

Foreign direct investment in insurance sector in India

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Abstract

One of the most striking developments during the last two decades is the spectacular growth of FDI in the global economy landscape. This unprecedented growth of FDI in 1990 around the world make FDI an important and vital component of development strategy in both developed and developing nations and policies are design in order to stimulate inward flows. FDI provides a win-win situation to the host and the home countries. Both countries are directly interested in inviting FDI, because they benefit a lot from such type of investment. Generally speaking FDI refers to capital inflows from abroad that invest in the production capacity of the economy and are usually preferred over other form of external finance because they are non-debt creating non-volatile and their returns depend on the performance of the projects financed by the investors. FDI inflow helps the developing countries to developed transparent, broad and effective policy environment for investment issues as well as, builds human and institutional capacities to execute the same. The insurance sector is of considerable importance to every developing economy; in includes the saving habit, which in turn generates long-term investible funds for infrastructure building. This Paper's objectives are to investigate the Indian Insurance sector, to know benefits of increased foreign direct investment limit in insurance sector, to know the Government policy regarding insurance sector in India, to know Issues in FDI in Insurance Sector.

Introduction

Even after the liberalization of the insurance sector, the public sector insurance companies have continued to dominate the insurance market, enjoying over 90 per cent of the market share. FDI is the process whereby residents of one country acquire ownership of assets for the purpose of controlling the production, distribution and activities of firm in another country.

A major role played by the insurance sector is to mobilize national savings and channelize them into investment in different sectors of the economy. FDI in insurance would increase the penetration of insurance in India; FDI can meet India's long-term capital requirements to fund the building of infrastructures. Insurance sector has the capability of raising long-term capital from the masses, as it is the only avenue where people put in money for as long as 30 years even more. An increase in FDI in insurance would indirectly be a boon for the Indian economy. The insurance sector has also been fast developing with substantial revenue growth in the non-life insurance market. Over the years, FDI inflow in the country is increasing. However, India has tremendous potential for absorbing greater flow of FDI in the coming years.

The role of foreign direct investment in the present world is noteworthy. It acts as the lifeblood in the growth of the developing nations. The wave of liberalization and globalization sweepings across insurance regulatory and development authority (IRDA) is in favour of an increase in foreign equity capital in the insurance joint ventures. The insurance markets in the world.

Objectives

- 1) To find out benefits of increased foreign direct investment limit in insurance sector.
- 2) To study the Government policy regarding insurance sector in India.
- 3) To know Issues in FDI in Insurance Sector.

Methodology of Study

The present study is purely depending upon secondary data which is procured from books, journals, magazines, newspapers and WebPages.

Overview of Insurance Sector in India

History of Insurance

A contract of insurance may be defined as a contract whereby, one person, called the 'insurer', undertakes, in return for the agreed consideration, called the 'premium' to pay to another person, called 'assured', a sum of money or its equivalent on the happening of a specified event. The aim of all insurance is to make provisions against dangers which beset human life and dealings. Those who seek it endeavor to avert disasters from themselves by shifting possible losses on the shoulders of others who are willing for pecuniary consideration, to take risk thereof, and in the case of life assurance, they endeavor to assure to those dependent on them a certain provision in case of their death, or to provide a fund out of which their creditors can be satisfied.

In India, insurance has a deep-rooted history. It finds mention in the writings of Manu (manusmrithi), Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra). The writing talks in terms of pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine. This was probably a precursor to modern day insurance. Ancient Indian history has preserved the earliest traces of insurance in the form of marine trade loans and carriers' contracts. Insurance in India has evolved over time heavily drawing from other countries, England in particular.

The British Period

1818 saw the advent of life insurance business in India with the establishment of the oriental life insurance company in Calcutta. This company however failed in 1834. 1870 saw the enactment of the British insurance Act. This era, however, was dominated by foreign insurance offices which did good business in India. The Indian life assurance companies act, 1912 was the first statutory measure to regulate life business. In 1928, the Indian insurance companies act was enacted to enable the government to collect statistical information about both life and non-life business transacted in India by Indian and foreign insurers including provident insurance societies. In 1938, with a view to protecting the interest of the insurance public, the earlier legislation was consolidated and amended by the insurance act, 1938 with comprehensive provisions for effective control over the activities of insurers.

The Nationalized Period

The insurance amendment act of 1950 abolished principal agencies. However, there were a large number of insurance companies and the level of competition was high. There were also allegations of unfair trade practices. The government of India, therefore, decided to nationalize insurance business. In nationalized era an ordinance passed on 19th January, 1956 nationalizing the life insurance sector and Life Insurance Corporation came into existence in the same year. LIC absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies-245 Indian and foreign insurers in all. The LIC had monopoly till the late 90s when the insurance sector was

reopened to the private sector. Due to new liberalization, privatization and globalization, the insurance sector was reopened to the private sector.

