The Indian insurance industry: challenges and prospects

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Foreword

India's rapid rate of economic growth over the past decade has been one of the more significant developments in the global economy. This growth has its roots in the introduction of economic liberalisation in the early 1990s, which has allowed India to exploit its economic potential and raise the population's standard of living.

Insurance has a very important role in this process. Health insurance and pension systems are fundamental to protecting individuals against the hazards of life and India, as the second most populous nation in the world, offers huge potential for that type of cover. Furthermore, fire and liability insurance are essential for corporations to keep investment risks and infrastructure projects under control. Private insurance systems complement social security systems and add value by matching risk with price. Accurate risk pricing is one of the most powerful tools for setting the right incentives for the allocation of resources, a feature which is key to a fast developing country like India.

By nature of its business, insurance is closely related to saving and investing. Life insurance, funded pension systems and (to a lesser extent) non-life insurance, will accumulate huge amounts of capital over time which can be invested productively in the economy. In developed countries (re)insurers often own more than 25% of the capital markets. The mutual dependence of insurance and capital markets can play a powerful role in channeling funds and investment expertise to support the development of the Indian economy.

This booklet aims to promote a better understanding of insurance in India today. Covering a broad range of topics, the booklet shows the diversity of Indian insurance, its development and its prospects. It also provides a lot of international comparisons which put developments in India into perspective. In so doing the booklet takes advantage of the fact that Professor Tapen Sinha, although Indian by nationality, has pursued a lot of his professional career overseas.

This booklet should help companies operating in India, or intending to enter the Indian market, to position themselves in this market. In addition it should provide background information on the right institutional and legal frameworks to further develop the industry in the best interests of India and its people.

Swiss Re supported the booklet by sponsoring Tapen's stay in India at the IIRM. While Tapen has taken full responsibility for the production of this booklet, I personally would like to thank him, as our contact with him gave us a better understanding of the Indian insurance markets.

Thomas Hess
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Swiss Re

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The views expressed in this paper do not necessarily reflect the views of the IIRM, the IRDA or Swiss Re. Nor does it reflect the views of any of the other institutions the author is affiliated with. All the errors and omissions are solely the responsibility of the author. The author is contactable at tapen@itam.mx.

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I. Introduction

In 2003, the Indian insurance market ranked 19th globally and was the fifth largest in Asia. Although it accounts for only 2.5% of premiums in Asia, it has the potential to become one of the biggest insurance markets in the region. A combination of factors underpins further strong growth in the market, including sound economic fundamentals, rising household wealth and a further improvement in the regulatory framework.

The insurance industry in India has come a long way since the time when businesses were tightly regulated and concentrated in the hands of a few public sector insurers. Following the passage of the Insurance Regulatory and Development Authority Act in 1999, India abandoned public sector exclusivity in the insurance industry in favour of market-driven competition. This shift has brought about major changes to the industry. The inauguration of a new era of insurance development has seen the entry of international insurers, the proliferation of innovative products and distribution channels, and the raising of supervisory standards.

By mid-2004, the number of insurers in India had been augmented by the entry of new private-sector players to a total of 28, up from five before liberalisation. A range of new products had been launched to cater to different segments of the market, while traditional agents were supplemented by other channels including the Internet and bank branches. These developments were instrumental in propelling business growth, in real terms, of 19% in life premiums and 11.1% in non-life premiums between 1999 and 2003.

There are good reasons to expect that the growth momentum can be sustained. In particular, there is huge untapped potential in various segments of the market. While the nation is heavily exposed to natural catastrophes, insurance to mitigate the negative financial consequences of these adverse events is underdeveloped. The same is true for both pension and health insurance, where insurers can play a critical role in bridging demand and supply gaps. Major changes in both national economic policies and insurance regulations will highlight the prospects of these segments going forward.

The objectives of this report are to explore the current state of development in India's insurance market and enumerate the opportunities and challenges offered by this exciting market.

This report begins with an overview of the Indian insurance market in Section II, which highlights the phenomenal growth experienced recently, in line with the country's improving economic fundamentals. Section III benchmarks the Indian insurance market against other regional counterparts. By comparing growth, penetration, density and other insurance variables, it can be shown that, whilst India is still an underdeveloped insurance market, it has a huge catch-up potential.

Section IV presents a necessary overview of the historical development of the sector, but the relevance to the current marketplace is not lost, as the original 1938 Insurance Act still forms the backbone of present insurance regulation. A more detailed dissection of current regulatory issues is offered in Section V. Sections VI and VII discuss issues in the life and non-life insurance sectors respectively. Developments with far-reaching implications, like the proliferation of bancassurance as an alternative distribution channel and the move to allow non-life insurance companies greater freedom in pricing their products, are looked at in detail.

Finally, Section VIII summarises the potential and pitfalls of rural insurance in India. Even though there is strong potential for expansion of insurance into rural areas, growth has so far remained slow. Considering that the bulk of the Indian population still resides in rural areas, it is imperative that the insurance industry's development should not miss this vast sector of the population.

