CHAPTER –VII

REFORMS IN THE INDIAN INSURANCE SECTOR

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7.1 INTRODUCTION:

The public sector of India is considered to be a holy cow. Its significance became apparent particularly after the adoption of the goal of socialistic pattern of society. Ever since the declaration of the Industrial Policy Resolution in 1948, the public sector enjoyed a prime position in India. However, it is said that the return on investment in public sector is dismally cow and hence in recent years some voice is raised against public sector and in favour of the private sector. Therefore, today, there is a wave for privatization in the whole world.

In the light of the above, a good number of experts have given different connotations for privatization. The Oxford English Dictionary (second edition) defines the term 'Private' as to make private as opposed to public. The Chambers Dictionary gives its meaning as "to make private or to denationalize". According to Ramaswamy R. Iyer, there is a tendency to use the word 'Privatization' in a range of senses from rather narrow to the very wide. In the words of Dr. S. R. Mahant, "Privatization is induction of management control, via transfer of ownership or otherwise, often both, from public owned or managed enterprises".

All the above definitions imply the transfer of enterprises or corporations from the state to private ownership. Privatization is often equated with commercialization while its basic purpose is to make the activity openly

competitive, privatization has been resorted for units engaged in activities which are already wholly commercialized.

Privatization is an economic measure which has now been resorted to by more than 75 countries around the world. Under the leadership of Mrs. Margaret Thatcher, the Government of the United Kingdom began a major effort for privatization in 1979, by denationalizing what successive governments had nationalized since 1945. In early 1980, privatization had raised $ 15 billion for the exchequer in U.K.

France made an effort for privatization in 1986. This programme was to cover 65 enterprises including major banks, insurance companies, financial holding groups and industrial groups. By the end of 1987, 13 enterprises were sold for $ 11 billion.

Both in U.K. and France privatization had eased the pressure on the public budget. The budget deficit in France fell from 3.3 per cent of G.D.P. in 1985 to 2.3 per cent in 1987. The Government of U.K. lowered the general tax rate mainly due to the reduction of pressure on government budget. As a result both the countries have improved their profits and economic performance since the privatization took place. More ambitious programmes of privatization have been carried out in Chile, Mexico, Malaysia and Turkey. Of Late, Pakistan and even Bangladesh have also tried to privatize their economies. In Latin America, Chile has privatized the financial sector,

including all major banks and insurance companies and even manufacturing, transport and telecommunication.

Mexico's banking industry was nationalized by the Government in 1982, due to heavy losses and external debt burden, the government decided to turn to privatization in 1985 and 236 states, owned companies were put to sale.

The process of privatization in Turkey, has begun since 1980. Bangladesh in 1970 and recently Pakistan have also taken steps for privatization. In South-East Asia, Malaysia started privatization process since 1985.

In India, however, the waves of privatization were generated during the eighties under the regime of Prime Minister Late Sri. Rajiv Gandhi and continued slowly and steadily in the office of Prime Minister Narasimha Rao. Now-a-days privatization is gathering momentum and it has become a burning issue at present in India. In this connection a number of reforms are introduced in the insurance sector including life insurance by the government of India. Hence, an attempt has been made in this chapter to throw a light on the reforms undertaken in the insurance sector specially on the life insurance of India and critically examined the reforms undertaken so far.

7.2 LIBERALIZING INDIA'S INSURANCE:

The New Economic Policies (NEP) were announced in 1991 by the Government of India with a focus on Liberalization, Privatization and Globalization (LPG). Under the new policy, a new economic and financial reforms were initiated.

The economic reforms were liberalizing licensing policy, abolishing MRTP act, attracting of Foreign Direct Investment (FDI), allowing foreign equity in Public Sector Undertaking (PSUs) etc. The financial reforms were for restructuring of banking sector, public sector, and commercial banks allowing in mutual fund investment business, rationalizing the Export-Import (EXIM) policy and so on. Under the phase of economic reforms, insurance sector has also been restructured.

