A Study on Indian Insurance Industry and Foreign Direct Investment

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Abstract

The government of India has increased the foreign direct investment to 49% from 26% with full Indian management control and through the FIPB route. However it is not yet made clear about how approval of the extra 23% investment will be made. There are still plethora of uncertainties, restrictions and potential economic risks. The economic liberalization which started in 2001 have bought new investments from global giants and the government was hard pressed to facilitate global integration by lowering trade barriers for the free flow of technology, intellectual and financial capital. Liberalization of insurance creates an environment for the generation of long term contractual funds for infrastructural investments. This paper's objectives are to investigate the Indian insurance industry and review on foreign investors on FDI, as well as an overview of the Indian Policy and Regulatory Environment.

Keywords: Government of India, Liberalization, Foreign Direct Investment, Regulatory Environment.

An Overview of Insurance Industry

In India, insurance has a deep-rooted history. Insurance in various forms has been mentioned in the writings of Manu (Manusmrithi), Yagnavalkya (Dharmashastra) and Kautilya (Arthashastra). The fundamental basis of the historical reference to insurance in these ancient Indian texts is the same i.e. pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine. The early references to Insurance in these texts have reference to marine trade loans and carriers' contracts.

Insurance in its current form has its history dating back until 1818, when Oriental Life Insurance Company was started by Anita Bhavasar in Kolkata to cater to the needs of European community. The pre-independence era in India saw discrimination between the lives of foreigners (English) and Indians with higher premiums being charged for the latter. In 1870, Bombay Mutual Life Assurance Society became the first Indian insurer.

At the dawn of the twentieth century, many insurance companies were founded. In the year 1912, the Life Insurance Companies Act and the Provident Fund Act were passed to regulate the insurance business. The Life Insurance Companies Act, 1912 made it necessary that the premium-rate tables and periodical valuations of companies should be certified by an actuary. However, the disparity still existed as discrimination between Indian and foreign companies. The oldest existing insurance company in India is the National Insurance Company, which was founded in 1906, and is still in business.

The Government of India issued an Ordinance on 19 January 1956 nationalizing the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The Life Insurance Corporation (LIC) absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies—245 Indian and foreign insurers in all. In 1972 with the General Insurance Business (Nationalization) Act was passed by the Indian Parliament, and consequently, General Insurance business was
nationalized with effect from 1 January 1973. 107 insurers were amalgamated and grouped into four companies, namely National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd and the United India Insurance Company Ltd. The General Insurance Corporation of India was incorporated as a company in 1971 and it commence business on 1 January 1973.

The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector. Before that, the industry consisted of only two state insurers: Life Insurers (Life Insurance Corporation of India, LIC) and General Insurers (General Insurance Corporation of India, GIC). GIC had four subsidiary companies. With effect from December 2000, these subsidiaries have been de-linked from the parent company and were set up as independent insurance companies: Oriental Insurance Company Limited, New India Assurance Company Limited, National Insurance Company Limited and United India Insurance Company Limited.

The insurance industry was privatized by passing the required regulations by the government. There were several problems being faced by the company such as limited reached, quality of service standards and penetration of enterprise. The Indian insurance sector was liberalized in the year 2001. FDI in insurance remains a debated and heated issue in India’s economic and political environment. Changes in the regulatory environment had path-breaking impact on the development of the industry. While the insurance industry still struggles to move out of the shadows cast by the challenges and uncertainties.

<table>
<thead>
<tr>
<th>Type of Insurance</th>
<th>No. of Public Sector Companies</th>
<th>No. of Private Sector Companies</th>
<th>Total Companies</th>
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<tr>
<td>Life Insurance</td>
<td>01</td>
<td>23</td>
<td>24</td>
</tr>
<tr>
<td>General Insurance</td>
<td>06</td>
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<tr>
<td>Re Insurance</td>
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</tr>
<tr>
<td>Total</td>
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<td>45</td>
<td>53</td>
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Source: www.irda.gov.in

Objectives

1. To review the current policy and regulations of Indian Insurance Industry
2. Indian policy and regulatory environment on FDI in Insurance Sector

FDI in Insurance

The government created a specific Board to deal with promotion of FDI in India and to be the sole agency to handle matters related to FDI. The ‘Foreign Investment Promotion Board’ (FIPB) as it is known, is chaired by the Secretary Industry (Department of Industrial Policy & Promotion or DIPP) within the office of the Prime Minister. Its key objectives are to promote FDI in India with investment promotion activities both domestically and internationally by facilitating investment in the country via international companies, NRIs (non-resident Indians) and other forms of foreign investors.

