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The volume and structure of the Russian life insurance market indicates its significant growth potential.....2

Life insurance market growth remains volatile.....3

Rates in Russia are much higher than abroad.....4

The prevalence of bank sales holds back the life insurance market.....6

Regulation is the key to sustainable development of the life insurance market.....7

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Life insurance market: how can its potential be unleashed?

Insurers' assets in this segment may exceed RUB 20 tln

- The ratio of the sum of life insurance premiums to GDP in Russia was 0.4% in 2020, while the global indicator exceeded 3%. Investment and credit life insurance (ILI and CLI, respectively) are predominant in the Russian market, which is atypical for developed markets. The Russian market is practically in the initial phase of development and has significant growth potential.
- In recent years, the growth rate of life insurance premiums in Russia has significantly outstripped the growth rates of the rest of the country's insurance market and the economy as a whole. In five years, the Russian life insurance segment has grown by more than 3.3 times. At the same time, this growth was and still is volatile, as it is subject to various regulatory risks and depends on the phase of the credit cycle.
- According to our assessment, rates, i.e. the cost of life insurance services, are much higher in Russia than abroad. Presumably, this largely explains the significantly lower popularity of life insurance in the Russian market.
- Another obstacle to the development of the life insurance market in Russia is insurers' dependence on banks. As the main channel for interaction between insurers and their clients, banks exert significant influence on product lines and the conditions of insurance contracts. The high fees charged by banks reduce the profitability of policies and may serve as a reason for the regulator to apply restrictions.
- The life insurance sector is an important element of the financial system of developed economies. Due to its significant growth potential and positive overall impact on the economy, the development of life insurance in Russia may become one of the key areas of government policy for developing the financial market until 2030, which is currently being drafted.
- Sustainable development of the market is possible only if a balance is maintained between the interests of clients and insurance companies. In an insufficiently mature market, this balance should be ensured through appropriate regulation. When taking measures to protect policyholders, it is important for the Bank of Russia to preserve the ability of honest insurers to conduct profitable business in conditions of free competition.

The volume and structure of the Russian life insurance market indicates its significant growth potential

Life insurance is a basic financial product that the population uses to manage risks associated with death and disability, as well as to accumulate capital and maintain quality of life after retiring. The average global level of life insurance premiums over the past five years has ranged within 3.3%–3.5% of GDP. The Russian indicator for 2020 amounted to a mere 0.4%. As we cannot see any fundamental reasons which would explain why Russians do not wish to manage the abovementioned risks, we can assume that currently the Russian life insurance market is at the initial stage of development and has very significant growth potential.

A sample of life insurance statistics provided by the Bank of Russia can be found in the appendices to this research. The dominating share of the life insurance market (over 98%) is occupied by lump sum payment products, while contracts that feature regular payments, including pension insurance policies, account for less than 2% of premiums. The most popular product is borrower insurance, with over 6 mln policyholders. As of the end of 2020, only 4.2 mln people were covered by other types of life insurance products, i.e. less than 3% of the Russian population. For comparison, according to data published by the Insurance Information Institute, around 54% of US residents have life insurance contracts. Most likely that statistic includes family members of insured individuals, but even taking that into account it can still be said that life insurance is much more popular in the US.

In terms of the size of premiums, the market's main products are ILI (market share is 42%), endowment life insurance (ELI; 32%) and CLI (22%). The Bank of Russia also includes pension insurance in its statistics, which has a share of less than 1%. Risk life insurance accounts for the remaining 3%.

Although they appear to be similar, ILI and ELI are actually fundamentally different. In our view, ILI is more of an investment product than an insurance product. In some cases, ILI policies have been sold without coverage of the risk of death during the policy period, which naturally provoked a negative reaction from the regulator. The main idea behind ILI policies is not to defend the policyholder against insurance risk, but instead to attempt to obtain higher investment income due to the expectation of an increase in the value of certain assets, which, in essence is speculation. At the same time, the structure of the product determines the need for a single initial payment and the acquisition of derivative financial instruments at the expense of these funds, the prices of which may be beneficial to sellers, and not buyers.

Unlike ILI, ELI involves the payment of regular contributions, which allow a large sum of capital to be accumulated by the end of the contract period. Under a typical ELI contract, the insured party's funds grow due to a guaranteed rate of investment income, as well as additional bonuses that the insurance company can pay at its discretion. Compared to ILI, this sort of contract structure reflects to a greater extent the needs of the population. In this regard, ACRA believes that the prevalence of ILI products in the Russian market is a temporary

phenomenon, which additionally indicates the immaturity of the market and its significant potential for growth.