The LIC of India had functioned as a single player in arena of life insurance for the last 44 years from 1956 to the year 2000, when the insurance industry was opened up and private insurance companies entered the field, to undertake major changes in both qualitative and quantitative aspects of insurance sector. This is a part of the globalization programme launched by the government of India and the consequent loss of monopoly status to the LIC of India. Globalization would imply that India is moving towards global trends and practices.

7.3 A MARKET HIGHLIGHTS AND THE BEST PROSPECTS:

The LIC at present has a network of 7 zones, 100 divisional offices and more than 2046 branch offices. The LIC personnel exceed 7,00,000, with approximately 1,25,000 employees and over 5,50,000 agents. The life fund of the LIC, which was established in 1956 to conduct life insurance transactions, has grown to approximately US $ 25 billion from a mere US $ 94 million in its inaugural year. Over 100 million lives are covered. The annual premium income which was US $ 21 millions in 1956, was increased to US $ 4.5 Billion in 1997-98. At present, business investments of the LIC is over US $ 23 billion.

7.3B. INSURANCE BUSINESS IN INDIA:

The table 7.1 reveals that the life insurance funds constitutes around 10 per cent of gross household savings in financial assets in India, and a little more than 1 per cent of gross domestic product.

Table 7.1: Life Insurance, Household Savings, and GDP.

Year	Life Insurance as a Percentage of Household Saving in Financial Assets	Life Insurance as a Percentage of Gross Domestic Product.
1980-81	7.6	0.7
1985-86	7.0	0.7
1990-91	9.5	1.0
1991-92	10.3	1.1
1992-93	8.8	1.0
1993-94	8.7	1.2
1994-95	8.1	1.2
1995-96	11.6	1.3
1996-97	10.3	1.2

Source: Report on Currency and Finance, Vol. II, 1996-97, Reserve Bank of India.

Table 7.2: Pattern of LIC's Investment.

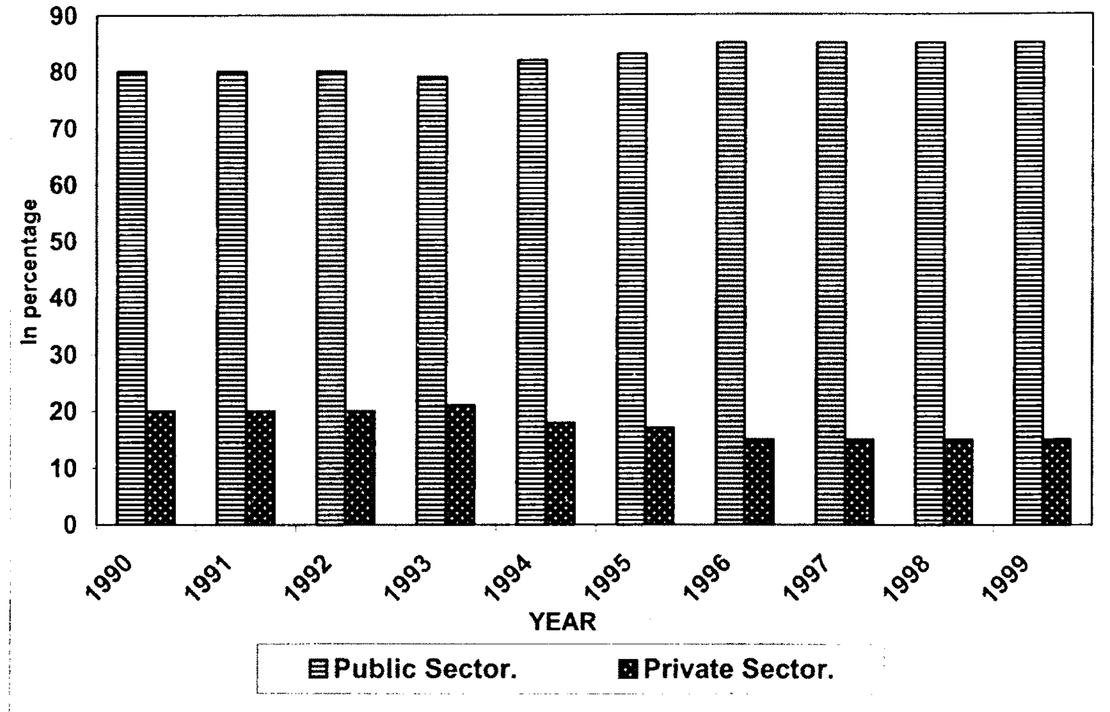
(In Percentage)

