FDI in the Insurance Sector
A Short Note
(Submitted by the Left Parties to the UPA)

The Finance Minister, while presenting the first Budget of the UPA government, has proposed to raise the FDI cap in three sectors. Elaborating upon the decision he said, "The NCMP declares that FDI will continue to be encouraged and actively sought, particularly in areas of infrastructure, high technology and exports. Three sectors of the economy fully meet this description. They are telecommunications, civil aviation and insurance." The specific proposal for the insurance sector is to raise the FDI cap from 26 to 49 percent. We argue below that this move is unjustifiable on several grounds.

Private Players, Foreign Equity and Profitability

The Union Government had opened up the insurance sector for private participation in 1999, also allowing the private companies to have foreign equity up to 26 per cent. Following the opening up of the insurance sector, 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 following table gives an aggregate picture of the current scenario of the insurance sector in India.(A full list of private companies in life and non-life insurance is given in the Appendix).

Type of Business	Nos. of Public Sector Companies	Nos. of Private Sector Companies	Total
Life Insurance	01	12	13
General Insurance	06	08	14
Re insurance	01	0	01
Total	08	20	28

According to the Annual Report of the IRDA, 9 out of the 12 private companies in life insurance suffered losses in 2002-03. 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.

Not only are the public sector insurance companies more profitable than the private ones, the private insurer which is most profitable (Reliance) is one which has no foreign equity. If profitability is taken to be an important indicator of efficiency, it is clear that the case for further hike in the FDI cap in the insurance sector cannot be made on efficiency grounds.

Questionable Reputation of the Foreign Partners

The record of some of the foreign companies who have started operating in India is being questioned abroad. A recent article published in The Economist (May 4, 2004) on 'AIG's Accounting Lessons' (AIG is Tata's partner in India)came with the screaming headline which said it all: *"The world's largest insurance company shows how to polish profits statement"*. The Prudential Financial Services (ICICI's partner in India) is facing 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 (New York Times, May 31, 2003 and Wall Street Journal, May 31, 2003). This follows a payment of $2.6 billion made by Prudential to settle a class-action lawsuit attacking abusive life insurance sales practices in 1997 and a $ 65 million dollar fine from state insurance regulators in 1996. It is evident that the questionable activities of these insurance companies are not deterred by state imposed penalties and litigations.

The financial health of many of the foreign insurance companies operating in India is also a cause of serious concern. The Economist (April 1, 2004) reports the sorry plight of Standard Life of UK (HDFC's partner in India), which is unable to remain afloat without the possibility of raising money in debt or equity markets. 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. The reason for the short fall in capitalization, among other things, is due to European Unions' new regulation on solvency called 'Solvency 2' that will be enforced across Europe from 2005 through 2007. 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 investments in equity and debt instruments in the past.

Several issues of *Sigma*, a reputed Swiss journal on insurance, have reported that the U.S. and Europe based insurance companies are faced with gloomy growth prospects in the advanced country markets, with several companies experiencing negative growth in the recent past. Moreover, tighter capital adequacy norms and other regulations that are currently being imposed in the advanced countries are forcing these insurance companies to seek less regulated markets in developing countries to undertake their high-risk ventures. Raising the FDI cap in India at this juncture 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 rediscovered in the advanced countries.

Competition in the Insurance Sector

Even after the liberalisation 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. In fact, the LIC, which is the only public sector life insurer, enjoys over 98 per cent of the market share in Life insurance.

Market Share of Life and non-Life Insurance Sectors
(as % of total premium underwritten by insurers)

Insurance Sector		2001-02	2002-03
Life Insurance	Private Sector	0.54	1.99
	Public sector	99.46	98.01
General Insurance	Private Sector	3.68	8.64
	Public Sector	96.32	91.36