II. An overview of India's insurance market

Insurance in India used to be tightly regulated and monopolised by state-run insurers. Following the move towards economic reform in the early 1990s, various plans to revamp the sector finally resulted in the passage of the Insurance Regulatory and Development Authority (IRDA) Act of 1999. Significantly, the insurance business was opened on two fronts. Firstly, domestic private-sector companies were permitted to enter both life and non-life insurance business. Secondly, foreign companies were allowed to participate, albeit with a cap on shareholding at 26%. With the introduction of the 1999 IRDA Act, the insurance sector joined a set of other economic sectors on the growth march.

During the 2003 financial year[1], life insurance premiums increased by an estimated 12.3% in real terms to INR 650 billion (USD 14 billion) while non-life insurance premiums rose 12.2% to INR 178 billion (USD 3.8 billion). The strong growth in 2003 did not come in isolation. Growth in insurance premiums has been averaging at 11.3% in real terms over the last decade.

Insurance development and potential

Notwithstanding the rapid growth of the sector over the last decade, insurance in India remains at an early stage of development. At the end of 2003, the Indian insurance market (in terms of premium volume) was the 19th largest in the world, only slightly bigger than that of Denmark and comparable to that of Ireland.[2] This was despite India being the second most populous country in the world as well as the 12th largest economy. Yet, there are strong arguments in favour of sustained rapid insurance business growth in the coming years, including India's robust economic growth prospects and the nation's high savings rates.[3]

The dynamic growth of insurance buying is partly affected by the (changing) income elasticity of insurance demand. It has been shown that insurance penetration and per capita income have a strong non-linear relationship.[4] Based on this relation and other considerations, it can be postulated that by 2014 the penetration of life insurance in India will increase to 4.4% and that of non-life insurance to 0.9% (Table 2.1).

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1 *This refers to the financial year ending 30 March 2004. Throughout this report, the "2003-2004 financial year" is interchangeable with the "2003 financial year" and so on. Data are based on the annual reports published by the IRDA and the "The Indian Insurance Industry (Non-Life)" reports produced by Interlink Insurance brokers Pvt. Limited. Figures for 2003 are estimates by Swiss Re Economic Research & Consulting.*

2 *Source: Swiss Re, sigma No 3/2004.*

3 *A recent study by Dominic Wilson and Rupa Purushothaman ("Dreaming with BRICs: the Path to 2050", Goldman and Sachs, Global Economics Paper No 99, October 2003) proposed a model that suggests long-term growth in India of 6% per annum. Furthermore, Dani Rodrik and Arvind Subramanian ("Why India can grow at Seven Percent", Economic and Political Weekly, 17 April 2004) show that India has had sustained growth in labour productivity, with a very low variation. They argue that the Indian dependency ratio will decline from 0.68 in 2000 to 0.48 in 2025. This alone will increase the savings rate from the current 25% of GDP to 39% of GDP. Higher factors of productivity growth and favourable demographics together could lead to an aggregate growth rate of around 7% a year.*

4 *Rudolf Enz, "The S-curve relation between per-capita income and insurance penetration," Geneva Papers on Risk and Insurance: Issues and Practice, Volume 25, No 3, July 2000, p 396-406.*

Table 2.1: Projection of life insurance and non-life insurance premiums, 2004-2014

	Life insurance		Non-life insurance	
	INR m	INR m, constant 2004 prices	INR m	INR m, constant 2004 prices
2004	749 971	749 971	203 856	203 856
2005	871 672	834 136	234 323	224 233
2006	1 025 957	934 358	271 830	247 561
2007	1 201 425	1 042 105	315 522	273 680
2008	1 403 362	1 159 284	368 094	304 074
2009	1 667 814	1 312 134	429 750	338 101
2010	1 983 051	1 485 832	496 953	372 350
2011	2 366 576	1 688 756	572 727	408 690
2012	2 804 561	1 905 996	651 736	442 924
2013	3 326 543	2 153 072	734 778	475 578
2014	3 947 899	2 433 546	828 433	510 659
Average growth rate between 2004-2014	*18.1%*	*12.5%*	*15.1%*	*9.6%*

Source: Swiss Re Economic Research & Consulting.

What will it take to realise this potential?

While the macro-economic backdrop remains favourable to growth, there are still major hurdles to overcome in order for India to realise this growth potential. This report will cover some of the key challenges and issues that have to be tackled by the Indian insurance market.