Year	Public Sector	Private Sector
1990	80	20
1991	80	20
1992	80	20
1993	79	21
1994	82	18
1995	83	17
1996	85	15
1997	85	15
1998	85	15
1999	85	15

Source: Industrial Credit and Investment Corporation of India (ICICI) and Various issues of Annual Reports and Accounts of LIC of India.

Note : As of March 31st of each year.

Fig 7.1 : Sector-wise Growth of LIC's Investment.



From the given information the LIC of India is characterized by the following conditions:

i) Limited Coverage: Life insurance funds account for only 10 per cent of gross household savings in financial assets, life insurance premiums constitute only 6 percent of gross domestic savings (GDS), only 22 per cent of the insurable population has been tapped according to the Malhotra Committee Report (1993), indicating low market penetration.

ii) High Premiums and Low Returns: A competitive industry should be able to increase coverage, mobilize more savings and provide higher returns.

iii) Eighty per cent of the LIC investments are in the public sector.

iv) A very small proportion of the LIC investments is in the private sector, table 7.2 and fig 7.1 have exhibited the same.

7.3C. POTENTIALS OF COMPETITIVENESS FOR LIFE BUSINESS IN INDIA: COMPARATIVE ANALYSIS:

For estimating the potentials of the Indian insurance market, it is better to look at the macro-economic variables. India has young demographic profile, where nearly two third of its population is under the age of 30. Yet, about 10 per cent of the population is over 60 years of age. This proportion is expected to rise sharply. By 2030, the Indian population is expected to stabilize at about 1.1 billion, about 20% of which will be over 60. Keeping in view, while compared it with across the country, the life insurance density (premium per capita) in India is dismal, and ranked 79 in the world. Developed countries like Switzerland and Japan stand first and second in the ranking order. Table-7.3 presents more details about insurance density.

Keeping in view, only 25 percent of the insurable population has been extended cover, market penetration is low, when compared it with across the country, which can be seen from the table-7.4. Accordingly, India's life insurance premium as a percentage of Gross Domestic Savings (GDS) and Gross Domestic Production (GDP) ranked 27th in mobilizing the savings in the forms of insurance premiums. In developed countries like South-Africa and United Kingdom,. life insurance premium constitutes over 50 percent of their GDS. Life insurance premiums account for over 25 per cent of GDS in the United State of America (USA), Japan and France, whereas in India, premiums account for less than 6 per cent of GDS and 2 per

cent of its GDP. Therefore, there is a vast scope for mobilizing insurance savings, assuming that India achieves conditions existing in the aforementioned countries in the future. Moreover, investment of insurance funds is skewed in India. Over 80 per cent of insurance funds are invested in the public sector, primarily in government and government backed securities. It is to note that this skew-ness is mainly the result of investment rules established by the government. Table 7.2 presents a distribution of the investments of life insurance funds.

Table 7.3: Insurance Density: Premiums Per Capita (in US $)- 1996.