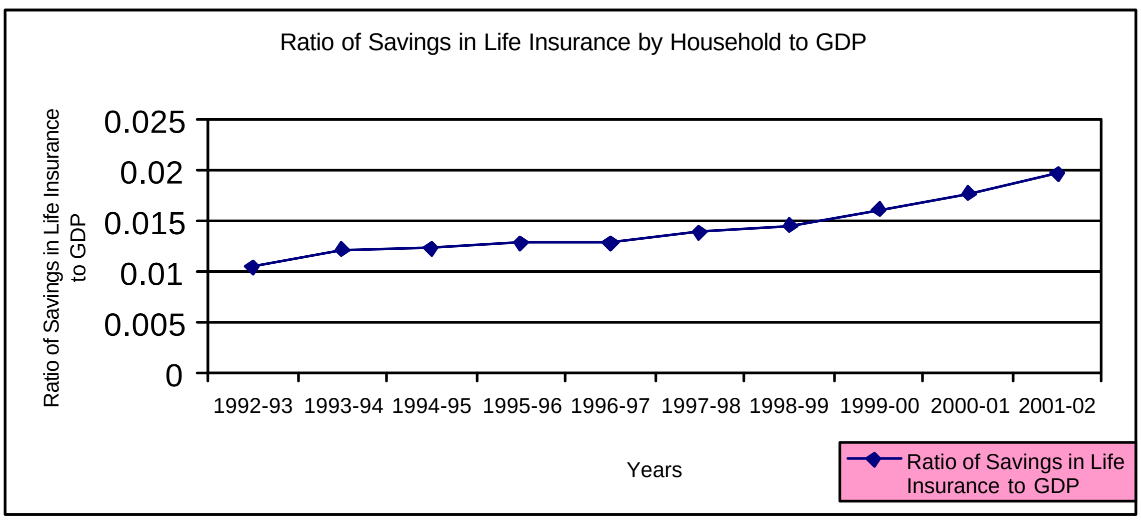
Source: IRDA Annual Report, 2002-03

Given the huge market share enjoyed by the public sector companies, the argument, which is often made by advocates of greater liberalisation, that the entry of private players would bring down the cost of insurance due to enhanced competition, does not seem to be convincing. The price making capacity of the market leaders in the public sector is likely to remain intact for the time being. The foreign insurance companies do have the reputation of charging less premium compared to the risks involved and promising abnormally high returns, in order to grab greater market share. Such competition, however, although capable of bringing down the 'cost' of insurance for a while, has often led to gigantic frauds and bankruptcies.

Moreover, as is the case in other markets, the initial flurry of entries into the Indian insurance market would invariably be followed by a phase of mergers and acquisitions that would lead to cartelisation, precluding the possibility of competition driving down the costs in the medium run. In the long run, other forms of non-price competition like aggressive advertisement wars, are likely to lead to increasing costs, eventually harming the interests of the consumers. These phenomena in the insurance market have been observed in several advanced countries. If the public sector companies start imitating the strategies of the foreign insurance companies in order to defend their market shares, it would be at the cost of undermining their important social objectives, which they have been fulfilling so impeccably till date.

Implications for Resource Mobilisation

A major role played by the insurance sector is to mobilize national savings and channelise 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, following the liberalisation of the insurance sector in 1999. Data from the RBI show that the trend of the savings in life insurance by the households to GDP ratio, while showing a clear upward trend through the 1990s signifying increasing business for the insurance sector, does not show any structural break after 1999 (see chart below). It can be inferred therefore that the foreign capital which flowed in after the opening up of the insurance sector has not been accompanied by any technological innovation in the insurance business, which would have created greater dynamism in savings mobilization.



Source: Handbook of Statistics, Reserve Bank of India

Far from expanding the market for the insurance sector, the business activities of the private companies are limited in urban areas, where a fairly good market network of the public sector insurance companies already exists. The glaring evidence for this is the composition of agents operating in the insurance sector. According to the IRDA Annual Report the number of insurance agents in urban and rural India was in 100:76 ratio in the public sector companies, in 2001-02. For the private insurance companies this ratio was 100:1.4. Due to their urban-biased operational activity, the private insurance companies can neither increase the insurance base of the economy significantly, nor lead to substantial employment generation. Given this scenario, further increase in foreign participation is only going to lead to intensified competition for the urban insurance markets, rather than leading to a growth in overall savings.

While the proposals for hike in FDI were placed, the arguments advanced were that FDI will continue to be encouraged and actively sought, particularly in areas of infrastructure, high technology and exports.

Are these arguments tenable?

<u>No new technology or product is brought into the country:</u>

The issue of foreign equity is often linked with induction of new technology and products. The private insurance companies have nothing to offer in this respect. In the insurance sector, there is no technology needed to be brought in from other countries, leave alone high technology. The mortality rates and other principles of insurance are based on the Indian conditions, because the policyholders are from this country. The products of LIC are being renamed by the private insurance companies and are sold as their own products. Hence, foreign expertise is also not involved in this sector.

So there is no justification even on this count. It was also argued that competition will expand market and the foreign insurers will bring better products. This has simply not happened. The size of the market has remained by and large the same and from this market the private companies are picking up the creamy sections in the metros seriously eroding the ability of public sector to cross subsidize its products in the rural areas.

