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Study of Indian Insurance & Financial Sector Reforms with special reference to Life Insurance

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Abstract:

The aim of this paper is to give a detailed description of the reforms that have taken place in the Insurance sector starting from a regime of deregulation in Insurance sector. LIC played a pivotal role in development of Insurance sector in India especially after Liberalisation. The nationalisation of life insurance business in 1956 and general insurance business in 1972. The entire reform takes place after when private and foreign players came into existence. The reform in one sector interlinked and reform in one sector call for simultaneously reform in other sectors so as to make the entire process most effective.

Key words: Life insurance, General Insurance, reforms, Development.

Introduction

The whole process of reforms in the field finance, banking and Insurance in India starts after 1991. As a result a series of reforms were introduced in these sectors to boost the growth of the economy. the Insurance market which covers both the Government state as well as Centre and private sector organisations. It is listed in the Constitution of India on the Union list in the Seventh Schedule meaning it can only be legislated by the central government.

The insurance sector before the reforms process this sector in India was a classic example of excessive government controls, regulations and Monopoly but now a days there are number of companies came in the existence and has gone through a number of phases by allowing private companies to solicit insurance and also allowing foreign direct investment of up to 26% (as of 2013 there have been proposals to extend the FDI up to 49%). However, the largest life-insurance company in India, Life Insurance Corporation of India is still owned by the government and carries a sovereign guarantee for all insurance policies issued by it. The reform process was not sudden but a steady one which happened after long deliberation with economic and financial experts and market participants and on the recommendation of many committees and working groups. As pointed out by Former governor Reddy, the approach towards was based on five principals:

1. Cautious and appropriate sequencing of reforms measures.
2. Introduction of norms that are mutually reinforcing
3. Introduction of Complementary reforms across sectors
4. Development of Financial institutions.
5. Development of Financial Markets

Objectives of the study

1. To know the reforms that have been taken place in various sectors of the economy namely banking sector, debt and equity market, banking sector, foreign exchange and Insurance sector.
2. To explore in detail about development of Insurance sector.
3. To examine the role of LIC in the economic Development

4. To interlink the insurance sector reforms with reforms in the other sectors.

History of Insurance in India

As far as the insurance has concern India has a deep-rooted evidence. Insurance in various forms has been mentioned in the writings of Manu, Yagnavalkya and Kautilya. The fundamental basis of the historical reference to insurance in these ancient Indian texts is the same i.e. combining of resources that could be re-distributed in times of calamities/mis-happening such as fire, floods, epidemics and famine. The early references to Insurance in these texts have reference to marine trade loans and carriers' contracts.

General Insurance in its current form has its history dating back until 1818, when Oriental Life Insurance Company was started by Anita Bhavsar in Kolkata to cater to the needs of European community. The pre-independence era in India saw discrimination between the lives of foreigners (English) and Indians with higher premiums being charged for the latter. In 1870, Bombay Mutual Life Assurance Society became the first Indian insurer.

At the dawn of the twentieth century, many insurance companies were founded. In the year 1912, the Life Insurance Companies Act and the Provident Fund Act were passed to regulate the insurance business. The Life Insurance Companies Act, 1912 made it necessary that the premium-rate tables and periodical valuations of companies should be certified by an actuary. However, the disparity still existed as discrimination between Indian and foreign companies. The oldest existing insurance company in India is the National Insurance Company, which was founded in 1906, and is still in business.

The Government of India issued an Ordinance on 19 January 1956 nationalising the Life Insurance sector and Life Insurance Corporation came into existence in the same year.

The Life Insurance Corporation (LIC) absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies—245 Indian and foreign insurers in all. In 1972 with the General Insurance Business (Nationalisation) Act was passed by the Indian Parliament, and consequently, General Insurance business was nationalized with effect from 1 January 1973. 107 insurers were amalgamated and grouped into four companies, namely National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd and the United India Insurance Company Ltd. The General Insurance Corporation of India was incorporated as a company in 1971 and it commence business on 1 January 1973.