Continents	Ranking	Country	Total Business	Life	Non-Life
North-America	3	USA	2460	1079	1381
	19	Canada.	1210	501	709
Latin-America	36	Chile.	161	102	59
	38	Argentina.	138	39	99
	41	Uruguay.	113	39	74
	43	Panama.	108	26	82
	45	Brazil.	95	18	77
	49	Costa Rica.	64	3	61
	51	Colombia.	49	10	39
	52	Venezuela.	47	1	46
	53	Mexico.	42	14	28
	61	Dominican Republic.	27	3	24
	65	Peru.	21	4	17
	66	El Salvador.	21	6	15
	64	Ecuador.	21	2	19
	67	Paraguay.	20	1	19
	71	Guatemala.	14	3	11
Europe.	1	Switzerland.	4663	3106	1557
	4	France.	2349	1559	790
	5	Netherlands.	2328	1268	1060
	6	Denmark.	2114	1255	859
	7	UK.	2110	1433	677
	8	Finland.	1972	1515	457
	9	Germany.	1858	762	1097
	11	Luxembourg.	1780	586	1194
	12	Austria.	1688	707	981
	13	Norway.	1584	690	894
	14	Ireland.	1519	904	615
	15	Belgium.	1507	670	837
	16	Sweden.	1477	812	665
	23	Iceland.	772	28	744

Continents	Ranking	Country	Total Business	Life	Non-Life
	24	Spain.	769	335	434
	25	Italy.	765	294	471
	27	Portugal.	609	288	321
	28	Cyprus.	479	251	228
	30	Slovenia.	452	75	377
	34	Grease	199	96	103
	37	Czech Rep.	143	39	104
	39	Croatia.	127	11	116
	44	Hungary.	98	31	67
	46	Slovakia.	83	21	62
	47	Poland	79	23	56
	56	Russia.	38	10	28
	62	Turkey.	25	4	21
	63	Bulgaria.	24	5	19
	77	Romania.	8	1	7
	81	Ukraine.	3	0	3
Asia.	2	Japan.	4132	3236	896
	17	South Korea.	1372	1037	335
	18	Singapore.	1355	978	377
	21	Hong Kong.	861	567	294
	22	Israel.	845	431	414
	26	Taiwan.	740	514	226
	31	United Arab Emirates.	276	39	237
	32	Qatar.	242	0	242
	33	Malaysia.	219	98	121
	35	Bahrain.	181	31	150
	40	Lebanon.	115	21	94
	42	Kuwait.	112	14	98
	48	Thailand.	76	36	40
	50	Oman.	63	10	53
	54	Saudi Arabia.	41	2	39
	60	Jordan.	28	8	20
	68	Syria.	19	0	19
	69	Philippines.	17	7	10
	70	Indonesia.	14	6	8
	78	PR China.	8	3	5
	79	India	7	5	2
	80	Pakistan.	4	2	2
	82	Vietnam.	2	0	2
Africa	29	South Africa.	466	367	99
	55	Libya.	39	2	37
	57	Morocco.	34	7	27
	58	Tunisia.	34	2	32
	59	Zimbabwe.	30	14	16
	72	Ivory Coast.	11	2	9
	73	Kenya.	10	2	8
	74	Egypt.	9	2	7
	75	Algeria.	9	0	9
	76	Nigeria.	8	1	7
Oceania.	10	Australia.	1805	1011	794
	20	New Zealand.	1092	305	787

Source: Rangachary: The Indian Insurance Industry (Edt.) the A.D. Shroff Memorial Trust Mumbai. 1999. PP.29 to 30.

Inference can be drawn from the analysis as below and highlight the need for the emergence of a competitive insurance industry in India. In the first instance, mobilization of domestic savings through the life insurance is low in India.

Table 7.4: Shares of Life Insurance Premium in GDS and GDP of Different Countries during 1994.

