"Indian Insurance Industry - A Wheel of Life"

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Abstract

Insurance industry being a service industry, could prima facie act as an engine of economic growth, as more than 42 percent of the country's current GDP is being generated by service sector. In this regard, an attempt was made to study the phases of growth of insurance industry in India right from its origin, nationalization of insurance business, formation of Life Insurance Corporation of India (LIC), followed by the phase of liberalization, reformation and the formation of Insurance Regulatory Authority (IRA). The paper ends with a review of ten years of liberalization of insurance market in India along with its current prospects and threats.

Key Words: Insurance, Nationalization, Reformation, Liberalization, LIC, IRDA, IRA

About Insurance:

Insurance is described as a social device to reduce or eliminate risk to life and property. Professor Rober Mehr and Professor Emesson Cammack (2000), rightly defined Insurance as a social device for reducing risk by combining a sufficient number of exposure units to make their individual losses collectively predictable, the predictable loss is then shared proportionally by all these in the combination. There are two branches of insurance viz, general insurance and life insurance general insurance deals with the exposure of risks of goods and property, whereas life insurance is a way to meet the contingencies of physical death and economic death.

Origin of Insurance:

The roots of insurance might be traced to Babylonia where traders were encouraged to assume the risk of the carvan trade through loans that were paid only after the goods had arrived safely a practice resembling bottamry and given legal force in the code of Hammurabi (C.2100.B.C). With the growth of towns and trade in Europe the medieval guilds undertook to protect their members from loss by fire and ship wreck and to provide decent burial and support in sickness and poverty. By the middle of the 14thcentury as evidenced by the earliest known insurance contract (Genoa 1347), marine insurance was practically universal among the maritime nations of Europe. In London Lloyd's coffee house (1688) was a place where merchants, ship owners and underwriters met to transact business. In 1693, the astronomers Edmony Halley constructed the first mortality table, based on the statistical laws of mortality and compound interest. The table constructed in the year 1756 by Joseph Dodson made it possible to scale the premium rate to age; previously the rate had been the same for all ages.

Insurance developed rapidly with the growth of British trade and commerce in the 17th and 18th centuries. The first joint stock company to engage in insurance was established by charter in England in 1720 and in 1735. The first insurance company in the American colonies was founded at Charfeston. Later, SC Fire Insurance Corporation was founded in New York City in 1787. The Presbyterian Synod of Philadelphia was founded in 1759. This was the first life insurance corporation in America, for the benefit of Presbyterian ministers and their dependents. In the 1830s the practice of classifying risk began.

Phase – I: Emergence of insurance in India

In 1818 a British firm called the Oriental Life Insurance Company was formed in Calcutta to serve the interest of those who came from Europe. This was followed by the establishment of the Bombay Life Assurance Company in 1823 in Bombay. The Madras Equitable Life Insurance Society in 1829 and The Oriental Government Security Life Assurance Company in 1874.The Bombay Mutual Life Assurance Society, an Indian insurer formed in 1871, was the first one to charge normal rates for Indian lives.

There were no specific regulations for the life insurance business until 1912, when it came to be formally regulated under the provisions of the Indian Life Assurance Companies Act 1912.In 1928 the Indian Insurance Companies Act was enacted to enable the government to collect statistical information about both the life and the non-life insurance business including the provident insurance societies. During the period from 1912 to 1930 the insurance business witnessed a setback. A number of changes took place from 1930 to 1938 and the Government of India passed Insurance Act 1938, with comprehensive provisions for the detailed and effective control over the insurers so as to protect the interest of insuring public.

Phase-II : Nationalization of Life Insurance Business

By 1956, as many as 154 Indian insurers 16 non Indian insurers and 75 provident societies have entered the life insurance business in India. However the geographical spread and the number of lives covered were rather small. Insurance companies by and large were governed by short term considerations and consequently the business was confined mainly to cities and the more affluent segments of society.

During this period a number of malpractices occurred in the industry causing Loss to the unsuspecting public.There was also some instances of mismanagement and mis-utilization of the funds collected. Despite the regulatory measures, the private insurance industry suffered from all the maladies such as under-cutting of premiums, unscrupulous management misfeasance falsification of reports questionable investment. The claims settlement ratio was abysmally poor and so was the high rate of expenses and managerial privileges. Winding up of companies was also not totally unknown. This process gathered momentum especially after the First World War and between 1914 and 1920 many insurance companies were closed down causing large losses for the small investors.

The former **Finance Minister Dr.C,D.Deshmukh(1994)** said in parliament during the debate on the life insurance bill 1956 that :"…the industry was not playing the role expected of insurance in a modern state and efforts at improving the standard by further legislation we felt, were unlikely to be more successful than in the past. The concept of trusteeship which should be the corner stone of life insurance seemed entirely lacking. Indeed most management had no appreciation of the clear and vital distinction that exists between trust moneys and those which belong to joint stock companies". Misuse of power position and privilege that we have reasons to believe occurs under existing conditions is one of the most compelling reasons that have influenced us in deciding to nationalize life insurance".

