ISSN 2320 – 2939 (Print) Vol 2 No.1
Acme Intellects International Journal of Research in Management, Social Sciences & Technology
& Department of Studies and Research in Business Administration, Tumkur University, Tumkur.
National conference On 'Indian Insurance Sector: Innovation, Sustainability and Social Impact' held on 22nd Nov 2014
Reforms through Research

FDI in Indian Insurance Sector – An Overview

by
RAVI.C.S[a] & KUNDAN BASAVARAJ[b]

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 Indian Policy and Regulatory Environment.

Keywords: *India, Foreign Investment, FDI, Inflows, Outflows, Insurance Industry.*

[a]RAVI.C.S,	[b]KUNDAN BASAVARAJ,
Research Scholar, Department of Post Graduate Studies and Research in Commerce, Sahyadri Arts and Commerce College, Kuvempu University, Shivamogga -577201	Associate Professor, Department of Post Graduate Studies and Research in Commerce, Sahyadri Arts and Commerce College, Kuvempu University, Shivamogga- 577201

1. Introduction

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.

With 36 crore policies, India's life insurance sector is the biggest in the world. The sector consists of 52 insurance companies, of which 24 are in life insurance business and 28 in non-life. The life insurance industry in the country is projected to increase at a compound annual growth rate (CAGR) of 12-15 per cent in the next five years. The industry plans to hike penetration levels to five per cent by 2020, and has the potential to top the US$ 1 trillion mark over the next seven years. The optimistic outlook is helped to a large degree by the Government of India's efforts to strengthen the sector. The Union Cabinet in July approved a proposal to relax foreign direct investment (FDI) limit in the domestic insurance sector to 49 per cent from 26 per cent, signalling the government's intent to draw capital and investment into the sector.

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. 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 total market size of the insurance sector in India was US$ 66.4 billion in FY 13. It is projected to touch US$ 350-400 billion by 2020. India was ranked 10th among 147 countries in the life insurance business in FY 13, with a share of 2.03 per cent. The life insurance premium market expanded at a CAGR of 16.6 per cent from US$ 11.5 billion to US$ 53.3 billion during FY 03-13. The non-life insurance premium market also grew at a CAGR of 15.4 per cent in the same period, from US$ 3.1 billion to US$ 13.1 billion.

Government Initiatives is very essential, the must taken significance step in The Union Budget 2014-15 increased the FDI limit in insurance to 49 per cent. The increase in the FDI limit could help the insurance industry in two ways. One, this could help companies access capital more easily and, two, it could act as a trigger for listing of insurance players, which will offer a better benchmark to value these companies.

In a bid to facilitate banks to provide greater choice in insurance products through their branches, a proposal could be made which will allow banks to act as corporate agents and tie up with multiple insurers. A committee established by the Finance Ministry of India is likely to suggest this model as an alternative to the broking model.

2. Objective of the Paper

1) To know the overview of insurance industry in India
2) To review current policy and regulations insurance industry
3) To understanding of the current position on FDI in insurance sector

3. 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.

3.1. 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.

3.2. 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.

3.3. 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.

Table 1: 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

Myths about hike in FDI in insurance from 26%to 49%, the following questions are most often raised and debated:

- What are the potential risks to the public insurance sector, and of course to the wider Indian economy?
- Could FDI in insurance be a disaster for the sector and the Indian economy?
- What reforms are necessary, if any, to protect the domestic and national interests?
- There are arguments that support and question FDI hike in the insurance Industry. However the following benefits are being increasingly recognized as a function of introducing FDI reforms in insurance:
- Capital for expansion

- Wider Scope for Growth
- Moving towards Global Practices
- Provide customers with competitive and innovative products, more options and better service levels.
- Infrastructure facilities.
- Boost Economic Life
- Job Opportunities
- Increase level of competition
- Inflation is controlled.
- Availability of new technology.
- New risk management practices.

The argument against FDI hike in insurance Industry focus particularly on regarding the potential risk of protecting interest of public and public sector insurers. An opinion against hike the FDI limit has been that insurers can instead look at domestic markets for capital, as foreign ownership would lead to forex outflows due to profit repatriation. So what were the outcomes of such a conventional approach? This has made insurance a major political issue as there is pressure on the government to create a monopoly and protect it from foreign and private competition.

4. 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% foreignequity 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.

5. Policy and Regulatory Environment

Due to Changes in the regulatory environment substantially impacted the industry dynamics. Apart from macro-economic, social, and demographic growth drivers, the evolving regulatory landscape had a significant impact on the FDI trends in the industry. The regulatory and supervisory policies are being reshaped and reoriented to meet the new challenges and opportunities in this Industry; however the current policy allowed FDI up to 26%.

Key Regulatory Changes are:

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

FDI in the Insurance Industry, 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. FDI up to 26% in the Insurance Industry is allowed on the automatic route subject to obtaining license from Insurance Regulatory & Development Authority (IRDA).FDI is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities/sectors as specified in the consolidated FDI Policy, issued by the Government of India from time to time. Mostly Indian companies entered into a joint venture with the foreign companies to do jointly the business of insurance.

Some of the key legislation that could have a potential impact on foreign investors setting up in India is listed as below:

- Life Insurance Corporation Act, 1956
- General Insurance Business (Nationalization) Act, 1972
- Insurance Regulatory and Development Authority (IRDA) Act, 1999
- Actuaries Act, 2006

6. Current Status of FDI Reforms in Indian Insurance Industry

The future of India's insurance sector looks good, driven by the country's favourable demographics, greater awareness, supportive government which enacts policies that improve business, customer-centric products, and practices that give businesses the best environment to grow. India's insurable population is anticipated to touch 75 crore in 2020, with life expectancy reaching 74 years. Life insurance is projected to comprise 35 per cent of total savings by the end of this decade, compared to 26 per cent in 2009-10.

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.

- 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.
- 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.
- Bill to raise FDI cap in the sector is pending in the Rajya Sabha for approval.
- 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.

7. Conclusion

Despite the current policy and regulatory environment not being 'perfect' for foreign investors, there are clearly moves towards improving the current position and facilitating FDI inflows without having a detrimental impact on various sectors of the economy. '26% insurance FDI limit in India is lowest in world' that's why most of India's 24 insurance companies have lost money in the past decade, hit by restrictions on foreign holding and by regulatory changes. The Cabinet approval of 49 per cent foreign direct investment in insurance is definitely a very positive sign, though we still need to wait and see whether it gets cleared by Parliament. Nonetheless, it indicates the government recognizes the capital requirements of the insurance industry and is taking steps towards bridging the capital gaps. In addition, it adds the advantage of the widening current account deficit being financed through greater capital account, non-debt, FDI inflows. The benefits of the increased FDI would be seen more in the long term than in the short term. Most prominent insurance companies have a presence in India and will be able to augment their shareholding.

This is also a window for Indian promoters to exit the insurance business if they feel it is not a part of their core growth strategy. Broadly, this would tend to create an environment, which consists of shareholders who are willing to invest and to stay committed to the Indian insurance growth story.

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

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 favoured destinations for foreign investors in the insurance sector. It is time for increasing the FDI cap to 49 per cent, commensurate with voting rights and if government not increased FDI limit foreign capital will find its way to other competing markets.

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