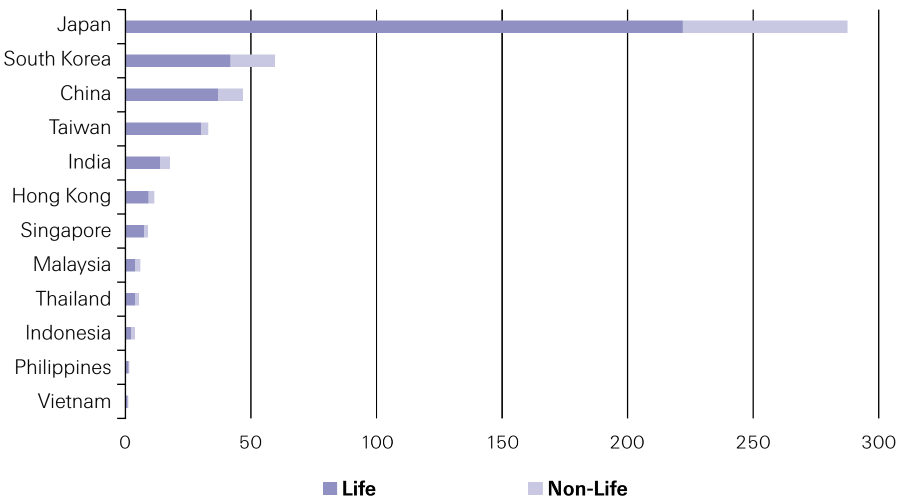
- On the regulatory side, there are outstanding issues concerning solvency regulations, further liberalising of investment rules, caps on foreign equity shareholdings[5] as well as the enforcement of price tariffs in the non-life insurance sector.
- The proliferation of bancassurance is rapidly changing the way insurance products are distributed in India. This will also have strong implications on the process of financial convergence and capital market development in India.
- Health insurance is still underdeveloped in India but offers huge potential, as there will be increasing needs to purchase private health cover to supplement public programmes. Likewise, the deficiencies in current pension schemes should offer significant opportunities to private providers.
- With the majority of the population still residing in rural areas, the development of rural insurance will be critical in driving overall insurance market development over the longer term.

5 *While the current cap on foreign ownership in Indian insurance companies is set at 26%, the Indian Government Budget 2004-05 proposes to raise the cap to 49%.*

III. India in the international context

The Indian insurance market is the 19th largest globally and ranks 5th in Asia, after Japan, South Korea, China and Taiwan.[6] In 2003, total gross premiums collected amount to USD 17.3 billion, representing just under 0.6% of world premiums. Similar to the pattern observed in other regional markets, and reflecting the country's high savings rate, life insurance business accounted for 78.5% of total gross premiums collected in the year, against 21.5% for non-life insurance business.

Figure 3.1: Insurance premiums in Asia, 2003, USD bllions



Sources: National insurance statistics; Swiss Re Economic Research & Consulting preliminary estimates.

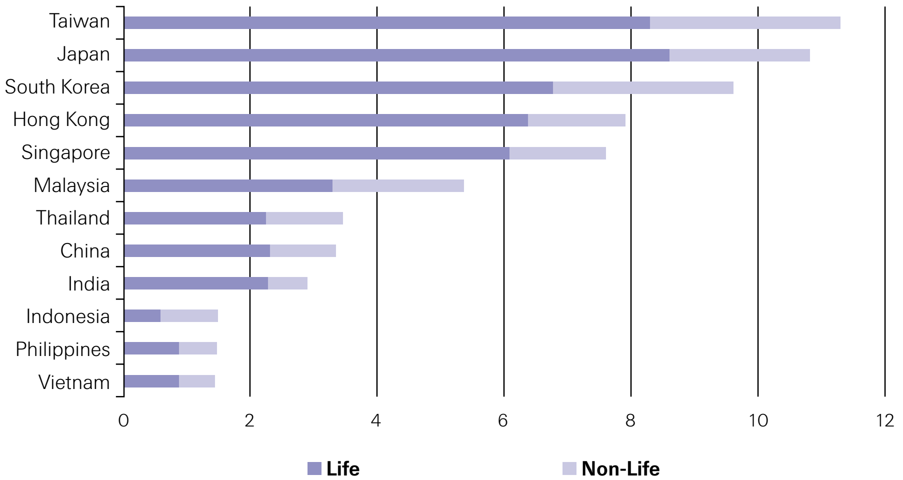
Insurance penetration

Insurance penetration (premiums as a percentage of GDP) has remained stable at a relatively low level in the early 1990s. Total insurance penetration in India was 1.5% in 1990 and was not much higher by the middle of the decade. By 2003, total penetration had risen to 2.88%, comprising 2.26% life insurance business and 0.62% non-life insurance business.

In the context of international comparison, insurance penetration in India is low but commensurate with its level of per capita income. In 2003, India had the 11th highest insurance penetration in Asia and ranked 54th worldwide.

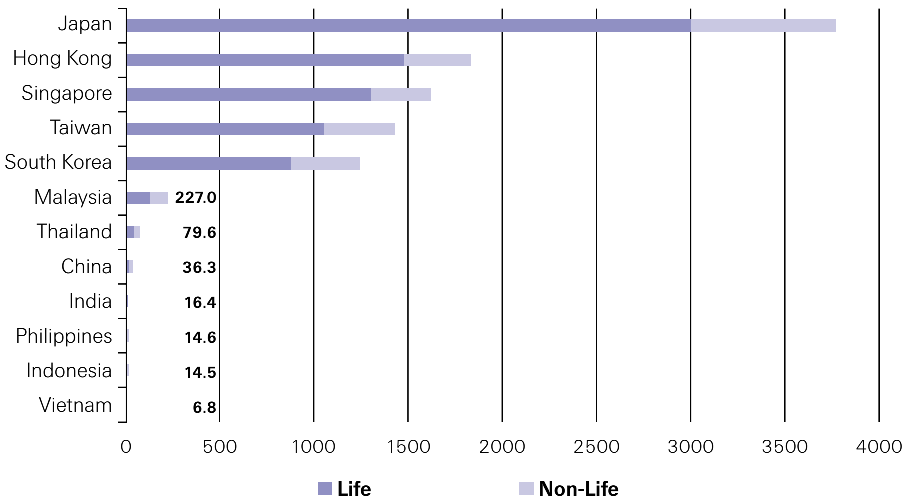
6 *Source: Swiss Re, sigma No 3/2004 "World insurance in 2003: insurance industry on the road to recovery".*

Figure 3.2: Insurance penetration in Asia, 2003, %



Sources: National insurance statistics; Swiss Re Economic Research & Consulting preliminary estimates.

