ISSN 0038-4046

SOUTHERN ECONOMIST

45th Year of Publication

Volume 45 Number 2 Rs. 20

FDI IN INSURANCE SECTOR

FOOD SECURITY SITUATION IN PUNJAB

LEADERSHIP AND IMPACT ON CORPORATE CULTURE

FOREIGN TRADE POLICY 2004-09

ECONOMIC & FINANCIAL DATA

MAY 15, 2006

FDI in Insurance Sector in India

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The Union Government had opened up the insurance sector for private participation in 1999 allowing them to have foreign equity up to 26 per cent. Following the opening up of the insurance sector, 12 private sector companies have entered the life insurance business. Apart from the HDFC, which has a foreign equity of 18.6%, all the other private Companies have foreign equity of 26 per cent. In general insurance, 8 private companies have entered, 6 of which have foreign equity of 26 per cent. Among the private players in general insurance, Reliance does not have any foreign equity. Company wise Life-insurers equity share capital with FDI proportion has been presented in Table1.

Table-1 shows that the ICICI prudential company has invested Rs 625 crore, out of which Rs 175.5 crore (26%) is foreign equity. It is one of the private leading insurance companies in India. Next come the Max New Yark life with Rs 3408 crore investment with a foreign equity of Rs 89.98 crore (26%), Birla sunlife with Rs 290 crore with a foreign equity of Rs Rs 75.4 crore (26%), HDFC Standard with Rs 255.5 crore with a foreign equity of Rs 47.52 crore (18.6 %). And the remaining all other players claim only 26 % of the foreign equity. The total equity capital is Rs 3238.71 crore with a foreign equity of Rs 782.34 crore (i.e. 26%). It can also be observed that no company injected much capital in this business during the period of 2001-02, 2002-03 and 2003-04.

Company wise Non-Life insurers equity share capital with FDI proportion has been presented in Table-2.

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Table-2 discloses that the ICICI Lambard has invested Rs 220 crore with Rs 57.2 crore of foreign equity (26%), which is the highest among the non-life insurance players in India, followed by Cholamandalam with an investment of Rs. 141.96 crore with Rs 36.91 foreign equity (26%). On the other hand, Reliance General has invested Rs 102 crore without any foreign equity. And the remaining players which entered the non-life insurance business seize 26% of foreign equity.

> After liberlisation of insurance sector in 1999, no significant change has taken place as for as mobilizing savings by this sector is concerned. The foreign capital that followed in after the opening up of the insurance sector has not been accompanied by any technological innovation in the insurance sector. It is, therefore, suggested to bring down the entry capital norm of Rs. 100 crore to Rs 60 crore for life and non-life insurance business and Rs 50 crore for health insurance, which would, obviously attract more number of domestic players and wean the sector from depending on foreign equity and Players.

In aggregate, all private insurers have invested Rs 1048.96 crore, out of which Rs 246.21 crore is foreign equity. It is clear from the table that no company injected more capital in this sector too during the period of 2001-02, 2002-03 and 2003-04. The insurance sector had attracted Rs 1,028.55 crore as foreign equity in the span of only four years.(.e 2000-01 to 2003-04). By the way, it is indispensable to observe the profitability of the private insurers and presented in Table-3.

Table-3 shows that 12 out of the 13 private companies in life insurance had suffered losses in 2003-04. The aggregate loss of the private life insurers amounted to Rs. 966.37 crore in contrast to that of Rs.551.81 crores surplus (after tax) earned by the LIC. In general insurance, 2 out of the 8 private insurers had forced losses in 2003-04, the Reliance company, with no foreign equity, earned Rs 8.02 crore, emerging as the most profitable player.

On the other hand, the public sector insurers in general insurance made an aggregate after tax profits of Rs. 1343.99 crore. The public sector insurance companies are more profitable than the private ones. If profitability is taken to be an important indicator of efficiency, it is clear that the case for further hike in the FDI cap in the insurance sector cannot be made on efficiency grounds. In the following paragraphs, the reputation of the foreign partners, competition, implication for resources mobilization, ratio of savings in life insurance by households to GDP and suitable suggestions have been presented.