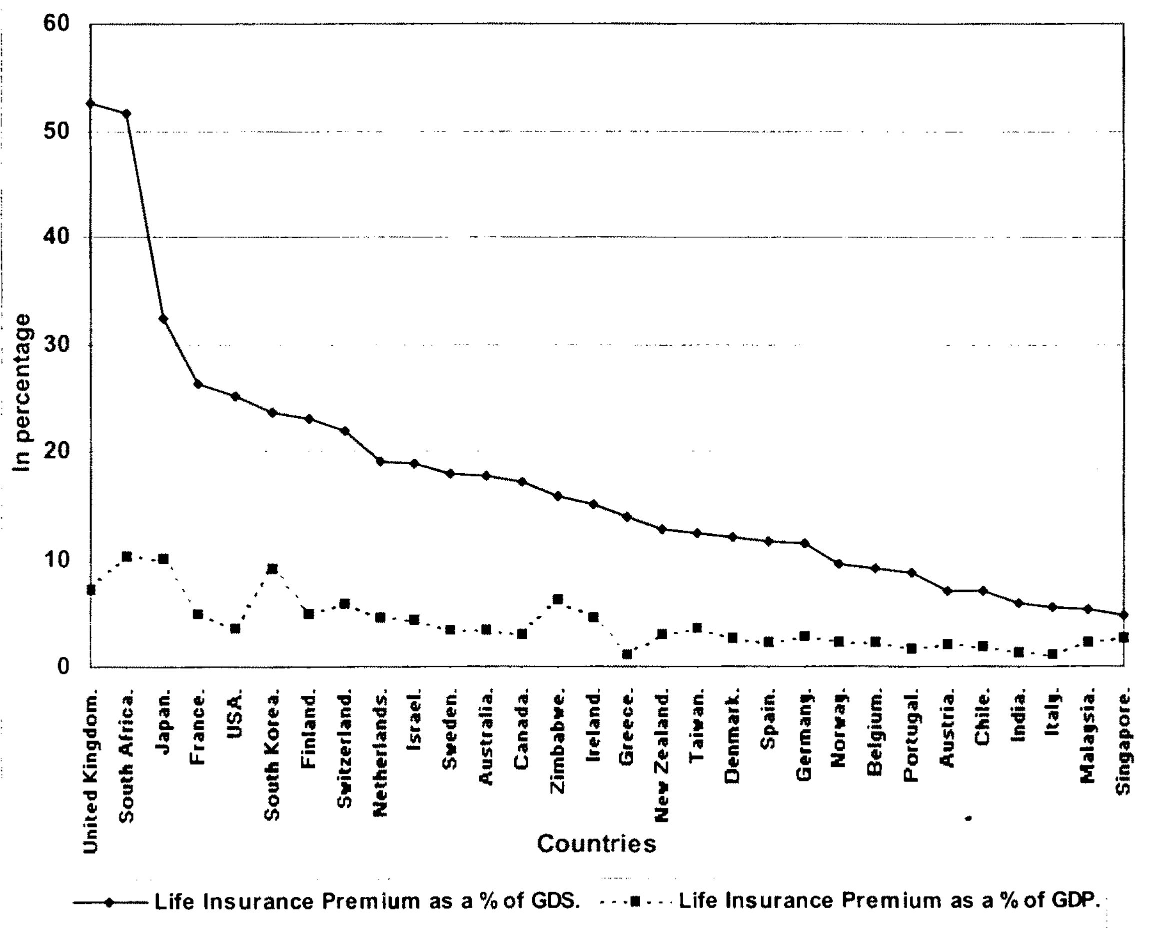
Rank	Country	Life Insurance Premium as a Percentage of GDS	Life Insurance Premium as a percentage of GDP
1	United Kingdom.	52.50	7.31 (9)
2	South Africa.	51.55	10.32 (13)
3	Japan.	32.46	10.10 (14)
4	France.	26.20	4.91 (9)
5	USA.	25.20	3.63
6	South Korea.	23.66	9.10 (12)
7	Finland.	23.10	4.98
8	Switzerland.	21.92	5.99
9	Netherlands.	19.04	4.51
10	Israel.	18.84	4.41
11	Sweden.	17.88	3.51
12	Australia.	17.78	3.48
13	Canada.	17.05	3.04
14	Zimbabwe.	15.88	6.27
15	Ireland.	14.96	4.59
16	Greece.	13.87	1.12
17	New Zealand.	12.75	3.04
18	Taiwan.	12.29	3.64
19	Denmark.	12.00	2.71
20	Spain.	11.68	2.23
21	Germany.	11.40	2.80
22	Norway.	9.57	2.33
23	Belgium.	9.13	2.38
24	Portugal.	8.76	1.65
25	Austria.	6.96	2.10
26	Chile.	6.96	1.95
27	India.	5.95 (9)	1.29
28	Italy.	5.60	1.13
29	Malaysia.	5.35	2.30
30	Singapore.	4.72	2.73

