Role of FDI in Insurance Sector in India

*** Dr. K. Sivaji**
**** Md. Abdul khader**

** Assistant Professor, Commerce and Business Administration Department, Acharya Nagarjuna University, Ongole Campus*
*** Research Scholar, Department of Commerce and Business Administration, Acharya Nagarjuna University, Nagarjuna Nagar, Guntur*

Abstract

India is no doubt a growth economy and many consider it an attractive country to invest in, particularly in its rapidly growing and changing insurance market. Indian insurance industry is one of the sunrise sectors with huge growth potential. Foreign direct investment plays an important role in the economic development of the country. However, Foreign Direct Investment (FDI) is released in the insurance industry, and despite many years of debate, the regulations are still not altered and there are still lots of restrictions. Foreign Investors are watching India, ready for a piece of the action in the insurance market, but there are still plethora of uncertainties, restrictions and potential socio-economic risks. However, the Government is gradually taking steps to open the sector. Due to economic liberalization started few years ago have started bringing in 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. Thus 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 current policy and regulations with a viewpoint of foreign investors so as to gain an understanding of the current position on FDI, as well as an overview of the India

Keywords: *Foreign Investment, Foreign Direct Investment (FDI, Inflows, Outflows, Insurance Industry. Policy and Regulatory Environment*

I Introduction

A milestone was achieved when the nation decided to privatize the industry along with requisite regulations. The industry functioned under a monopoly for several decades thereafter. However, other problems surfaced such as limited reach and penetration of enterprise and deteriorating servicing standards. Indian insurance sector was liberalized in 2001. Liberalization has led to the entry of the largest insurance companies in the world, who have taken a strategic view on India being one of the top priority emerging markets. The Insurance industry in India has undergone transformational changes over the last 12 years.FDI in insurance remains a widely 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 of the last few years, the strong fundamentals of the industry augur well for a roadmap to be drawn for sustainable long-term growth.

The insurance sector is of considerable importance to every developing economy; it inculcates the savings habit, which in turn generates long-term investible funds for infrastructure building There is hardly a facet of the Indian psyche that the concept of 'foreign' has not permeated. This term, connoting modernization, international brands and acquisitions by MNCs in popular imagination, has acquired renewed significance after the reforms initiated by the Indian Government in 1991 (Mishra & Bhatnagar, 2009). As per guidelines, issues by the Government of India the insurance sector also opened for foreign investors. In addition, Indian insurance companies can issue equity shares, fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares subject to pricing guidelines/valuation norms prescribed under FEMA Regulations for foreign direct investment in Indian insurance companies (FDI Circular, 2012). According to this policy Applications for foreign direct investment in insurance sector addressed to the Insurance Regulatory and Development Authority (IRDA) in order to ensure that the 26 per cent limit of foreign shareholding applicable for the insurance sector. Guidelines for FDI in Insurance Sector The

Insurance sector was opened up for private sector in 2000 after the enactment of the Insurance Regulatory and Development Authority Act, 1999 (IRDA Act, 1999). This Act permitted foreign shareholding in insurance companies to the extent of 26 per cent with an aim to provide better insurance coverage and to augment the flow of long-term resources for financing infrastructure (Yashwant Sinha, 2013). FDI in the Insurance sector, as prescribed in the Insurance Act, 1938, is allowed under the automatic route. This will be subject to the condition that Companies bringing in FDI shall obtain necessary license from the Insurance Regulatory & Development Authority for undertaking insurance activities. All such investments can be made under the automatic route in terms of Schedule 6 to Notification No. FEMA 20. Now 26 percent FDI is allowed under the automatic route without prior approval either of the Government or IRDA in all activities/sectors as specified in the consolidated FDI Policy. However, there was demand of 49 % of FDI in insurance sector. But Insurance is a long-term contract and there are some deferent risks in this business and well as investment in this sector. According to Amanulla Khan (2012), president, AIIEA, An insurance company deploys funds in long-term investments in order to be able to pay claims that may arise in the future. Insurance funds are thus suitable for developing national infrastructure and capital formation. In a developing country like India, the government needs to retain some control over domestic savings instead of allowing foreign investors to enjoy control over Indian savings. The Parliamentary Standing Committee came to the same conclusion. It recommended that the cap on foreign direct investment (FDI) be retained at 26 per cent.

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.

What's in it for Companies Entering India?