Reputation of Foreign Partners

The record of some of the foreign companies who have started operating in India is being questioned abroad. An article published in *The Economist* (May 4, 2004) on 'AIG's Accounting Lessons' (AIG is Tata's partner in India) came with the screaming headline which read them: "The world's largest insurance company shows how to polish profits statement". The Prudential Financial Services (ICICI's partner in India) is facing an enquiry by the securities and insurance regulators in the U.S. based upon the allegations of having falsified documents and forged signatures and of asking their clients to sign blank forms (*New York Times*, May 31, 2003 and *Wall Street Journal*, May 31, 2003). This follows a payment of $2.6 billion made by Prudential to settie a class-action lawsuit attacking abusive life insurance sales practices in 1997 and a $ 65 million dollar fine from state insurance regulators in 1996. It is evident that the questionable activities of these insurance companies are not deterred by state imposed penalties and litigations. (A short note submitted by the Left Parties to the UPA "FDI in the Insurance Sector" obtained through Internet.)

The financial health of many of the foreign insurance companies operating in India is also a cause of serious concern. *The Economist* (April 1, 2004) reports the sorry plight of Standard Life of UK (HDFC's partner in India), which is unable to remain afloat without the possibility of raising money in debt or equity markets. AMP closed its life insurance operations for new business in June 2003. Royal Sun Alliance also shut down their profitable businesses in 2002. A recent report by Mercer Oliver Wyman, a consultancy, found that European life insurance companies are short of capital by a whopping 60 billion euros. The reason for the short fall in capitalization, among other things, is that of European Unions' new regulation on solvency called 'Solvency 2' that will be enforced across Europe from 2005 through 2007.

Table-1 — Equity Share Capital of Life Insurance Companies

(Rs in Crore)

	Life insurer	2001-02	2002-03	2003-04	Foreigner	Indian	FDI (%)
1	ICICI Prudential	190	425	675	175.5	499.5	26
2	Max New York Life	250	255	346.08	89.98	256.1	26
3	HDFC Standard Life	168	218	255.5	47.52	207.98	18.6
4	Allianz Bajaj	150	150.03	150.07	39.02	111.05	26
5	Birla Sun Life	150	180	290	75.4	214.6	26
6	Tata AIG Life	185	185	231	60.06	170.94	26
7	OM Kotak Mahindra	101	131.3	151.26	39.33	111.93	26
8	AVIVA life	0	154.8	242.8	63.13	179.67	26
9	ING Vysya Life	110	170	245	63.7	181.3	26
10	SBI Life	125	125	175	45.5	129.5	26
11	AMP Sanmar	125	125	160	41.6	118.4	26
12	MetLife	110	110	160	41.6	118.4	26
13	Saharalife	0	0	157	0	157	0
TOTAL		1664	2229.13	3238.71	782.34	2456.37	

Source: *IRDA Annual Report* 2003-04, Statement No.26, p.117

Table-2
Equity Share Capital of Non-life Insurance Companies

	Insurer	2001-02	2002-03	2003-04	Foreign	Indian	FDI (%)
1	Royal Sundaram	130	130	130	33.8	96.2	26
2	Tata-AIG	125	125	125	32.5	92.5	26
3	Reliance General	102	102	102	0	102	Nill
4	IFFCO-Tokio	100	100	100	26	74	26
5	ICICI-Lombard	110	110	220	57.2	162.8	26
6	Bajaj Allianz	110	110	100	28.6	81.4	26
7	HDFC CHUBB	0	101	120	31.2	88.8	26
8	Cholamandalam	49.5	105	141.96	36.91	105.05	26
Total		726.5	883	1048.96	246.21	802.75	

Source: *IRDA Annual Report* 2003-04, Statement No.26,p.117

According to the Mercer Oliver Wyman Report the German, Swiss, French and British insurers suffer from severe capital inadequacy, which is a result of undertaking risky investments in equity and debt instruments in the past. Several issues of Sigma, a reputed Swiss journal on insurance, have reported that the U.S. and Europe based insurance companies have captured gloomy growth prospects in the advanced country markets with several companies experiencing negative growth in the recent past. Moreover, tighter capital adequacy norms and other regulations that are currently being imposed in the advanced countries are pushing these insurance companies to seek less regulated markets in developing countries and to undertake high-risk ventures. Raising the FDI cap in India at this juncture would expose our financial markets to the speculative activities of the foreign insurance companies at a time when the virtues of regulating such activities are being rediscovered in the advanced countries.