Source: ENVOSCAN Information, Special Vol.2 1996-97, LIC of India.

Note : Figures in the Parentheses pertains to the year 1999.

This can be explained partly by the fact that India is a low income developing economy whose domestic savings potential in long-term assets is not as high as that of developed economies. However, the current level of insurance premium as a percentage of GDS is also indicative of the low penetration of insurance in India. Further fig 7.2 shows the shares of life insurance premium in terms of GDS and GDP in different countries.

Fig 7.2: Shares of Life Insurance Premium in GDS and GDP of Different Countries during 1994.



However, to comprehend the strong growth of the life insurance business in India, one may consider the new and total premium collected during 1987-97. The table 7.5 reveals the new premium and total premium income of life insurance business in India.

Further, table 7.5 also represents that the LIC experienced a slow down in new premium and total income growth during 1992 to 1997. This reflects, a lack of innovation in the insurance market. The advent of competition in the insurance industry, could mobilize greater new premium and total income growth by the introduction of innovative products to the market.

Table 7.5: Growth of LIC Premium and its Total Premium Income in India-1987-97[1].

(In millions of US $)

Year	New Premiums Receivable	Total Premium Income[2]
1987-88	170.58	552.47
1988-89	227.53	694.59
1989-90	296.71	900.94
1990-91	360.24	1129.17
1991-92	423.06	1407.29
1992-93	481.88	1690.82
1993-94	592.94	2071.53
1994-95	599.76	2456.94
1995-96	665.65	2860.94
1996-97	790.82	3428.94
Annualized Growth in Percent[3]		
1988-92	25.50	26.30
1992-97	13.30	19.50
1988-92	18.60	22.50

Source: Reproduced from "India's Savings Rate: Analysis and Policy Prescriptions. Shipping Credit and Investment Corporation of India (SCICI), 1997".

Note : 1. Considers only individual insurance.
2. Includes both first year and renewal premiums, but excludes annuities.
3. Average annual compound rate.

Secondly, the return on savings in the form of insurance is normally high only when the unpredictable event against which insurance coverage is taken actually occurs, otherwise, returns are low. In India, returns are particularly low because of the high premiums charged by the LIC. Premiums are based on mortality tables of 1975. But, life expectancy has increased considerably since 1975. (New mortality table having 1994-96 as the reference period are available but have not been adopted). Individuals normally allocate a specific proportion of their savings from income for purchasing insurance coverage. To attract individuals to increase their allocation for insurance savings beyond that threshold requires incentives in the form of higher returns. In a competitive insurance market, one method that insurance companies will use to compete for customers is to provide higher returns. In the existing monopoly market, there is no incentive for the LIC to provide higher returns to the customers.

Thirdly, in a competitive insurance market, the industry is able to mobilize long term savings from the domestic economy for which there is strong demand, particularly for financing investments in infrastructure projects. Insurance companies are able to finance projects with long maturity horizons, because their liabilities are long term in nature.

Fourthly, either due to tradition or law, insurance companies reflect a preference for fixed income lending instruments in many countries. If this preference prevails in India (assuming opening up of the industry), insurance companies will play a major role in the development and expansion of the long-

term debt market in India. Such an occurrence bodes well for long-term infrastructure projects in the country.