We consider the fact that indicators of risk life insurance are extremely low in comparison with other products to be another argument in favor of the conclusion about the immaturity of the Russian insurance market. A risk life insurance policy provides for payment in the event of death or disability of the insured party during the term of the contract. At the same time, there are no payments at the end of this period, which significantly reduces the cost of insurance. Risk life insurance is the most simple and accessible product that provides financial safety to the insured party and the members of their family in the event of death or disability of the former and does not involve any additional complexities related to investment or accumulation of capital. It is precisely the simplicity and accessibility of this product that makes it so popular in developed markets.

Life insurance market growth remains volatile

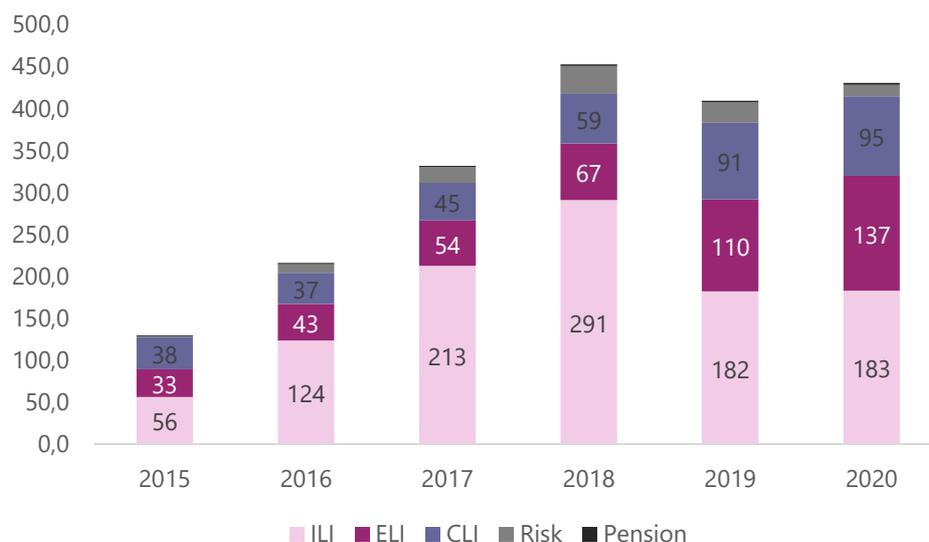
In recent years, the growth of premiums in the life insurance segment in Russia has considerably outstripped the growth of the rest of the national insurance market and the economy in general. According to the Bank of Russia, the total size of life insurance premiums amounted to RUB 431 bln in 2020, while in 2015 it equaled RUB 130 bln, so over the last five years the life insurance segment grew by more than 3.3 times. At the same time, the other segments of the insurance market grew by only 24% over the specified period, and GDP and the population's income in nominal terms grew by 29% and 14%, respectively.

It is noteworthy that such significant growth in the life insurance segment was recorded in relation to a rather low base. The ratio of life insurance premiums to GDP (the so-called penetration rate) in Russia was 0.16% five years ago. Even after such a tangible increase in premiums in 2020, the penetration rate was only 0.4%, which is much lower than global indicators.

Over the past five years, the dynamics of the life insurance market have mainly been determined by the rise and fall of its largest segment — ILI. Since its appearance in 2009 and up until 2018, ILI grew rapidly. However, the measures implemented by the Bank of Russia to counter dishonest actions when selling ILI led to a sharp fall in the volume of premiums in this segment in 2019.

The CLI segment also made a significant contribution to the growth of life insurance premiums. The performance of this segment mainly reflected the boom in the retail lending market. Premiums stopped growing in the CLI segment in 2020 due to lower lending activity of banks as the solvency of borrowers declined as a result of the COVID-19 pandemic. It seems that the resumption of growth in the retail lending market in 2021 will lead to growth in borrower insurance premiums. However, it must be noted that demand for CLI is inherently volatile since it is subject to credit cycle risks. In addition, a very significant share of borrower insurance premiums are used to cover commission fees received by the lending bank. In this part, the volumes of premiums are potentially exposed to the risks of future regulatory restrictions aimed at protecting the rights of policyholders.