In the Union Budget 2014-15 on July 10, 2014, Finance Minister has proposed to increase the foreign direct investment (FDI) limit in the insurance sector, up to 49% from 26% with full Indian management and control through the FIPB route. Additionally, to boost financial savings, Government also raised the 80C investment cap to ₹1.5 lakh from ₹1 lakh.

The move to provide funds for the capital intensive industry needs to be acknowledged, with a hope of huge capital inflows, which would lead to product innovation, better
customer service mechanism and higher insurance penetration in the country. But there could be a dampener in the form of voting rights, which is limited to 26%. Additionally, the increase in 80C deduction limit to 1.5 lakh, may help the insurers to tap the new business, which has been declining. With tax sops let’s hope it’s a beginning of ‘acche din (better days)’ for the life insurance industry, as this may encourage people to invest in long term savings instruments like life insurance.

The Cabinet Committee on Economic Affairs headed by Prime Minister has approved the limit of Foreign Direct Investment (FDI) in Insurance sector to 49 percent from the existing 26 percent. The cabinet has cleared the FDI limit in insurance companies through FIPB route which necessitates the management control with the Indian promoters.

Policy and Regulatory Environment

Key regulatory changes are;

1999: IRDA Bill cleared and liberalization of the sector & formation of an independent regulator
2001: IRDA issues Third Party Administrator regulations (TPAs) & foreign players allowed to enter with FDI limit of 26%.
2002: IRDA insurance brokers and corporate agent regulation.
2006: Entry of Standalone health insurance Players allowed.
2007: Creation of Indian Motor Third party Insurance Pool & Price Deterrification
2011: Merger Acquisition Guidelines.
2012: Introduction of Declined Risk pool, TP premium increase
2014: FDI limit increased to 49%

Key legislation which may impact on foreign investors setting up Insurance Company in India;

Insurance Act, 1938
Life Insurance Corporation Act, 1956
General Insurance Business (Nationalization) Act, 1972

Insurance Regulatory and Development Authority (IRDA) Act, 1999
Acutaries Act, 2006

Benefits of Increased FDI in Insurance Industry in India

The higher FDI cap will immensely help the insurance sector which is extremely short on investments. Benefits of Increased FDI limit in Insurance Sector are as below;

Increased Insurance Penetration– With the population of more than 120 crores, India requires Insurancemore than any other nation. However, the insurance penetration in the country is only around 3 percent of our gross domestic product with respect to over-all premiums underwritten annually. This is far less as compared to Japan which has an insurance penetration of more than 10 percent. Increased FDI limit will strengthen the existing companies and will also allow the new players to come in and thereby enabling more people to buy life cover.

Level Playing Field – With the increase in foreign direct investment to 49 percent, the insurance companies will get the level playing field. So far the state owned Life Corporation of India controls around 70 percent of the life insurance market.

Increased Capital Inflow – Most of the private sector insurance companies have been making considerable losses. The increased FDI limit has brought some much needed relief to these firms as the inflow of more than 10,000 crore is expected in the near term. This could go up to 40,000 crore in the medium to long term, depending on how things pan out.

Job Creation–With more money coming in, the insurance companies will be able to create more jobs to meet their targets of venturing into under insured markets through improved infrastructure, better operations and more manpower.
Favorable to the Pension Sector – If the pension bill is passed in the parliament then the foreign direct investment in the pension funds will also be raised to 49 percent. This is because the Pension Fund Regulatory Development Bill links the FDI limit in the pension sector to the insurance sector.

Consumer Friendly – The end beneficiary of this amendment will be common men. With more players in this sector, there is bound to be stringent competition leading to competitive quotes, improved services and better claim settlement ratio.

Conclusion

Despite the current policy and regulatory environment not being ‘perfect’ for foreign investors, there are clearly moves towards improving the current position and facilitating FDI inflows without impacting on other sectors of the economy. The benefits of the increased FDI would be seen more in the long term than in the short term. Most prominent insurance companies have a presence in India and will be able to augment their shareholding. There is also a threat for Indian promoters in the insurance business as they are supposed to face competition from foreign companies. Broadly, this would tend to create an healthy competition.

Many international studies have estimated that the insurance industry in India can grow by over 125 per cent in the next ten years. In fact, India has been identified as one of the fastest growing insurance markets. The current policy is trying to encourage Joint Ventures in insurance industry so as to boost the domestic insurer’s growth in this area. However; there is also the risk that some foreign insurers will not be interested in investing unless they have 100% ownership and that the current policy will prevent them from choosing India as an Insurance destination.

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