Competition in Insurance Sector

Even after the liberalisation of the insurance sector, the public sector insurance companies have continued to dominate the insurance market, enjoying over 76 per cent of the market share. In fact, the LIC, which is the only public sector life insurer, enjoys over 73.91 per cent of the market share in Life insurance. Given the huge market share enjoyed by the public sector companies, the argument, which is often made by advocates of greater liberalisation, that the entry of private players would bring down the cost of insurance due to the enhanced competition,does not seem to be noticed. The price making capacity of the market leaders in the public sector is likely to remain intact for the time being. The foreign insurance companies do have the reputation of charging less premium compared to the risks involved and promising abnormally high returns in order to grab greater market share. Such competition, however, although capable of reducing the 'cost' of insurance for a while, has often led to gigantic frauds and bankruptcies.

Moreover, as is the case in other markets, the initial flurry of entries into the Indian insurance market would invariably be followed by a phase of mergers and acquisitions that would lead to cauterization, precluding the possibility of competition driving down the costs in the medium run. In the long run, other forms of non-price competition like aggressive advertisement wars are likely to result in increasing costs, eventually harming the interests of the consumers. These phenomena in the insurance market have been observed in several advanced countries. If the public sector companies start imitating the strategies of the foreign insurance companies in order to defend their market shares, it would be at the cost of undermining their important social objectives, which they have been fulfilling so impeccably till date.

Resource Mobilisation

A major role played by the insurance sector is to mobilize national savings and channelise them into investments in different sectors of the economy. However, no significant change seems to have occurred, as far as mobilizing savings by the insurance sector is concerned, following the liberalisation of the insurance sector in 1999. Data from the RBI shows that the trend of the savings in life insurance by the households to GDP ratio, while showing a clear upward trend through the 1990s signifying increasing business for the insurance sector, does not show any structural break after 1999 It can, therefore, be inferred therefore that the foreign capital which flowed in after the opening up of the insurance sector to private players has not been accompanied by any technological innovation in the insurance business, which would have created greater dynamism in savings mobilization.

Rural and Urban areas

The business activities of the private companies are limited in urban areas, where a fairly good market network of the public sector insurance companies already exists. The glaring evidence for this is the composition of agents operating in the insurance sector. According to the IRDA Annual Report, the number of insurance agents in urban and rural India was 100 and 76 accordingly in the public sector in 2003-04. For the private insurance companies this ratio was 100:39.

On account of their urban-bound operational activity, the private insurance companies can neither increase the insurance base of the economy significantly, nor lead to substantial employment generation. Given this background, further increase in foreign participation is only going to yield on intensified competition for the urban insurance markets, rather than lead to a growth in overall savings. To place the proposal for hike in FDI, the government advanced such arguments that FDI would continue to be encouraged and actively sought, particularly in the areas of infrastructure, high technology and exports.

Induction of new Technology

The issue of foreign equity is often linked to the induction of new technology and products. The private insurance companies have nothing to offer in this respect. In the insurance sector, there is no need for technology to be brought in from other countries, leave alone high technology. The mortality rates and other principles of insurance are based on the Indian conditions, because the policyholders are from this country. The products of LIC are being renamed by the private insurance companies and are sold as their own products. Hence, foreign expertise is also not involved in this sector. Therefore there is no justification even on this count. It was also argued that competition would expand market and the foreign insurers would bring in better products. The size of the market has remained by and large the same and from this market the private companies are picking up the creamy sections in the metros seriously eroding the ability of public sector to subsidize its products in the rural areas.

Long-term Investment in Social and Infrastructure sectors

Life insurance is all about mobilising the savings for long term investment in social and infrastructure sectors. It was also argued that opening up of insurance market would enable huge flow of funds into infrastructure. The record of private companies on this is dismal. More than fifty percent of the policies they sell are unit-linked insurance where the decision on investment of savings element in insurance is taken by the policyholders.

In fact, as per a press report, ninety five percent of policies sold by Birla Sun Life and over 80 percent of policies sold by ICICI Prudential were unit-linked policies during 2003-04. Under these schemes, nearly 50 percent of the funds were invested in equities, thus, limiting the fund availability for infrastructural investments. As against this, the LIC has invested Rs.38140.94 crore as on 31.3.2004, (98.92 per cent of the total investment in infrastructure by the entire life insurance sector) in power generation, road transport, water supply, housing and other social sector activities. The figures provided by the IRDA Reports further suggest that the share of the public sector life and non-life insurance companies in investment in infrastructure is greater than their market share.