This long pending decision of the Indian government to increase the cap on Foreign Direct Investment (FDI) in the Indian insurance sector is a great opportunity for global industry participants who want to improve their market position and diversify their operations in India. India enjoyed robust growth of 7.2 percent from FY01 to FY10.1 However, the uncertain global business environment resulted in lower growth from FY10 to FY14 and stressed balance sheets as high interests hampered investments. In contrast, the long-term growth outlook is bright owing to inherent strengths that characterize the Indian economy – burgeoning consumer and urban class, growing working age population and high domestic demand amongst others. Household and financial savings are expected to increase from US$369 billion to US$540 billion and from US$202 billion to US$248 billion respectively over the next two years on account of higher disposable incomes.2 The Indian economy is expected to exhibit one of the highest growth rates amongst the larger economies, reaching a GDP of over US$7,700 billion by Purchasing Power Parity in 2018.

Number of Insurance Companies in India

Type of Business	No of Public Sector Companies	No of Private 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

The first major reform initiative by the new Indian government led by the Prime Minister Narendra Modi increasing the FDI limit in the Indian insurance sector from 26 percent to 49 percent – will be a welcome move for many companies wishing to enter the market or expand the ownership of their current operation. We expect the legislation, once approved, to trigger new M&A and an inflow of capital as insurers take up the option to increase their stake to 49 percent.

Opportunities for Foreign Investors in Life Insurance in India

1. Proposal to increase FDI to 49 percent from 26 percent limit
2. Market is still dominated by one Public Sector player, providing opportunities for private sector players to target specific growth opportunities.
3. As distribution moves towards open architecture, licensed distributors of insurance services could provide a one stop solution for all financial services needs of the consumer.
4. The pension segment has a very low contribution to the overall life insurance sales as of now and is expected to increase substantially with growth and ageing of the private sector work force.

Opportunities for Foreign Investors in General Insurance in India

1. Proposal to increase FDI to 49 percent from 26 percent limit
2. Low penetration, especially in health insurance provides significant room for growth
3. Opportunity to forge partnerships with healthcare providers to provide a seamless value chain
4. State governments are aggressively promoting universal health insurance and are aiming to provide minimum levels of health
5. Insurance cover to all citizens leading to rapid growth opportunities, improving performance of motor insurance
6. Conformity in product structures provides opportunities for differentiation in a fast growing, but crowded market

Insurance at Glance

At a glance

	No of companies	Profitable companies
Life Insurers	**24**	**17**
Public companies	1	1
Private companies	23	16
Non-life insurers	**21**	**13**
Public companies	4	4
Private companies	17	9

FDI received in 2012-13:

Life: 6045.9 cr (23.69% of capital)

Non-life: 1586.6 cr (16.67%)

(As per IRDA annual report released in Jan 2014)

- Proposal was pending since 2008
- ₹25,000 cr expected to flow in
- Once passed by Parliament, same investment norms will apply to the pension sector

Arguments for and Against The Increase In The FDI Limit?

The proposed regulation to increase the FDI to 49 percent will only be allowed after the prior approval of the Foreign Investment Promotion Board (FIPB) and support from the parliament. There is also a rider attached to the increase that management control must remain in Indian hands. There are many arguments, which are currently going on in the Indian market both in favor and against this move. The opposition parties along with some major existing players have shown resistance to this new regulation on the grounds that will threaten the stability of the Indian financial market and hence requires fresh scrutiny. The resistance is also due to the fact that in some cases, where there are multiple Indian partners, increasing the stake of the foreign insurance company to 49 percent will make it the largest shareholder. On the other hand, it is also true for the economy to have a well-developed and evolved insurance sector an increase in the FDI limit is an important step, providing long term funds for the development of infrastructure where there's currently a funding gap of almost US$300 billion8 and help improve the adoption of international best practice. With one of the lowest FDI limits globally for insurance, we feel that the increased FDI cap is necessary for the cash starved insurance sector. It is estimated that around US$3-4 billion9 can flow into the sector following an increase in the FDI limit. 70-75 percent of this is expected in the life insurance sector. In addition, with the increase of the FDI cap there is a possibility of certain insurance companies looking to IPO. Given recent poor performance, many insurers are reluctant to consider an IPO at this stage.

However, with the help of foreign players, profitability can improve as the foreign partner can help:

1. deliver product innovation
2. leverage technology (particularly in relation to distribution)
3. Implement client-servicing tools It can also protect consumers against insolvency through adoption of improved governance and risk management tools.

In addition, there is potential for consolidation, with a number of smaller players exiting. Here is also the potential for consolidation, with a number of smaller players exiting.

A Winning Formula

In this challenging business environment, the new regulation is mutually beneficial for both – Indian and foreign players. We believe the change will act as a catalyst to help the industry rediscover its growth while presenting foreign investors with the ability to capitalize on the underlying opportunity. Active foreign participation is critical for the sector, bringing improving standards and implementation of best practice and in turn driving competition, better quality products and improved customer experience and choice.