Figure 3.3: Insurance density in Asia, 2003, USD



Sources: National insurance statistics; Swiss Re Economic Research & Consulting preliminary estimates.

Insurance density

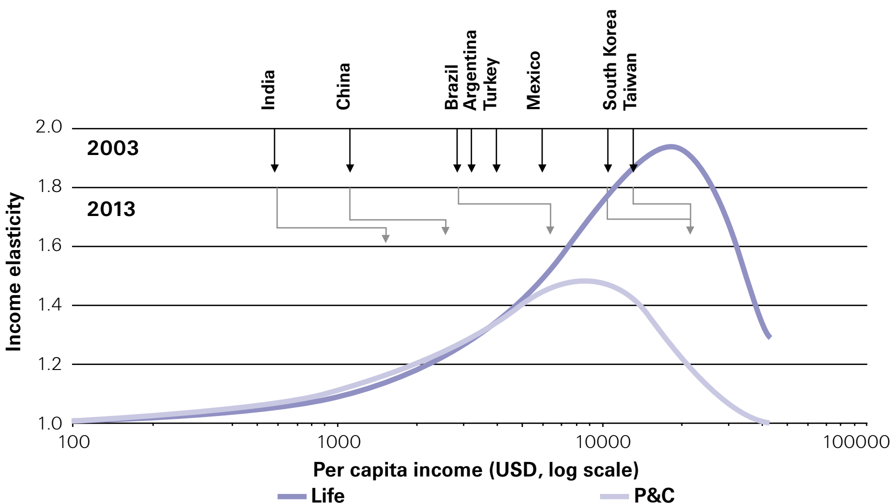
Another measure of insurance development is per capita spending on insurance, ie insurance density. By this measure, India is among the lowest-spending nations in Asia in respect of purchasing insurance (Figure 3.3). An average Indian spent USD 16.4 on insurance products in 2003, comprising USD 12.9 for life insurance and USD 3.5 for non-life insurance products. The level of spending is comparable to that of the Philippines (USD 14.6 in total), Indonesia (USD 14.5) and Sri Lanka (USD 12.5). It lags behind China, which spent USD 36.3 per capita on insurance products in 2003. One factor that has been slowing down the improvement of insurance density is India's relatively high population growth rate, which has averaged 1.7% over the past ten years.

Demand elasticity and growth potential

India's low level of insurance penetration and density has to be viewed in the context of the country's early stage of economic development. Per capita income in India is currently at around USD 600 but is expected to increase rapidly, which could bring in an era of accelerated demand for insurance. International experience tends to suggest that demand for insurance will take off once per capita income has surpassed the USD 1000 mark (Figure 3.4). This income level is deemed high enough for households to consider insurance protection, particularly as many people begin to own their homes and cars.

The empirical relationship between insurance demand elasticity and per capita income can be characterised as a bell-shaped curve. Elasticity remains relatively low at a low income level but increases at an accelerated rate once it has passed the USD 1000 level. The following chart depicts the current position of different emerging markets as well as their expected position by 2013.

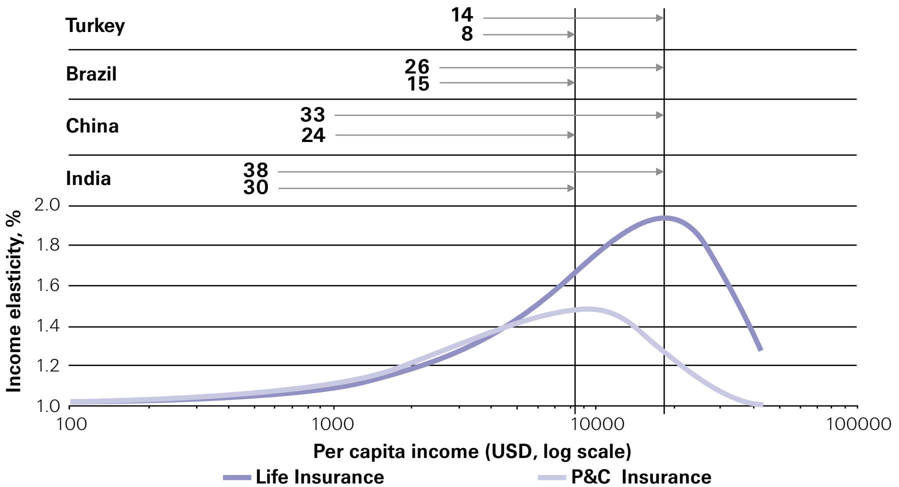
Figure 3.4: Relation between growth in income and demand for insurance



Sources: Swiss Re Economic Research & Consulting.