In the light of these developments the demand for stricter government control of the industry gathered momentum and called for nationalization of insurance business - which almost became a foregone conclusion.

Phase- III: Formation of Life Insurance Corporation of India (LIC)

The Government of India took the first step towards nationalization of life assurance business in India on 19th January 1956 by promulgating an ordinance vesting the management and control of life insurance business of 154 Indian, 16 Non-Indian Insurers and 75 Provident Societies operating in the country. On June 18, 1956 they put a bill through the parliament which emerged as the Life Insurance Corporation Act (XXXI of 1956) which was gazette the next day. It came into force in July 1956.

By this act all the assets and liabilities pertaining to the life assurance business in India of all registered Indian Insurers were to be transferred to and vested in the Life Insurance Corporation of India as from the appointed day. According to this act, a corporation called the Life Insurance Corporation of India (LIC) was established which started its career on September 1, 1956. Mr.H.M.Patel of the Indian Civil Service (ICS) and Secretary, Ministry of Finance, was nominated as its First Chairman. At the time of its inception, The LIC had five zonal offices, 33 divisional offices and 212 branches.

Pandit Jawaharlal Nehru (1994), the then Prime Minister expressed confidence that (Lok Sabha debates, 1956)," Its objective will be to serve the individual as well as the state. The profit motive goes out of it and the service motive becomes much more dominant. I trust that this corporation will serve an ever-increasing number of our people and will do this work in the true spirit of service. We require life insurance to spread rapidly all over the country and to bring a measure of security to our people".

Phase-IV: Liberalization of Insurance

Insurance companies in the developed world also sell products for old age income security in form of pensions and annuities. The absence of pension coverage forms a very important gap to be filled by the life insurance sector. LIC largely remains a slow moving, overstaffed behemoth. The phased globalization of the Indian economy that started in the early 1990s began to have its impact on the monopolistic structure of the Indian Insurance industry. The liberalization of insurance market was among the objectives of the Uruguay round negotiations conducted under the auspices of

General Agreement on Trade and Tariff (GATT). However, LIC was put on its toes when in 1993, the Government of India appointed a committee headed by **Shri.R.N.Malhotra (Report on Malhotra Committee, 1994)** to examine the reforms required in the insurance sector.

The Government with the committee came out with the following arguments in justification of liberalization:

1. Insurance penetration and density in the country is low.
2. The country needs massive investments in infrastructure and liberalizing insurance and pensions will help mobilization of long term funds.
3. Allowing foreign companies would help them bring a substantial portion of their world wide premium funds into Indian infrastructure and
4. India is a large economy and a big market with ample space for both private and public sector.

Phase-V: Reformation of insurance industry

In 1993, Malhotra Committee, headed by former Finance Secretary and RBI Governor N.Malhotra, was formed to evaluate the Indian insurance industry and recommended future direction. The Malhotra Committee was setup with the objective of complementing the reforms initiated in the financial sector. In 1994 the committee submitted the report and some of the key recommendations included:

i) Structure:

- Government stake in the insurance companies to be brought down to 50%.
- Government should take over the holdings of GIC and its subsidiaries so that subsidiaries can act as independent corporations.
- All the insurance companies should be given greater freedom to operate.
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ii) Competition:

- Private companies with a minimum paid up capital of Rs.1 billion should be allowed to enter the industry.
- No company should deal in both life and general insurance through a single Entity.
- Foreign companies may be allowed to enter the industry in collaboration with domestic companies.
- Postal life insurance should be allowed to operate in the rural market.
- Only one state level life insurance company should be allowed to operate in each state.
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iii) Regulatory Body:

- The Insurance Act should be changed.
- An insurance regulatory body should be set up

iv) Investments:

- Mandatory investments of LIC life fund in government securities to be reduced from 75% to 50%.
- GIC and its subsidiaries are not to hold more than 5% in any company.

v) Customer Service:

- LIC should pay interest on delays in payments beyond 30 days.
- Insurance companies must be encouraged to set-up unit.

vi) Linked pension plans.

- Computerization of operations and updating of technology to be carried out in Insurance industry.

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Phase – VI: Formation of Insurance Regulatory Authority

On the recommendations of Malhotra Committee Indian Parliament passed Insurance Regulatory Development Act (IRDA) in the year 1999. Its main aim is to activate an insurance regulatory authority essential for proper monitoring and control of the Insurance industry. Due to this act several Indian private companies have entered in the insurance market and some companies have joined with foreign partners.