7.4 OPENING UP OF THE LIFE INSURANCE SECTOR: GLOBALIZATION.

A foregoing comparative performance analysis of the LIC with the global experience in the insurance industry has witnessed and compelled to opening up of both the life and non-life insurance industry for the new private players. The problems, which are existing in the LIC at present are:

(1) Lack of competition in the life insurance industry, which reflects among other things, insufficient responsiveness to customer needs,
(2) High premium cost,
(3) Accessible lapsation of life policies,
(4) Huge untapped market,
(5) Over staffing,
(6) Growth of restrictive staff practice,
(7) Lags in software technology, and
(8) Lack of awareness, the monopoly of LIC.

Keeping its role in view the insurance sector constitutes a very important and vital financial intermediary for the growth of the economy. The negotiations on financial services in the context of General Agreement on Trade in Services (GATS) were concluded in December 1997. The largest component of the services sector as included in the financial sector is insurance.

To mitigate the non-coverage of both life and non-life insurance problems, on April 1, 1993 the government of India, set up the committee under the

Chairmanship of M. L. Malhotra for the reforms of the insurance sector. The committee has identified a number of problems in the insurance sector, and placed various recommendations in its report for changes in its structure, functioning and the general policy framework, keeping in mind the reforms under way in other parts of the financial sector and the economy. The committee submitted its report on 1st April 1994, but IRDA bill was accepted in October 1999 by the Cabinet with FDI limited to 26 per cent. Therefore, since October 2000 private insurance companies are returning into the insurance sector.

7.4A. ADVANTAGES OF LIBERALIZATION:

Liberalization and Privatization in insurance sector make the sector more efficient in many ways yielding many benefits of which some important benefits are:

i) Competition would result in better customer service and help improve the range quality and price of insurance products.

ii) Though the nationalized insurance industry has built-up large volumes of business, overall insurance penetration is still quite low. Therefore, entry of new players would speed up life and general insurance.

iii) There is growing competition in the non-insurance financial sector, including commercial banks, mutual funds, merchant banks, leasing companies, and other non-banking financial institutions.

iv) The world-class technology will be available in the market, bringing about tremendous improvement in servicing.

v) It will also lead to an increase in employment.

vi) Social and rural obligation will also be served as IRDA Act has come out with clear regulations in this regard which make the development in this area mandatory.

vii) Out of 50 year services, the existing insurance companies are financially strong and have created extensive infrastructures in terms of professional talent and marketing the service networks. Therefore, they are in a position to face competition.

From the above lobbies in insurance sector, the appreciation of government's efforts comes from a section of the society which said that atlast the government decided to end the monopoly of the state's insurer, recognize and enhance the importance of the insurance sector is generating the scarce long term resources for the purposes of investment and consequently for development of economy[1]. Moreover, privatization of the Indian insurance sector will make state-owned insurance companies more competitive and efficient, Finance Minister Yashwant Sinha said "With the entry of new players state-owned companies will have to offer innovative policies and value added services to remain competitive". "However, LIC and GIC, the public sector insurance companies can compete well with the new

1. Rangachary, N. 1999., Op. Cit. P. 1.

players and remain number one even after the sector is opened for private sector", he said. By providing new products and better service to the customers, state owned insurance companies can attract more policy holders. As Rangacharya [2] said that the entry of new insurance companies into the Indian market will help to stem the tide of the outflow and develop the indigenous capacity and strength of Indian market.