II. Insurance Industry in India – Overview

In India, insurance has a deep-rooted history. It finds mention in the writings of Manu (Manusmrithi), Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra).The writings talk 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 pre cursor 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.

A. Pre Liberalization 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.

B. The Nationalized Period: In nationalized period an Ordinance was issued on 19th January, 1956 nationalizing the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The 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 economic policy i.e., liberalization, privatization and globalization, the insurance sector was reopened to the private sector. In 1993, the Malhotra Committee was constituted by the government for conducting a study on insurance, in its report in 1994 stated that only 22% of the Indian population are insured and recommended that the private sector be permitted to enter the insurance industry. On recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority was constituted as an autonomous body to regulate and develop the insurance industry.

C. Post Liberalization Period: 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 45 private sector insurance companies.

III. FDI in Insurance – A Historical Perspective

Insurance in India started without any regulations in the nineteenth century. After the independence, the Life Insurance Company was nationalized in 1956, and then the general insurance business was nationalized in 1972. The LIC had monopoly till the late 90swhen the insurance sector was reopened to the private sector. In 1998, the cabinet decides to allow 40% foreign equity in private insurance companies and 26% to foreign companies and 14% to non-resident &investors (FIIs) but again in 1999 the committee decides that foreign equity in private insurance should be limited to 26%.

In 1999, the Insurance Regulatory and Development Authority (IRDA) were constituted as an autonomous body to regulate and develop the insurance industry .Since end of 2000; While Life insurance has been privatized. Indian Government has opened the entry door for foreign players with a maximum of 26 per cent of foreign holding and private companies in Life insurance sector (World Bank Economic Review 2000).

At present there are 44 private insurance companies authorized by the Insurance Regulatory and Development Authority (IRDA) operating in the country. These comprise of 23 life insurance, 17 general insurance and four health insurance companies, since the insurance sector was opened for private sector in the year 2000. These are all joint ventures between the Indian promoters who hold up to 76% and foreign insurance companies who hold up to 26% as mandated by the law.

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.

IV. Current Status of FDI Reforms in Indian Insurance Industry

The Insurance Amendment Bill to raise FDI cap in the insurance industry from 26 per cent to 49 per cent has been pending in the Rajya Sabha since 2008. India is full of potential but hit by regulatory hurdles, a sharp dip in GDP growth and uncertain market conditions. Even though current norms allow FDI up to 26 per cent, several foreign players have quit India. The hike in FDI cap is subject to parliamentary nod, not an easy task given that the ruling coalition is in a minority.

1) At present foreign investment in private insurance companies is restricted to 26% of their capital, which is now proposed to be increased to 49% by passing an amendment to the Insurance Act.
2) The reform if it gets passed in Parliament will be big boost the industry. According to industry observers, a lot of international companies have been waiting to enter India and a further opening up of the sector will give them an entry point.
3) Bill to raise FDI cap in the sector is pending in the Rajya Sabha for approval.
4) Application needs to be approved by two levels at Automatic Approval - by the country's Central Bank, the Reserve Bank of India (RBI), Mumbai and subject to obtaining license from IRDA.

V What are the Ultimate Benefits of Increased FDI in Insurance Sector?

1. **Insurance products**: Private as well as government insurers will benefit from the proposed hike of FDI; these companies will offer better and wide range of insurance products to customers at larger competitive prices.

2. **Smaller Companies**: FDI will help smaller insurance companies to break-even faster and help monetize (convert into currency) the holdings of the promoters of the older life insurance companies.

3. **Capital inflow**: Immediate capital inflows of $2 billion and long term inflows of about $10 billion can be expected.

4. Aggression: The industry has been cautious in selling products which are capital intensive, it will be able to become more aggressive.

5. **Technology**: Insurers will not just get capital but also technology and product expertise of the foreign partner who is the domain expert.

6. New Players: We can expect about 100 life and non-life insurance companies to serve a market of our size. Increasing FDI could see 25-30 new insurers entering the market.

7. **State-Run Companies**: People in the country have more faith on government insurance companies and less on private ones, this hike will benefit the state-run companies more than the private ones. "Skill Development: The Key to Economic Prosperity" Role Of FDI And Insurance Sector: Indian Perspective 190

8. **Penetration**: With the population of more than 100 crores, 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. 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.

9. Employment: 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.

10. 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.

11. 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.

12. 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.

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

VI 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 insures 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 The Business & Management Review, Volume 5 Number 4 January 2015 International Conference on Issues in Emerging Economies (ICIEE), 29-30th January 2015 36 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. However, 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

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 endangering the interest of the policyholders. 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 person too would not stand to gain through insurance, particularly as a means of social security.

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