Figure 1. Out of all the life insurance segments, only ELI demonstrates stable growth, RUB bln



Sources: Bank of Russia, Russian Union of Insurers, Association of Life Insurers

ELI is the only segment that has demonstrated stable growth. From 2015 to 2020, ELI contract premiums grew annually by more than 20%. The most growth — 63% — was achieved in 2019 amid lower volumes of ILI. Over those five years, the total volume of ELI premiums grew by more than four times, while ILI premiums grew by 3.2 times. We assume that the ELI segment will grow faster than ILI in the future and increase its share in the life insurance market. At the same time, the prevalence of volatile segments in the market does not yet allow us to claim that the growth of the life insurance market is sustainable.

Rates in Russia are much higher than abroad

In ACRA's opinion, the massive difference in the degrees of penetration of life insurance in the Russian and foreign markets requires an explanation. This difference can hardly be explained by purely historical reasons. In recent years, the proliferation of new products and technologies in the markets is a global trend. In terms of the majority of banking products, the Russian market is abreast with European countries and the US. Russia's significant lag in the life insurance segment indicates certain barriers to the realization of potential demand.

Oftentimes, the low penetration of life insurance in the Russian market is associated with the insufficient level of tax benefits that insureds receive. In Europe and the US, unlike in Russia, high income tax rates and significant tax benefits under life insurance contracts create significant incentives for potential policyholders. However, in our opinion, the level of tax incentives cannot be the only factor explaining the difference in level of penetration. The basic need for insurance coverage against serious risks for each person exists objectively, regardless of ancillary factors, such as tax benefits.

The main reason for the relatively low volumes of the Russian life insurance market, in our opinion, is the high cost of insurance services (insurance rates). We decided to compare the terms of insurance under risk life insurance

programs available to residents of Russia and the US. The risk life insurance segment was selected for the comparison purposes due to the fact that, unlike, for example, endowment insurance, it offers a simpler insurance service, namely, protection against the risk of death within the term of the contract (without any complications associated with investments and capital accumulation).

It should be noted that US insurance companies, unlike Russian ones, offer a wide range of risk life insurance products. In addition, the general awareness of risk life insurance programs is rather low in Russia, as most life insurers prefer investment and endowment insurance programs, and only a few companies have risk insurance programs.

Table 1. Standard terms of risk life insurance in Russia and the US

	Russia	US
Sex	Male	Male
Age	50 years	50 years
Place of residence	Moscow	New York
Employment	Office worker	Office worker
Risk	Death from any cause	Death from any cause
Insurance coverage	RUB 5 mln	USD 250,000
Insurance term	20 years	20 years
Insurance premium	RUB 10,400 per month	USD 44 per month
Rate (annual insurance premium, % of coverage)	2.5%	0.2%

Source: offers from insurers

The comparison shows that the difference in rates is too high to be associated with different mortality rates in Russia and the US. At the same time, this difference, in our opinion, is sufficient to explain why almost 54% of the US population has insurance coverage, whereas in Russia, this percentage is lower by an order of magnitude.

The low penetration level of life insurance, tiny share of risk life insurance, and high insurance rates make the Russian market potentially promising for foreign insurers, who might be more interested in entering the market since the adoption of the federal law on the admission of foreign insurance companies' branches to the Russian market in June 2020. In this case, one can expect insurance premiums to grow and competition among insurance companies to increase, which is certainly beneficial for customers.

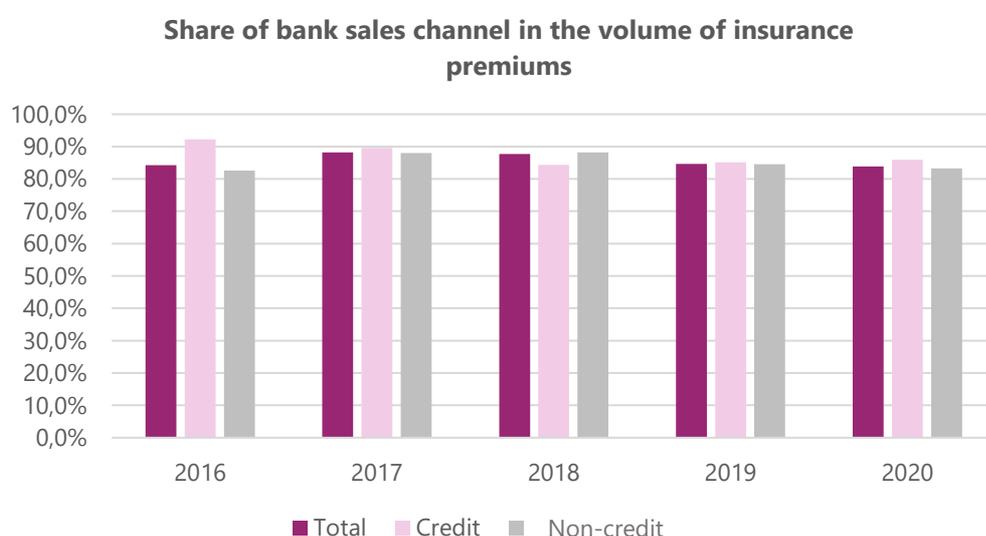
At the same time, political risks and high regulatory requirements, which practically do not differ for branches and subsidiaries, restrain the expansion of foreign companies. According to our information, so far the significant foreign players have not announced their desire to establish branches and enter the Russian market. The recent departure from Russia of one of the largest global