Despite the FDI cap being set at 26%, the investment from the insurance sector to the infrastructure sector was predominantly from the public sector companies. Therefore, the argument that raising the FDI cap in the insurance sector would help in mobilizing resources for infrastructure does not hold any weight. On the other hand, greater foreign control is more likely to lead to a decline in the share of investment of the private insurance companies into the infrastructure sector, given the record of the foreign insurance companies in siphoning resources for speculative financial ventures. It is also worth mentioning that the only insurance company involved in insuring Indian exports is the Export Credit Guarantee Corporation of India, which provides insurance cover to export credit.

The ECGC has been in existence since 1957. It is functioning under the United India Insurance Co. No private player with foreign partnership has ventured into this area. Moreover, the LIC and other public sector units are the only ones to undertake overseas operations, as reported by the Annual Reports of the IRDA. Foreign participation has also not helped in marketing Indian insurance products abroad.

India's domestic savings: Foreign investors are not interested in minority holding at whatever level but in securing controlling interest. Nor they are interested in bringing additional resources for development. They are interested in gaining control over India's domestic savings. Their overriding reason is profit.

Social responsibilities: Foreigners have no new products to render. They confine themselves to skimming the cream of the business eschewing all social responsibilities. The public sector insurance, on the contrary, is seen expanding insurance cover to hitherto uncovered area and investing heavily in social and economic development.

The foreign partner would be the majority shareholder: The hike of the foreign equity will increase the ability of the private companies to manipulate and exploit the insurance market. Once the foreign partner's equity goes up to 49% and the Indian partner puts up his share for public offer, the foreign partner would be the majority share holder and effectively control the company. Thus, the foreign capital will gain greater access and control over the domestic savings. This has happened in other industries including Banks.

Targeting urban elite: The private companies have been eyeing on the urban elite and cornering premiums of higher denominations and they are completely absent in rural and other socially purposive insurance cover and foreign investment creates an even climate of competition against the public sector. They will become much more aggressive in this respect with the availability of increased foreign capital.

Table-3 — P& L a/c of Insurers for the period ended 31-Mar-04

(Rs.in Crore)

	Life Insurer	Losses	Profits
1	ICICI Prudential	221.58	
2	Max New York Life	232.76	
3	HDFC Standard Life	23.44	
4	Allianz Bajaj	26.81	
5	Birla Sun Life	77.74	
6	Tata AIG Life	58.09	
7	OM Kotak Mahindra	92.42	
8	AVIVA life	64.2	
9	ING Vysya Life	62.99	
10	SBI Life	16.41	
11	AMP Sanmar	77.8	
12	MetLife	12.13	
13	Saharalife	na	
	Sub total	**966.37**	
	LIC (profits)		**551.81**
	Life Insurance	**966.37**	**551.81**
	GENERAL INSURER		
1	Cholamandalam	6.15	
2	HDFC Chubb	22.19	
3	Royal Sundaram		8.02
4	Tata-AIG		15.3
5	Reliance General		9
6	IFFCO-Tokio		9.58
7	ICICI-Lombard		31.78
8	Bajaj Allianz		21.7
	Sub Total	**28.34**	**95.38**
	Public Sector		**1343.99**
	Total profit/loss	28.34	1439.37

Source: IRDA Annual report 2003-04

The private companies keep a safe distance away: In general insurance, motor third party insurance which is a chronically loss making portfolio is practically being handled by the public sector. On the other hand, the private players were interested in Medical insurance and marine and fire. These areas are mostly catering to the needs of richer clients.

The same old products, The same old advertisements, The same old customers base and The same trite strategies: The products of LIC (PSU) are being renamed by the private insurance companies and are sold as their own products. Hence, Foreign expertise is also not involved in this sector.

Unit Link Insurance Policy (ULIP): Insurance is all about mobilizing the savings for long term investment in social and infrastructure sector. According to the IRDA annual report 2003-04, 95% of policies sold by Birla Sun Life and over 80% of policies sold by ICICI prudential were unit link policies. And, others sold more than 50% of the policies, which were Unit link Policies, where the policyholders took the decision on the investment of savings in insurance. Based on the above discussion, the following suggestions have been made to develop the insurance sector from domestic savings with Indian entrepreneurs only.

