisations from primary market so far whenever it enters the market.
- LIC is not the only the largest insurance company in India but also globally it ranks fifth in terms of net premium earned.
- Even so, Insurance penetration and density for India remains below the Asian and developed countries.
- On a comparative basis, LIC dominates the insurance space in terms of AUM, total premium and profitability.
- However, in terms of performance parameters, the private sector entities within them the three listed institution backed insurers have a better performance in terms of persistency ratio, solvency ratio and claim settlement ratio.
- Incremental savings allocation shows increasing share of insurance and mutual funds segments.




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