7.4B. SALIENT FEATURES OF THE INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY ACT (IRDAA), 1999:

As highlighted in a pre-budget 2000-01 document of Indian Economic Survey 1999-2000, the following are the salient features of IRDA Act 1999:

i) The insurance sector in India has been thrown open to the private sector. The second and third schedules of the Act provide for removal of exclusive privilege of existing corporations/companies to do life and general insurance business.

ii) An Indian insurance company is a company registered under the companies Act, 1956 in which foreign equity does not exceed 26 per cent of the total equity shareholding, including the equity shareholding of Non-Resident Indians (NRIs), Foreign Institutional Investors (FIIs) and Overseas Corporate Bodies (OCBs).

iii) After the commencement of an insurance company, the Indian promoters can hold more than 26 per cent of the total equity holding for a period of ten years, the balance shares being held by non-promoter Indian share holders which will not include equity of the foreign promoters, and share holding of FIIs, NRIs and OCBs.

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2. Rangacharya, N. 1999. Op.Cit. P.14.

iv) After the permissible period of ten years, excess equity above the prescribed level of 26 per cent will be dis-invested as per a phased programme to be indicated by IRDA. The central government of India is empowered to extend the period of ten years in individual cases and also to provide for higher ceiling on share holding of Indian promoters in excess of which dis-investment will be required.

v) On foreign promoters, the maximum of 26 per cent will always be operational. They will, thus, be unable to hold any equity beyond this ceiling at any stage.

vi) The Act gives statutory status for the Interim Insurance Regulatory Authority (IRA) set up by the Central Government through resolution in January 1996.

vii) All the powers presently being exercised under the Insurance Act, 1938 by the Controller of Insurance (COI) will be transferred to the Insurance Regulatory and Development Authority (IRDA).

viii) The IRDA Act also provides for the appointment of COI by the Central Government when the Regulatory Authority is superseded.

ix) The minimum amount of paid-up equity is Rs.100 crores in case of life insurance as well as general insurance and Rs.200 crores in case of re-insurance.

x) Solvency margin (excess of assets over-liabilities) is fixed at not less than Rs.50 crores for life as well as general insurers; for reinsurance solvency margin stipulated at not less than Rs.100 crores in each case.

xi) Insurance companies will deposit Rs.10 crores as security deposit before starting their business.

xii) In the non-life sector, IRDA would give preference to companies providing health insurance.

xiii) Safeguards for policy holders funds include specific provision prohibiting investment of policy holders funds' outside India and provision for investment of funds in accordance with policy directions of the IRDA, including social and infrastructure investments.

xiv) Every insurer shall provide life insurance or general insurance policies (including insurance for crops) to the persons residing in the rural sector, workers in the unorganised or informal sector or for economically vulnerable or backward classes of the society and other categories of persons as may be specified by regulations made by IRDA.

xv) Failure to fulfill the social obligations would attract a fine of Rs.25 lakhs in case the obligations are still not fulfilled, license would be cancelled.

Whatever may be the benefits availed by opening up of the insurance sector in India, this has not been free from opposition of the IRA Bill, which emanates from the opening of the insurance business to competition and it is pointed out that the entry of foreign players in the insurance sector, that the government thoughtlessly entered into an area where no progressive steps were considered

necessary. Besides, the persons against the opening up of the insurance sector say that all that was required to be done for the healthy existence and growth of insurance companies in India had already been done and no further progress would be needed. According to U. S. Congressional Committee report in 1990, more than 420 insurance ventures collapsed, 370 of the seeking insolvency in between 1970 to 1990. According to the Sigma-Swiss report that most of the American insurance corporate-prudential, metropolitan and first executive were in trouble over fines, many companies entered in to the black list during the period from 1975 to 1992.

Moreover, it is argued that if foreign companies are allowed to enter, they will capture the lion's share of the market potential due to their enormous financial clout. Hence, the competition will become meaningless. Therefore, it can be drawn that foreign companies will not provide social insurance, they will skim the prime area of operation for profit, and will neglect the social sector. Besides, they will not provide subsidized insurance coverage, and the customer satisfaction is the last priority in their agenda.

From the above it is clear that the IRDA Act marks the end of monopoly of the government in the insurance sector, which seeks to promote the private sector (including limited foreign equity) in the insurance sector. It however, gives priority in the utilization of policy holders' funds for the development of social and infrastructure sectors.