insurers, MetLife, which sold its Russian subsidiary to PJSC Sovcombank, also indicates a lack of significant interest from foreigners at present.

The prevalence of bank sales holds back the life insurance market

In our opinion, one of the main factors that determine the life insurance market's structure and the high level of insurance rates is the dependence of insurers on the banking sales channel. According to the Bank of Russia, in 2020, 84% of life insurance premiums were received through credit institutions. At the same time, this indicator differs insignificantly for credit and other types of life insurance: 86% and 83%, respectively. Banks, being the main channel of communication between insurers and customers, have a significant impact on product lines and contract terms.

Figure 2. Banks are the main sales channel of life insurance contracts

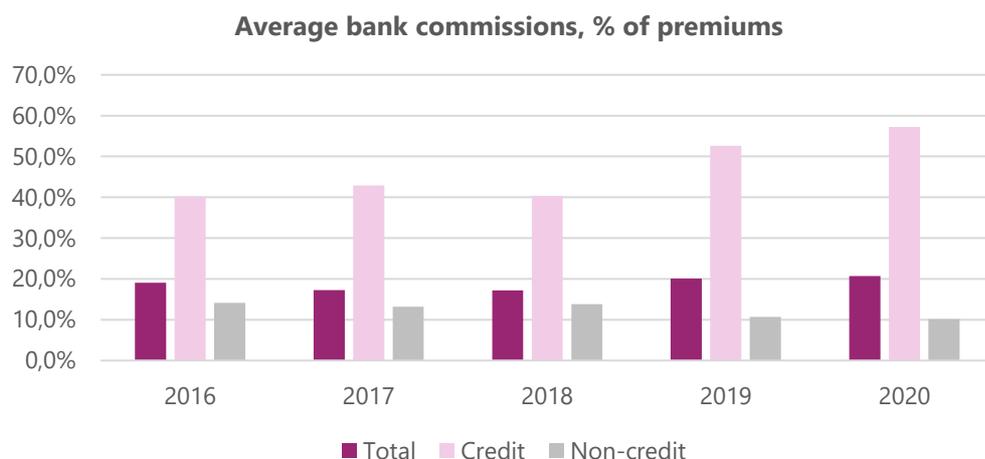


Source: Bank of Russia

The rapid growth in investment insurance has been achieved through the active promotion of this product to bank clients. ILI policies were sold to clients as a more profitable alternative to deposits in the face of declining interest rates. However, client expectations were mostly unmet. According to the Bank of Russia, the average return on three-year ILI policies that expired in 2020 amounted to 4.7% and the average return on five-year policies equaled to 3.1%. At the same time, the average return on deposits was 7% in 2017–2020 and 8.1% in 2015–2020.

High commission fees charged by banks had an extremely negative impact on the investment insurance performance. Occupying a dominant position between insurers and their clients, credit institutions are able to decide the commission fees that they receive out of premiums paid by policyholders. The amount of the commission is deducted from the funds of the ILI risk fund, which significantly reduces investment income even in the case of a successful choice of strategy.

Figure 3. Bank commissions on credit insurance have been growing, and they are still high on other types of insurance



Source: Bank of Russia

We see a gradual decrease in the level of commissions charged for non-credit life insurance, which, of course, will have a positive effect on the return on insurance policies. However, the current average level (10%) is still too high. At the same time, commissions on credit life insurance continue to grow, which may provoke regulatory measures.