LIC had monopoly till the late 90s when the Insurance sector was liberalised to the private sector. Before that, the industry consisted of only two state insurers: Life Insurers and General Insurers (General Insurance Corporation of India, GIC). GIC had four subsidiary companies. With effect from December 2000, these subsidiaries have been de-linked from the parent company and were set up as independent insurance companies: Oriental Insurance Company Limited, New India Assurance Company Limited, National Insurance Company Limited and United India Insurance Company Limited.

Banking Reforms in India

Massive reforms were first introduced in the commercial banks since it constituted the biggest segment of the financial sector. Later on these reforms were extended to the other sectors. Several Measures were introduced to ensure flexibility, operational autonomy and competition in the banking sector through introduction of international best practices and prudential regulations. The approach was to increase the capitalisation of the banks from government resources to bring them up to certain level of capitalization and then allow them to increase the capitalisation by allowing private investment up to 49 %. Meanwhile new private sector banks came into existence and number of foreign bank branches was increased to augment competition into the banking system. The following are the reforms undertaken:

1. Allowing the operational/Functional autonomy to PSU banks and to curtail the ownership of PSU banks through allowing them to raise equity from the market up to 49 % of their paid up capital.
2. Adopting the international best practices and norms on capital adequacy requirement, accounting, income recognition, provisioning and exposure.
3. To provide simple path for entry of Indian private sector, foreign and joint –ventures banks and insurance companies, permission for foreign investment in the financial sector in the form of FDI as well as portfolio investment, permission to banks to diversify business activity.
4. Reduction in reserve requirement, market determined pricing for government securities, disbanding of administered interest rates with a few exceptions and enhanced transparency and disclosure norms.
5. Introduction of pure inter-bank call money market, auction-based repos-reserves repos for short term liquidity management.
6. Setting up of CIBIL for sharing on defaulters and other borrowers.
7. Establishing of the CCI.
8. Establishing of the Board of Financial Supervision for supervising the commercial banks, financial institutions and NBFCs.
9. The RBI initiated a prompt Corrective action scheme in 2002.

The lending rates have been linked to PLR and PLR is itself the benchmark rate. Banks are permitted to lend below even be lower. The subsidization in priority sector lending has also been reduced though SSI, agriculture and sports still have some direct lending.

LIC as Nation Builder Role

On 1st September 2012 (Business & Finance, 01-9-2012) LIC completes 56 years of its glorious and purposeful existence. It was on this day in the year 1956, that LIC of India came into being with the government of India nationalizing the life insurance business through an ordinance on 19th January 1956. Ever since 1956, LIC has progressed from strength to strength. In the process, it has fulfilled its objectives and has been immensely contributing to the nation building activities. Today, LIC is an Institution of national importance and operates at a very large scale and efficiency. It has created a significant value for its customers and dominates the life insurance industry in our country. LIC has institutionalized a culture of Trust within its organization which is the basis for its extraordinary success. LIC has grown today to be the premiere public sector financial institution and the pride of India.

LIC has invested Rs. 8,19,835 crores as on 31.3.2012 in central/state government securities, power generation, road transport, water supply, housing and other social activities. LIC has played a very important role in nation building. LIC's contribution to the Five Year Plans has been commendable. It contributed Rs. 184 crore to the second Five Year Plan (1956-61), Rs. 3, 94,779 to tenth Five Year Plan (2002-2007) and Rs.7,04,151 Crores to the eleventh Five Year Plan (2007-2012. The most amazing aspect is that around 25% of internal borrowings of the central government are met by LIC every year. On an initial investment of Rs.5 crores in the year 1956 by the Union Government, it's share of the valuation surplus of 5% for the year 2011-12 worked out to be Rs. 1281.23 Crore. With an investment of just Rs.5 crore, till this fiscal year end, the government received a cumulative dividend of Rs. 11,376.10