India's improving economic fundamentals will support faster growth in per capita income in the coming years, which will translate into stronger demand for insurance products. It is also worthwhile to note that it generally takes longer for life insurance demand to reach saturation than non-life insurance (in terms of rising income elasticity). Based on the growth assumption provided by Swiss Re Economic Research & Consulting, it can be seen that the window of opportunity in India's insurance market will remain wide open for a prolonged period of time. Strong growth can be sustained for 30–40 years before the market reaches saturation as income elasticity starts to decline (Figure 3.5).

Figure 3.5: Number of years to reach maximum elasticity



Sources: Swiss Re Economic Research & Consulting.

Market characteristics

While India is widely expected to remain one of the fastest growing emerging insurance markets in the world, growth will nonetheless depend on its intrinsic market characteristics. The following section will review some of the key market characteristics of India in a regional and international context.

Market concentration and foreign market share

It is not surprising that the Indian market is highly concentrated, given that de-monopolisation of the insurance business only started in earnest from 2000. Currently, the insurance market in India is still heavily dominated by the Life Insurance Corporation of India (LIC) and the four state-owned non-life insurers.[7] They respectively held 87% of the life insurance market and 83% of the non-life market in 2003[8]. It can be seen from Table 3.1 that India is one of the Asian insurance markets

7 *These are National Insurance Company Limited, New India Assurance Company Limited, Oriental Insurance Company Limited and United India Insurance Company Limited. They have since been de-linked from GIC.*

with the highest concentration of business, in part reflecting the still dominant positions of these former monopolies. On a positive note, the high level of concentration will offer larger companies the opportunity to reap benefits from economies of scale and scope, although the lack of a profit-maximisation focus in public-sector companies could be a counteracting force.

Table 3.1: Concentration ratio (share of top-5 insurers by gross premiums written, in per cent)

	Non-life insurance	Life insurance
China	96	98
Vietnam	92	NA
India	86	99
South Korea	78	83
Japan	63	60
Taiwan	48	73
Singapore	45	91
Thailand	40	86
Indonesia	40	59
Philippines	38	73
Malaysia	34	73

Note: Figures are based on 2002 premiums, except for Indian non-life, which refers to the 2003 financial year.
Sources: National insurance statistics.

While the insurance business is highly concentrated in India, the share of foreign companies is low (Table 3.2). Since there is a 26% cap on foreign shareholdings, none of the Indian insurers can be considered as "majority foreign-owned". Nevertheless, for the sake of comparison, the share of private-sector companies which mostly have foreign partnerships has been used as a proxy. In these terms, the share of foreign insurers in India is estimated at 13% and 14% respectively in the life (new business) and non-life insurance sectors for the 2003 financial year.[9] India differs from other Asian markets in the sense that its life insurance market is still heavily dominated by indigenous players, partly reflecting the fact that demonopolisation only took hold in 2000. In contrast, most Asian life insurance sectors are already heavily populated by foreign insurers. Conversely, foreign non-life insurers have achieved penetration in India similar to those in other Asian markets. It can be expected that foreign insurance companies will continue to expand their market share in India in the coming years, notwithstanding the fact that public sector insurers are also proactively strengthening their business strategies to fight rising competition.

8 *This refers to the financial year ending March 2004. The life figure refers to only first year and single premiums collected. The non-life figure refers to gross direct premiums within India. Including the state-owned Export Credit Guarantee Corporation Limited, the share of the public sector will have increased to 86%. Source: IRDA Journal, May 2004.*

9 *The share of private sector life companies of total in-force business stood at 2% in the 2002 financial year.*

Table 3.2: Foreign market share (in per cent)

	Non-life insurance	Life insurance
Singapore	53	57
Philippines	26	61
Indonesia	25	48
Malaysia	25	79
Taiwan	12	33
Vietnam	7	54
Thailand	7	50
Japan	6	17
South Korea	1	11
China	1	2
India	0	0

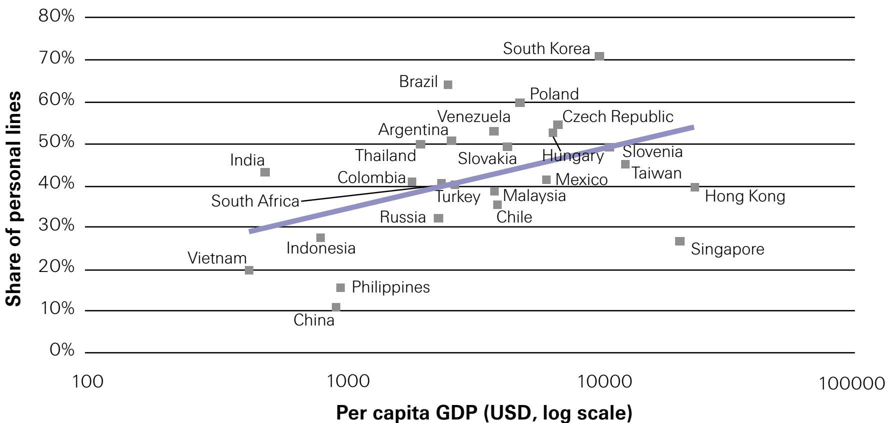
Note: *Foreign market share is defined as the share of premiums collected by foreign majority-owned insurers, including branches and subsidiaries. Figures are based on 2002 premiums. In India, foreign joint ventures began to enter in 2000, but foreign shareholdings are restricted to 26% of capital.*

Sources: *National insurance statistics.*

Mix of non-life business

The mix of non-life business in India resembles most other developing regional economies. Motor and fire policies are the backbone of non-life business in India. They also contributed the most to overall premium growth in the last five years. Compared to other markets, personal lines insurance is relatively well-developed in India. This is mainly manifested in personal motor and private residential fire policies. In comparison, even though motor and fire are also the key lines of non-life business in China, they are mainly purchased by corporations. In fact, among emerging markets with a similar level of per capita income, India has the highest share of personal lines business.