<u>Flow of funds for infrastructure a myth:</u>

Life insurance is all about mobilising the savings for long term investment in social and infrastructure sectors. It was also argued that opening up of insurance market would enable huge flow of funds into infrastructure. The record of private companies on this is dismal. More than fifty percent of the policies they sell are unit-linked insurance where the decision on investment of savings element in insurance is taken by the policyholders. In fact as per a press report, ninety five percent 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. As against this, the LIC has invested Rs.40, 000 crores as at 31.3.2003 in power generation, road transport, water supply, housing and other social sector activities.

The Law Commission of India released a consultation paper on 16th June 2003 on the revision of the Insurance Act, 1938. The consultation paper proposes a suitable amendment to Section of 27C of Insurance Act allowing insurers especially carrying on general insurance business to invest funds outside India. So, once the law is amended to allow insurers to invest funds abroad, the exports that these private companies would generate, would be the export of savings of the people.

Raising the FDI cap also does not seem justifiable as far as channelising savings into investments are concerned. The life insurance sector invested a total of Rs. 31335.89 crores in the infrastructure sector in 2002-03. Out of this the contribution of the LIC was Rs. 30998.16 crores, which was 98.92 per cent of the total investment in infrastructure by the entire life insurance sector. The figures provided by the IRDA Reports further suggest that the share of the public sector life and non-life insurance companies in investment in infrastructure is greater than their market share. Despite the FDI cap being set at 26%, the investment from the insurance sector to the infrastructure sector was predominantly from the public sector companies. Therefore, the argument that raising the FDI cap in the insurance sector would help in mobilizing resources for infrastructure, does not hold. On the other hand, greater foreign control is more likely to lead to a decline in the share of investment of the private insurance companies into the infrastructure sector, given the record of the foreign insurance companies in siphoning resources for speculative financial ventures.

It is also worth mentioning that the only insurance company involved in insuring Indian exports is the Export Credit Guarantee Corporation of India, which provides insurance cover to export credit. The ECGC has been in existence since 1957. It is functioning under the United India Insurance Co. No private player with foreign partnership has ventured into this area. Moreover, the LIC and other public sector units are the only ones to undertake overseas operations, as reported by the Annual Reports of the IRDA. Foreign participation has also not helped in marketing Indian insurance products abroad.

Conclusion

Governments of the advanced countries like the U.S. continue to apply pressure on developing countries to open up their insurance sectors. China, for instance was pressurized to open up its insurance sector, in return of its entry into the WTO. However, the existing regulations on foreign capital in the insurance sector in China has been a source of continuing debate in the U.S.- China Economic and Security Review Commission, where the Chinese side has resisted attempts to force further deregulation.

The unilateral move to further liberalize the insurance sector in India is unjustifiable. Events over the decade of the 1990s have borne out the fact that financial liberalisation does not contribute positively to investment and economic growth. Countries which enthusiastically opened up their financial sectors in order to attract capital inflows often experienced enhanced volatility in their financial markets and speculative attacks on their currency.

Further opening up of the insurance sector to foreign capital, which serves as a vital financial intermediary of the national economy, is therefore not warranted.

Appendix

List of Private Companies in Life Insurance

Name of the Private Life Insurance Company	% of Foreign Equity	Name of the Foreign partner
Allianz Bajaj Life Insurance Co. Ltd.	26	Allianz
Birla Sun Life Insurance Co. Ltd.	26	Sunlife
HDFC Standard Life Insurance Co. Ltd.	18.60	Standard Life
ICICI Prudential Life Insurance Co. Ltd.	26	Prudential
ING Vysya Life Insurance Co. Ltd.	26	ING
Max New York Life Insurance Co. Ltd.	26	New York Life
MetLife India Insurance Co. Ltd.	25.99	Metlife
Om Kotak Mahindra Life Insurance Co. Ltd.	26	Old Mutual
SBI Life Insurance Co. Ltd.	26	Cardiff
Tata-AIG Life Insurance Co. Ltd.	26	AIG
AMP Sanmar Life Insurance Co. Ltd.	26	Sanmar Life Insurance Co.
Dabur-CGU Life Insurance Co. Ltd.	26	CGU Life Assurance Company

List of Private Companies in General Insurance

Name of the Private General Insurance Company	% of Foreign Equity	Name of the Foreign partner
Royal Sundaram Alliance Insurance Co. Ltd	26	Royal Sun Alliance
Reliance General Insurance Co. Ltd	Nil	

IFFCO-Tokio General Insurance Co. Ltd	26	Tokio Marine
Tata-AIG General Insurance Co. Ltd	26	AIG
Bajaj Allianz General Insurance Co. Ltd	26	Allianz
ICICI Lombard General Insurance Co. Ltd	26	Lombard
Cholamandalam General Insurance Co. Ltd	Nil	
HDFC-CHUBB General Insurance Co. Ltd	26	CHUBB