The Liberalized Period

The insurance regulatory and Development Authority was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA opened up the market in August 2000 with the invitation for application for registrations. The bill allows foreign equity stake in domestic private insurance companies to maximum of 26% of the total paid-up capital and seeks to provide statutory status to the insurance regulator. Foreign companies were allowed ownership of up to 26%. In December, 2000, the subsidiaries of the general insurance corporation of India were restructured as independent companies and at the same time GIC was converted into a national reinsurer. Parliament passed a bill de-linking the four subsidiaries from GIC in July, 2002.

Today there are a number of private sector insurance companies. The table below shows the breakup of insurance companies:-

Number of insurance companies in India

Type of Business	No. of Public sector companies	No. of Private sector companies	Total companies
Life Insurance	01	23	24
General Insurance	06	22	28
Re Insurance	01	0	01
Total	08	45	53

Source: Insurance Regulatory & Development Authority Official Website www.irda.org

Government Policy regarding Insurance Sector in India

While presentation the Union Budget for 2013-14, the Finance Minister announce as follows:

“ In order to remove the ambiguity that prevails on what is Foreign Direct Investment and what is Foreign Institutional Investment, I propose to follow the international practice and lay down a broad principle that where an investor has a stake of 10% or less in a company, it will be treated as FDI. A committee will be constituted to examine the application of the principle and to work out the details expeditiously”

Pursuant to the announcement, a committee was constituted by Government of India under the chairmanship of Dr. Arvind Mayaram, Secretary DEA, Ministry of finance and recommended that-

1. Foreign investment of 10% or more through eligible instruments made in an Indian listed company would be treated as FDI. All existing foreign investments below threshold limit made under the FDI route shall however, continue to be treated as FDI.
2. An investor may be allowed to invest below the 10% threshold and this can be treated as FDI subject to condition that the FDI stake is raised to 10% or beyond within one year from the date of the first purchase. The obligation to do so will fall on the company. If the stake is not raised to 10% or above, then the investment shall be treated as portfolio investment.
3. In case an existing FDI falls to a level below 10%, it can continue to be treated as FDI without an obligation to restore it to 10% or more, as the original investment was an FDI.
4. In a particular company, an investor can hold the investments either under the FDI route or under the FII route, but not both.

Insurance being integral part of the financial sector plays a significant role in India's economy. Apart from protecting against mortality, property and casualty risks and providing a

safety net for individuals and enterprises in urban and rural areas, the insurance sector encourages saving and provides long-term funds for infrastructure development and other long gestation projects of the nation. The development of the insurance sector in India is necessary to support its continued economic transformation.

This millennium has seen insurance come a full circle in a journey extending to nearly 200 years. The process or re-opening of the sector had begun in the early 1990s and the last decade and more has seen it been opened up substantially. In 1993, the government set up a committee under the chairmanship of R.N.Malhotra, former governor of RBI, to propose recommendations for reforms in the insurance sector. The objectives were to complement the reforms initiated in the financial sector. The committee submitted its report in 1994 wherein, among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies are allowed to enter by floating Indian companies, preferably a joint venture with Indian partners.

The IRDA opened up the market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26%. The Authority has the power to frame regulation under section 114-A of the Insurance Act, 1938 and has from 2000 onwards framed various regulations protection of policyholders interests. Today there are 28 general insurance companies (Non-life) including the Export Credit Guarantee Corporation (ECGC) and Agriculture Insurance Corporation of India, 24 life insurance companies that have set up operations in the life segment post opening up of the sector 20 are in joint venture with foreign partners. Of the twenty two private insurers who have commenced operations in the non-life segments, 18 are in collaboration with foreign partners.

Benefits of Increases in Foreign Direct Investment Limit in Insurance Sector

The cabinet committee on economic affairs headed by Prime Minister Narendra Modi has approved the limit of foreign direct investment 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. This was a long due reform which the Modi government has undertaken and is surely bound to benefit the insurance sector.

Let's look at the six key benefits of increased foreign direct investment limit in insurance sector:-

- **Increased insurance penetration**

With the population of more than 100 cores, India requires insurance more 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, 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 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 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 operation 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.