Suggestions

1. Reduce the paid up capital from Rs 100 crore to Rs 60 crore to enable private players to enter life and non-life insurance and to Rs 50 crore in health insurance and restrict to Indian entrepreneurs only: Over the six year of liberalization, enough has been trumpeted about the extremely limited penetration of life insurance sector in India and private players promises about technology and penetration, which has not been materialized in practices. In this connection, it is suggested that to reduce entry capital from Rs 100 crore to Rs 60 crore for life and non-life insurance and Rs 50 crore for health insurance rather than to liberalize sovereignty Insurance Act 1938, thus driving domestic savings to other countries.

2. LIC policies may not have the government guarantee in near future, it is, therefore, suggested that the government should allow the LIC to go for public issues, because any insurer has to meet the solvency margin requirements, which were stipulated by the IRDA in 2004 and survival of PSU is essential.

3. **Bancassurance:** It helps insurance companies in more ways than one. Insurance companies can leverage bank's existing database of customers to enhance the list of potential targets. But the major challenge for bancassurance lies in changing the mind set of bank employees and improving the quality of distribution through bank branches and leveraging it effectively to increase penetration.

4. **Post Offices/ SHGs:** Insurance companies should sell their policies through post offices and Self Help Groups.

5. **Brokers:** Brokers are different from typical insurance agents. Even if they receive commission from a particular insurance company, they can still promote schemes of other insurance companies to the client. Insurance brokers help corporation as well as individuals to choose the right product at the right time and at the right price and these people can give non-biased advises to their clients. It is, therefore, suggested to sufficiently fund the brokers to penetrate insurance business rather than depend on huge FDIs.

6. **Rigorous scrutiny:** The insurance companies are trustees of public money, so IRDA should adopt a rigorous system for scrutiny of applications based on financial strength, track record and the reputation of the promoters, with regard to the compliance with regulation and the strength of the internal control system, product innovations, technical and managerial skills, and commitment to contribute to India's development as a regional insurance hub an international financial center for setting up insurance companies by the Indians only.

7. **Tax incentives:** Government should encourage insurers by offering tax incentives rather than imposing Service tax and Cess on them The tax may be called "premium tax" rather than the service tax because no service is done.

8. **ULIP:** Private companies were the first to extended Unit Linked Insurance Policies (ULIP) in the form of insurance-cum-investment. But ULIP is a long-term investment and must be brought to the notice of the customers. It is suggested that the private companies be strictly regulated and that must they follow the laid-down capital and solvency requirements, which ensure that they are trust worthy in the long run.

9. Investment guidelines for insurance companies prescribed by the regulators must be changed so as to allow and promote access to insurance funds by the corporate sector and infrastructure projects.

10. **Awareness of insurance in rural India:** There is pressing need for increasing awareness, suitable rural insurance products, effective distribution systems and importantly, the orientation of insurance products towards financial risk protection, with low sum assured and small premiums. The distribution cost of rural insurance products is so high when compared to the urban products. As in the case of micro rural insurance, it is necessary to have low-cost, seasonal payment mode and effective distribution system should be created to serve the large un-served rural people. Finally, Based on above facts, it is better to make internal structural adjustments than to bank enormous FDIs, compromising on domestic savings.

Conclusion

According to the IRDA annual report 2003-04, 12 out of the 13 private insurance companies in life insurance business suffered losses in 2003-04. The aggregate loss of the private insurers amounted to Rs 966.37 crore in contrast to the R 551.81 crore surplus (after tax) earned by the LIC. In general insurance, Reliance General insurance company has earned a profit of Rs 9 crore in 2003-04 without any foreign equity.

After liberlisation of insurance sector in 1999, no significant change has taken place as for as mobilizing savings by this sector is concerned. The foreign capital that followed in after the opening up of the insurance sector has not been accompanied by any technological innovation in the insurance sector. The private players are adopting the same old products, the same old advertisements, and the same old customers base. It is, therefore, suggested to bring down the entry capital norm of Rs 100 crore to Rs 60 crore for life and non-life insurance business and Rs 50 crore for health insurance, which would, obviously attract more number of domestic players and wean the sector from depending on foreign equity and Players.

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