We believe that the virtual absence of an alternative to the banking sales channel has an extremely negative impact on the development of life insurance. In our opinion, to reduce their dependence on banks, insurance companies should invest in the creation and expansion of agent networks, engage independent financial advisors, and reach clients online.

Regulation is the key to sustainable development of the life insurance market

The following conclusions may be made based on the above considerations:

1. The growth potential of the Russian life insurance market is enormous. Reaching the world average level of penetration means that, given the current level of GDP, the annual life insurance premium may exceed RUB 3 tln. At the same time, the assets of life insurers may reach about RUB 20–30 tln.
2. On the other hand, this potential is being unleashed relatively slowly, which indicates the presence of barriers to market development, including high rates and the dependence of insurers on the bank sales channel.

It is also worth noting the important role of life insurance for the economy. Life insurance contracts are usually long term. To secure payments in the distant future, insurance companies form significant reserves, which can be invested in long-term projects or financial instruments. In developed life insurance markets, these reserves may be significant, thus forming a solid supply of investment resources and supporting long-term economic growth. In this regard, we believe that the development of life insurance should become one of the key drivers of

the government's strategy for the development of the financial market until 2030, which is currently being developed.

Obviously, the sustainable development of the market is possible only a balance between the interests of clients and insurance companies is observed, which, in case of the immature Russian market, should be ensured through appropriate regulation. The Bank of Russia is taking measures to combat unfair market practices. In particular, standards have been introduced for making clients aware of the risks associated with investment life insurance. In addition, at the beginning of this year, the Bank of Russia sent recommendations to insurers to limit sales of ILI to unqualified clients. The regulator also presented draft regulation that defines the basic standards for endowment and investment insurance for public discussion.

These measures are designed to strengthen the protection of policyholders, and they will contribute to the promotion of life insurance among the general public. At the same time, we believe that it is important to avoid placing an unnecessary regulatory burden on honest insurance companies, which must remain able to conduct profitable business in a competitive environment.

Appendix 1. Life insurance market statistics

	Premiums		Number of contracts	Number of insureds	Coverage
	in 2020		as of December 31, 2020		
	RUB bln	%	Thousand	Thousand people	RUB bln
Contracts that exclude annuities	423.4	98%	10,253.1	21,753.3	11,927.2
made with individuals	398.2	93%	10,147.0	10,202.3	9,639.3
policyholder has a share in investment income	285.3	66%	2,579.8	2,619.3	2,769.2
insurance premium is paid as a lump sum	219.2	51%	1,352.0	1,352.3	1,402.9
insurance premium is paid in installments	66.2	15%	1,227.8	1,267.0	1,366.3
policyholder has no share in investment income	112.9	26%	7,567.3	7,583.0	6,870.0
insurance premium is paid as a lump sum	91.2	21%	5,985.0	5,993.7	4,117.5
insurance premium is paid in installments	21.7	5%	1,582.3	1,589.3	2,752.5
made with legal entities	25.2	6%	106.0	11,551.1	2,288.0
policyholder has a share in investment income	3.1	1%	2.8	4.6	10.9
insurance premium is paid as a lump sum	2.7	1%	0.3	1.3	6.0
insurance premium is paid in installments	0.4	0%	2.5	3.3	4.9
policyholder has no share in investment income	22.0	5%	103.2	11,546.4	2,277.1
insurance premium is paid as a lump sum	21.5	5%	101.6	11,303.0	2,006.7
insurance premium is paid in installments	0.6	0%	1.6	243.4	270.5
Contracts that include annuities	4.8	1%	147.3	581.6	164.4
Pension insurance	2.3	1%	36.2	199.5	22.0
Total	430.5	100%	10,436.5	22,534.4	12,113.6

Source: Bank of Russia

Appendix 2. Life insurance product statistics

	Premiums		Number of contracts	Number of insureds	Coverage
	in 2020		as of December 31, 2020		
	RUB bln	%	Thousand	Thousand people	RUB bln
Investment life insurance	182.90	42%	1,365.48	n/a	1,239.60
Endowment life insurance	136.90	32%	n/a	n/a	n/a
Credit life insurance	94.55	22%	6,197.23	n/a	5,756.04
Risk life insurance	13.90	3%	n/a	n/a	n/a
Pension insurance	2.3	1%	36.2	199.5	22.0
Total	430.5	100%	10,436.5	22,534.4	12,113.6

Source: Bank of Russia

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