Crore which is unimaginable in any other institution. The Government of India has entrusted several social security schemes to LIC. Over 1.63 crore landless households under Aam Aadmi Bima Yojana till date are covered by LIC. Taking up the cause of financial inclusion, over 57.76 lac people have been insured under LIC's Micro insurance schemes. As a part of Corporate Social Responsibility, the 'Golden Jubilee Foundation' has been dedicated to the cause of promoting education, health and to provide relief to the people who are poor. So far LIC has sanctioned more than 140 projects worth Rs.18.06 crores, across the country. LIC Golden Jubilee Scholarship Scheme provides scholarship to economically weaker sections of the society to pursue higher education. Every year 1000 deserving students are given scholarship under this scheme dedicated towards nation building; LIC is one of the strongest pillars of India's social and economic structure.

Ever since the opening up of the insurance sector in the year 2000, LIC is performing marvelously dominating the insurance market. The public sector LIC has surprised the critics with a very strong performance.

The Compounded Annual Growth Rate (CAGR) of LIC during the last ten years has jumped to 30.24% from 15.23% since inception. LIC's total policies have risen from 10.12 Croresin to 34 Crores in conventional business along with 10.45 crores of customer base in group business. LIC's Life fund has grown from 1.54 lakh crore to 12.83 lakh crore. LIC's asset base has grown from 1.60 lac crore to 14.17 lakh crore by September 2012. The new business premium has gone up from Rs.5930 Crore to Rs. 81515 Crore. Total Premium Income has increased from Rs.27489 Crore to 202802.90 Crore. Thus, through this amazing performance, LIC has retained it's domination over the market. It is holding on to a market share of 81 percent in number of policies and 74 percent in new business premium. The LIC has also an impressive share of

87.4% in the total assets under management. Insurance is a promise which needs to be fulfilled on the happening of an eventuality. LIC settles 99.86% of the claims which is a world record. The track record of the private insurance companies on settlement of claims is abysmally low. In spite of such a strong performance, it is surprising to note that the rating agencies to facilitate the entry of foreign capital to access the domestic savings of the Indian people, are trying to arm twist by down grading the investment rating of LIC ironically quoting that LIC is exposed to investments in government securities.

The performance of private insurance companies even after a decade of operation is not encouraging. Out of the 23 private insurance companies, 16 have reported operating losses and majority of them are yet to break even. The private insurance companies sell more than 90% of their policies in ULIPs where the returns are dependent on the vagaries of the volatile stock market. According to the government, the public sector LIC has dominated the investment in infrastructure development by accounting for more than 94% where as the private companies are unable to invest for infrastructure development of our country.

In spite of the sterling performance by the Life Insurance Corporation of India, the government, under pressure from the international finance capital, is making attempts to weaken the public sector. The Insurance Laws (amendment) bill 2008 which seeks to increase the FDI cap in insurance from 26% to 49% is a pointer in this direction. More Over, the hurdles created by IRDA with regard to clearing new plans, in recruitment of agents, suspending group superannuation scheme (P&GS) etc are all the hindrances which LIC is able to successfully overcome till now.

Reforms in other Segments of the Financial Sector

Non-banking financial companies (NBFCs), especially those involved in public deposit taking activities, have been brought under the regulation of RBI. Development Finance Institutions, specialised term-lending institutions, NBFCs, Urban Cooperative Banks and Primary Dealers have all been brought under the supervision of the Board for Financial Supervision. With the aim of regulatory convergence for entities involved in similar activities, prudential regulation and supervision norms were also introduced in phases for DFIs, NBFCs and cooperative banks.

The SEBI has been established to regulate the securities market. Another important development under the reform process has been the opening up of mutual funds to the private sector in 1992, which ended the monopoly of UTI, a public sector entity.