Mission statement of IRDA

❖ To protect the interest of and secure fair treatment to policy holders
❖ To bring about speedy and orderly growth of the insurance industry for the benefit of the common man and to provide long term funds for accelerating growth at the economy.
❖ To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates
❖ To ensure that insurance customers receive precise, clear and correct information about products and services and make them aware of their responsibilities and duties in this regard
❖ To ensure speedy settlement of genuine claims, to prevent insurance frauds and other malpractices and put in place effective grievance redressal machinery.
❖ To promote fairness, transparency and orderly conduct in financial markets dealing with insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players
❖ To take action where such standards are inadequate or inefficiency enforced and
❖ To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirements of prudential regulation.

Phase-VII: Ten years of liberalization of insurance market in India

The Indian insurance industry has registered impressive growth in the past one decade. Many private players entered the market and most of the companies have entered as joint ventures with participation of a foreign partner holding 26% of the total paid-up equity capital. While four private sector companies had underwritten life business during the financial year 2000-01, the number of private players competing for business during the year 2001-02 alone increased to eleven and as of now, 2008-09 it numbered twenty one in total. The following table gives the total number of insurance companies in India in the year 2011.

Registered Insured in India

Type of business	Public Sector	Private Sector	Total
Life Insurance	1	23	24
General Insurance	6*	18**	24
Re-insurance	1	0	1
Total	**8**	**41**	**49**

Source: IRDA Annual Report 2008-09

* Includes specialized insurance companies - ECGC and AIC.

**Includes two stands alone Health Insurance Companies-Star Health & Allied Insurance Co. and Apollo DKV

Phase-VIII: Current scenario of Insurance Industry in India:

The life insurance grew at a very fast pace with new business premium increasing from Rs. 19857.28 crore in 2001-02 to Rs. 87006 crore in 2008-09.The growth continues and for the current financial year with new premium touching Rs.75347.27 crore as at 31st January 2010, similarly the total premium income increased from Rs. 221791 crore in 2008-09. The total assets under management rose to Rs. 931000 crore as at the end of 31st march 2009 (T.S. Vijayan, Chairman LIC). The premium mobilized through life insurance as a present of GDP has touched 4.1% in 2008-09. The opening up of the sector to the private players witnessed the introduction of a number of new products deserving the attention of the customers and possibly the Indian insurance market is one of the fastest growing markets (Finance Minister Pranab Mukerjee,2010).

But the happenings of the world during the year 2008 brought a new experience that also has to be taken into consideration. The crisis which has engulfed the financial sector of the US has far reaching implications both for the international economic order underlying globalization especially the global financial architecture as well as the policy regimes in developing countries. Countries like India were told to emulate the US financial system and integrate with the international financial markets in order to benefit from the globalization of finance.

At this juncture happened the first jolt in the US economy, the stock market crash and collapse of the IT boom in the year 2000.This led to the recession in the US in 2001 which caused a global slowdown. Liberalized rules for banks coupled with easy liquidity conditions enabled mortgage lending banks to adopt reckless lending strategies, fuelling housing demand. In order to push up their credit business, these mortgage lenders indulged in sub-prime lending, giving housing loans even to those borrowers whose ability to repay the loans were doubtful. These loans were then packaged into securities and were sold off to other financial institutions like the wall street based investment banks and hedge funds, in complex transactions that were made possible by financial deregulation in United States.

The assumption underlying financial deregulation was that financial innovations would enable the mortgage lenders and banks to insulate themselves against loan defaults by spreading the risks associated with these loans. This, however was a flawed assumption since spreading of risks through complex derivatives cannot make the risk disappear completely. Eventually a full blown crisis surfaced in the US in 2006 when the housing bubble went burst. Sharp fall in the property prices led to the collapse of hundreds of mortgage lenders engaged in subprime lending, with even the largest mortgage lender in US, countrywide financial heading towards bankruptcy .This had a deepening impact when the list of investment banks and leading insurance companies were marked bankrupted. Among them were Lehman Brothers, the fourth largest investment bank in US, Merill Lynch, Bear Sterns, Fannie Mae, Freddie Mac and the world largest insurance company AIG managed to survive only after the injection of $ 180 billion (Prasenjit Bose, 2008) from the US government. Similar problems were faced by OECD countries, which also witnessed similar real estate bubbles over the past decade.

Conclusion:

The insurance sector in the country has completed its cycle from being an open competitive market to full nationalization and then back again to a liberalized market, in which private players and public sector companies are in perfect competition. But at this juncture because of the significant events occurring in the US and other advanced developed economies, there arise the need for policy makers of India to rethink their economic strategy, as this has been a period of two decades of globalization of finance. The global financial turmoil witnessed today should also be considered to safeguard the interest of Indian financial system.

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