Issues in FDI in Insurance Sector

1) Efficiency of the companies with FDI

The opening up of this sector for private participation in 1999, allowed the private companies to have foreign equity up to 26 per cent. Following this up 12 private sector companies have entered the life insurance business. Apart from the HDFC, which has 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 and Cholamandalam does not have any foreign equity. The aggregate loss of the private life insurers amounted to Rs. 38633 lakhs in contrast to the Rs. 9620 crores surplus (after tax) earned by the LIC. In general insurance, 4 out of the 8 private insurers suffered losses in 2002-03, with the Reliance, a company with no foreign equity, emerging as the most profitable player. In fact the 6 private players with foreign equity made an aggregate loss of Rs. 294 lakhs. On the other hand the public sector insurers in general insurance made aggregate after tax profits of Rs. 62570 lakhs.

2) Credibility of foreign companies

The argument that foreign companies shall bring in more expertise and professionalism into the existing system is debatable after the recent incidents of the global financial crisis where firms like AIG, Lehman Brothers and Goldman Sachs collapsed. Earlier too, the Prudential Financial Services (ICICI's partner in India) faced an enquiry by the securities and insurance regulators in the U.S based upon allegations of having falsified documents and forged signatures and asking their clients to sign blank forms. This was after it made a payment of \$2.6 billion to settle a class-action lawsuit attacking wrong insurance sales practices in 1997 and a \$ 65 million dollar fine from state insurance regulators in 1996. AMP closed its life 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. 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 investment in equity and debt instruments in the past. Hence FDI in insurance in India would expose our financial markets to the dubious and speculative activities of the foreign insurance companies at a time when the virtues of regulating such activities are being discussed in the advanced countries.

3) Greater channelization of saving to insurance

One of the most important duties played by the insurance sector is to mobilize national saving and channelize 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 even after the liberalization of the insurance sector in 1999. Therefore the private or foreign participation has not been able to achieve the goal.

4) Flow of funds to infrastructure

The primary aim of life insurance is about mobilizing the savings for the development of the economy in long term investment in social and infrastructure sectors. The same vision was argued for the opening up of insurance market would enable huge flow of funds into infrastructure. But more than fifty percent of the policies they sell are ULIPS where the investments go into the equity markets. As per a report, 95% 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 are invested in equities thus limiting the fund availability for infrastructural investments. On the other hand, the LIC has invested Rs. 40,000 crore as at 31.3.2003 in power generation, road transport, water supply, housing and other social sector activities. IRDA figures further imply that the share of the public sector life and non-life insurance companies in investment in infrastructure is greater than their market share.

Advantages of FDI in Insurance Sector

1) Capital for Expansion

FDI has the potential to meet India's long term capital requirements to fund the building of infrastructures which is critical for the development of the country. Infrastructure has been the major factor which has restricted the progress of the Indian economy. Insurance sector has the capability of raising long term capital from the masses as it is the only avenue where people put in money for as long as 30 years even more. An increase in FDI in insurance would indirectly be a boon for the Indian economy, the investment notwithstanding but by making more people invest in long term funds to fuel the growth of the Indian economy.

2) Wider Scope for Growth

FDI in insurance would increase the penetration of insurance in India, where the penetration of insurance is abysmally low with insurance premium at about 3% of GDP against about 8% global average. This would be better through marketing effort by MNCs, better product innovation, consumer education etc.

3) Moving Towards Global Practices

India's insurance market lags behind other economies in the baseline measure of insurance penetration. At only 3.1%, India is well behind the 12.5% for the UK, 10.5% for Japan, 10.3% for Korea and 9.2% for the US. Currently, FDI represents only Rs. 827 crore of the Rs.3179 crores capitalizations of private life insurance companies.

4) Provide Customers with Competitive Products, More Options and Better Service Levels

Opening the FDI in the insurance sector would be good for the consumers, in a lot of ways. Increasing FDI will impact on a lot of industries in a positive.

Conclusion

Many international studies have estimated that the insurance sector 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 insurance sector 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.

With this, a plethora of business opportunities in India has been thrown open to the foreign investors. In life insurance business, India is ranked 10th among the 88 countries for which data are published by Swiss Re. India has seen an increase in its FDI in 2012, at a time when the aforesaid limit were not even approved- a sign that suggests India is set to be one of the favored destinations for foreign investors in the insurance sector.

Increased role of foreign capital may lead to the possibility of exposing the economy to the vulnerabilities of the global market by way of likely inheritance of unsound balance sheets and financial health of the foreign partners through joint ventures and subsidiary routes Flight of capital outside the country and also endangering the interest of the policy holders. The present global economic scenario, any further hike in FDI at this juncture may not be in the interest of the Indian insurance sector, whereby the common man too would not stand to gain through insurance, particularly as a means of social security.

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