The Indian corporate sector has been allowed to tap international capital markets through American Depository Receipts, Global Depository Receipts (GDRs), Foreign Currency Convertible Bonds (FCCBs) and ECBs. Similarly Overseas Corporate Bodies (OCBs) and NRIs have been allowed t open offshore funds to invest in equities abroad.

Reforms in the Insurance Sector

Insurance in India has gone through two Classical transformations. Before 1956, insurance was private with minimal government intervention. In 1956, life insurance was nationalised and have monopoly. In 1972, general insurance was nationalised as well. But, unlike life insurance, a different structure was created for the industry. One holding company was formed with four subsidiaries. As a part of the general opening up of the economy after 1992, a government appointed committee recommended that private companies should be allowed to operate. It takes six years to implement the recommendation. Private sector was allowed into insurance business in 2000. However, foreign ownership was restricted.

Not more than 26% of any company can be foreign-owned.

Introduction of New Legal Structure

Malhotra Committee report came out with Legal structural changes in the insurance industry . Due to insatiability in the Central Government in power slowed the process. The dramatic climax came in 1999. On March 16, 1999, the Indian Cabinet approved an Insurance Regulatory Authority Bill designed to liberalize the insurance sector. The government fell in April 1999 just on the eve of the passage of the Bill. The deregulation was put on hold once again.

A new government came to power and passed the IRDA Act. This Act repealed the monopoly conferred to the Life Insurance Corporation in 1972. The authority created by the Act is now called the Insurance Regulatory and Development Authority. It was decided to allow 26% foreign equity participation in insurance joint ventures.

Government has reduced directed investments from 70% to 45% with effect from 1st April 1995. The government has also notified a scheme in November 1998 of an insurance Ombudsman. The Ombudsman will settle disputes regarding adjustment o premium and payments of claims.

Insurance Ombudsman

In exercising the powers conferred by the Insurance Act, 1938, the central government, by notification, has framed the Redressal of Public Grievances Rules, 1998. These rules apply to life and general insurance in respect of personal lines insurance.

In order to regulate the insurance companies the government established the IRDA in April 2000. It would be for the Authority to ensure that the insurance companies maintain adequate solvency at all times, invest their funds prudently and in conformity with law, do not invest in any affiliate of the promoters, appoint fit and proper person as managers and maintain high standards of transparency on company accounts.

Conclusion

To strengthen the Insurance sector government need to expand the insurance sector to meet the need and growth as the increasing business activity needed protection in the form of insurance. This sector was progressed well since nationalisation, needed reforms and that opening up could increase competition and thereby efficiency. The reforms measures in the insurance sector were introduced later than the banking sector. In spite of the late start the sector has experienced huge changes over the past few years. A large nuber of private insurance companies generally with foreign capital participation, have entered the sector. The current profile sector of Indian insurance industry reflects that, notwithstanding the entry of private sector players, in terms of both assets and liabilities, insurance companies from the public sector continue to dominate the industry.

Liberalisation of entry norms in insurance segment has brought about a see change in product composition. While in the past, tax incentives were the major driving force of the insurance industry, particularly life insurance industry, in the emerging situation the normal driving force of an insurance industry is taking important roles. Driven by competitive forces and also the emerging socioeconomic changes including increased wealth, education and awareness about insurance products have resulted in introduction of various novel products profile, there have also been salutary improvements in consumer service in recent years, driven largely by the impact of new technology usage, better technical know-how consequent upon foreign collaboration and focused product targeting, dovetailed to specific segments of the populace as well as crossselling of products through bancassurance.

It is expected that entire process goes further in the development of the insurance market, change in risk perception of the insured, in the sense, that the potentially insured views a particular risk as worth being insured. For this companies need to educate the consumers and offer them better products at competitive prices. This is also a part of social responsibility of the companies along with other social objectives like catering to the needs of the less privileged sectors of the society like rural and agricultural sector, making insurance reach every nook and corner for the country and spreading awareness about the need for insurance.

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