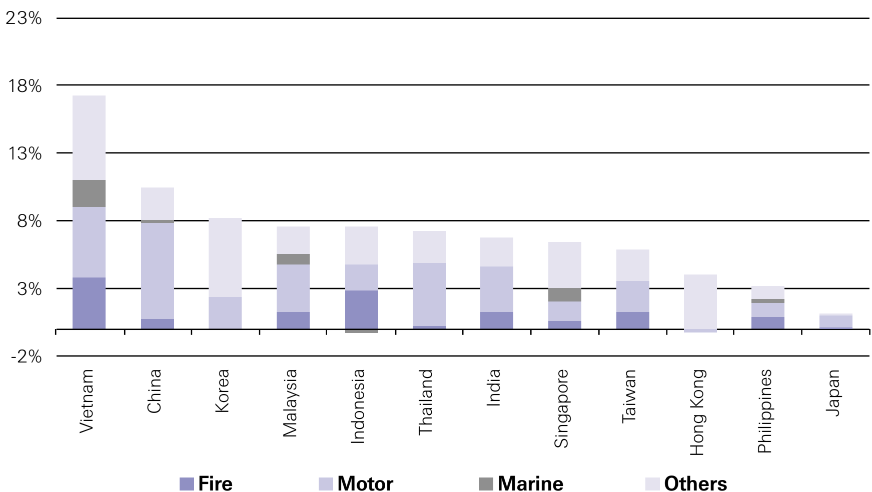
Figure 3.6: Share of personal lines and per capita GDP



Sources: *National regulatory statistics, Swiss Re Economic Research & Consulting.*

Despite the relatively well-developed personal lines business in India, it is expected that growth in the area will stay strong in the coming years. The growth in sales of motor vehicles remains high and demand for additional protection strong. Furthermore, there is plenty of room for growth in personal accident, health and other liability classes. Rising household income and risk awareness will be the key catalysts to spurring more demand for these lines of business in the future. In particular, health insurance could potentially have an important role in driving insurance market development forward. Increasing demand for quality health protection coupled with pressures on the public coffers could spur more demand for health insurance provided by insurers.

Figure 3.7: Contribution to real non-life premium growth by line, 1992-2003

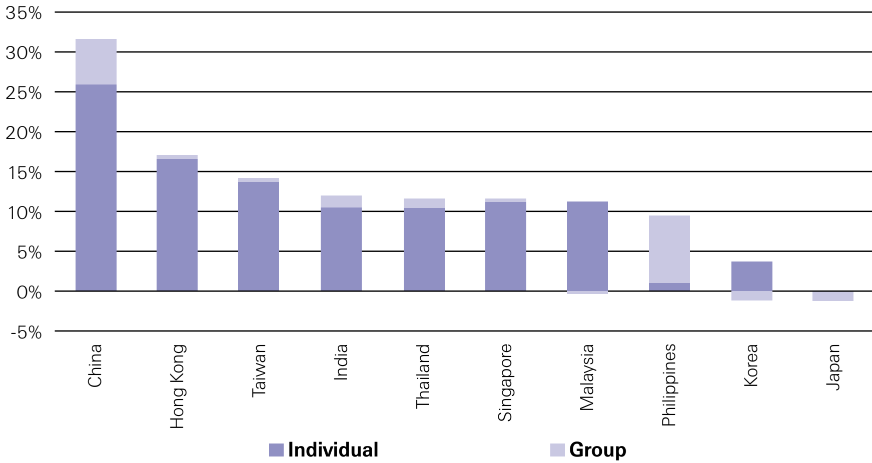


Sources: National regulatory statistics, Swiss Re Economic Research & Consulting.

Mix of life business

Similar to most Asian markets, life insurance premium growth in India is driven mainly by individual business (Figure 3.8). Group business contributed only marginally to the overall growth of life insurance premiums. This is explained in part by the focus of sales on savings products to individuals. At the same time, relatively few life insurance benefits are provided by companies to their employees. In India, as in most developing Asian markets, life insurance is viewed as a savings vehicle rather than a product for risk protection. Reflecting this, the risk content ratio (risk premiums as a percentage of total life insurance premiums) for the region is estimated at below 2%.

Figure 3.8: Contribution to real life premium growth by line, 1992-2003



Note: Group life data for Philippines and Thailand include both group and industrial life figures while those for Hong Kong exclude retirement schemes.
Sources: National insurance statistics; Swiss Re Economic Research & Consulting.

IV. History of insurance development in India

Modern insurance came with a British accent

Insurance in its modern form first arrived in India through a British company called the Oriental Life Insurance Company in 1818, followed by the Bombay Assurance Company in 1823, and the Madras Equitable Life Insurance Society in 1829. They insured the lives of Europeans living in India. The first company that sold policies to Indians with "fair value" was the Bombay Mutual Life Assurance Society starting in 1871.[10] The first general insurance company, Triton Insurance Company Limited, was established in 1850. For the next hundred years, both life and non-life insurance were confined mostly to the wealthy living in large metropolitan areas.

Table 4.1: List of insurance/reinsurance companies in India as of June 2004

Life insurers (14)
Public sector (1) Life Insurance Corporation of India (LIC)
Private sector (13) Allianz Bajaj Life Insurance Company Limited, Birla Sun Life Insurance Company Limited, HDFC Standard Life Insurance Company Limited, ICICI Prudential Life Insurance Company Limited, ING Vysya Life Insurance Company Limited, Max New York Life Insurance Company Limited, MetLife Insurance Company Limited, Om Kotak Mahindra Life Insurance Company Limited, SBI Life Insurance Company Limited, Tata AIG Life Insurance Company Limited, AMP Sanmar Assurance Company Limited, Aviva Life Insurance Company Pvt. Limited, Sahara India Life Insurance Company Limited
Non-life insurers (14)
Public sector (6) National Insurance Company Limited, New India Assurance Company Limited, Oriental Insurance Company Limited, United India Insurance Company Limited, Export Credit Guarantee Corporation, Agriculture Insurance Company of India Limited
Private sector (8) Bajaj Allianz General Insurance Company Limited, ICICI Lombard General Insurance Company Limited, IFFCO-Tokio General Insurance Company Limited, Reliance General Insurance Company Limited, Royal Sundaram Alliance Insurance Company Limited, Tata AIG General Insurance Company Limited, Cholamandalam General Insurance Company Limited, HDFC Chubb General Insurance Company Limited
Reinsurers (1)
General Insurance Corporation of India (GIC)

Source: IRDA Annual Report, 2002-2003. Figures in brackets refer to the number of companies in that category.

10 *Before that, Indians were charged a loading fee of up to 20% more than the British consumers of the same age.*

Regulation of insurance companies began with the Indian Life Assurance Companies Act, 1912. In 1938, all insurance companies were brought under regulation when a new Insurance Act was passed. It covered both life and non-life insurance companies. It clearly defined what would come under life and non-life insurance business. The Act also covered, among others, deposits, supervision of insurance companies, investments, commissions of agents and directors appointed by the policyholders. This piece of legislation lost significance after the insurance business was nationalised in 1956 (life) and 1972 (non-life), respectively. When the market was opened again to private participation in 1999, the earlier Insurance Act of 1938 was reinstated as the backbone of the current legislation of insurance companies, as the IRDA Act of 1999 was superimposed on the 1938 Insurance Act.

By mid-2004, there were 21 private sector insurance companies operating in India, alongside eight public sector companies (Table 4.1). Of these, there were 14 life insurance companies comprising one public (the old monopoly) and 13 private companies. Most private companies had foreign participation up to the permissible limit of 26% of equity.[11] One such charter worth special mention is the joint venture between the State Bank of India (SBI) and Cardif SA of France (the insurance arm of BNP Paribas Bank) – SBI Life Insurance Company Limited. Since the SBI is a bank, the Reserve Bank of India (RBI) needed to approve the SBI's participation because banks are allowed to enter other business on a "case-by-case" basis. It is also an encouraging sign that the authorities are ready to accommodate more diverse forms of corporate structures, as bancassurance will become an important channel for the distribution of insurance. At the same time, in a few joint ventures, Indian banks shared the domestic equity portion with other non-bank entities. It still remains to be seen how this new mode of corporate cooperation will develop going forward.

The latest group to receive an outright charter for operating a life insurance company is the Sahara Group (on 5 March 2004). Sahara's entry is notable for two reasons. Firstly, Sahara would be the first domestic corporation to enter the Indian life insurance market without any foreign partner. Secondly, it would become the first non-banking financial company to operate in the life insurance sector.

In the non-life insurance sector, there were 14 companies operating in India by mid-2004. Six of them are public-sector companies, of which four were former subsidiaries of the GIC that operated as nationalised companies, and the other two are the Export Credit Guarantee Corporation Limited and the Agriculture Insurance Company of India Limited. The rest are private-sector companies. Most of these private-sector companies have foreign partners with a maximum of 26% of shares, but there are also purely domestic companies (eg Reliance General Insurance Company Limited).

Life insurance business

When the life insurance business was nationalised in 1956, there were 154 Indian life insurance companies. In addition, there were 16 non-Indian insurance companies and 75 provident societies also issuing life insurance policies. Most of these policies were centred in the metropolitan areas like Bombay, Calcutta, Delhi and Madras. The life insurance business was nationalised in 1956 with the Life Insurance Corporation of India (LIC) designated the sole provider – its monopolistic status was revoked in 1999.

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11 Refer to Table 4.5.

There were several reasons behind the nationalisation decision. Firstly, the government wanted to channel more resources to national development programmes. Secondly, it sought to increase insurance market penetration through nationalisation.[12] Thirdly, the government found the number of failures of insurance companies to be unacceptable. The government argued that the failures were the result of mismanagement and nationalisation would help to better protect policyholders.

Thus, the post independence history of life insurance in India is largely the history of the LIC. From the perspective of national economic policy, the LIC has been instrumental in the implementation of monetary policy in India.[13] For example, 52% of the outstanding stock of government securities is held by just two public-sector institutions – V the State Bank of India and the Life Insurance Corporation of India – in approximately equal proportion.[14] The lack of investment channels in India and the cautious approach adopted by the regulator are also factors contributing to the high concentration of insurance assets in government securities.

Table 4.2 shows the historical development of LIC's financial data. In nominal terms, during that period the total income of the LIC grew 700-fold. The largest part of payments to policyholders has been through the maturity of policies. This proportion has gone up over time, relative to death benefits. To a certain extent, this reflects the increasing popularity of life insurance products as savings vehicles in lieu of life protection.[15] It can also be discerned that the operating costs (as percentage of premiums) remained high over a sustained period of time, with a decline in the past two decades. Part of this decline has come from the increased sale of group policies which are cheaper to sell per policy than individual life policies.[16]

Table 4.2: Financial statement of LIC (in billions of rupees)

Income	**1957***	**1963****	**1972-3**	**1982-3**	**1992-3**	**2001-2**
Total premium income	0.886	1.511	3.897	12.18	1 79.872	498.22
Income from investment including miscellaneous income	0.193	0.352	1.366	6.894	42.570	239.6
Total income	1.079	1.863	5.263	19.074	122.442	737.82
Outgo						
Commission etc to agents	0.077	0.141	0.368	1.027	7.726	45.94
Salaries & other benefits to employees	0.122	0.223	0.581	1.197	7.998	31.62
Other expenses of management	0.046	0.079	0.137	0.39	2.560	9.21
Taxes etc			0.002	0.538	4.227	11.36
5 % valuation surplus paid to government	0.017				1.054	8.14

12 Apparently this has not been very successful. As reported in earlier sections, the insurance penetration rate has remained fairly stable throughout the nationalisation period. It rose only in the late 1990s.

13 This does not imply the LIC is determining monetary policy objectives in its investment strategies but its appetite for government securities has meant that it has become the largest holder of central government bonds.

14 The Reserve Bank of India Weekly Statistical Supplement, 11 October 2003.

15 The same phenomenon is observed in the rise of insurance funds in total household financial savings (as % of GDP) from 1.0% in 1991 to 1.5% in 2000. Source: India Central Statistics Organisation.

16 It is well known in the literature that Group Life Policies are cheaper. For example, the standard textbook Life Insurance (1988 edition) by Kenneth Black Jr. and Harold Skipper Jr. write, "The nature of the group approach permits the use of mass-distribution and mass-administration that afford group insurance important economies of operation that are not available in individual insurance." (pp. 719-720)

Payments to policyholders	1957*	1963**	1972-3	1982-3	1992-3	2001-2
Claims by maturity	0.208	0.313	0.770	3.507	22.436	122.15
Claims by death	0.079	0.126	0.261	0.864	5.082	21.42
Annuities	0.005	0.004	0.015	0.078	1.042	10.08
Surrenders	0.044	0.051	0.192	0.782	7.248	22.91
Total outgo	0.581	0.954	2.326	8.383	59.373	282.83
Operating cost/premium income	27.65%	29.32%	27.87%	21.46%	22.89%	17.42%
Operating cost/total income	22.71%	23.78%	20.63%	13.70%	14.93%	11.76%

** 16 months from 1.9.1956 to 31.12.1957*

*** 15 months from 1.1.1962 to 31.3.1963*

Sources: Calculations based on Malhotra Committee Report, 1994, Appendix XXVI, p 148 and LIC Annual Reports.

Investment portfolio of the LIC

The investment portfolio of LIC over time is summarised in Table 4.3. Broadly, the first item of "Loans to state and central government and their corporations and boards" has steadily fallen from 42% to around 18% in twenty years. In their place, the share of the second item "Central government, state government, and local government securities" has gone up steadily from 55% in 1980 to 80% in 2000. As such, the LIC (along with the State Bank of India) has become one of the two largest owners of government bonds in India. Whether it is in government loans or bonds, GIC has steadfastly made available over 95% of its investment to Indian government liabilities. It can be seen that the companies have so far refrained from investing in equities or overseas. Recently, however, the LIC has taken a more aggressive stance in boosting its equity investment, both through private placements and secondary market purchases in the stock exchanges. In financial year 2003-2004, it recorded equity investment profit of INR 2,400 crore.

Table 4.3: Distribution of investment portfolio of the Life Insurance Corporation 1980-2000 (in per cent)

Year	Loans to government	Government bonds	Special central government	Unapproved	Foreign	Total
1980-81	41.7	55.0	1.6	1.1	0.6	100.0
1990-91	33.6	59.2	5.6	1.1	0.5	100.0
1991-92	4.9	85.5	6.9	1.9	0.8	100.0
1992-93	34.1	60.1	4.2	1.1	0.5	100.0
1993-94	31.4	63.4	3.6	1.1	0.5	100.0
1994-95	28.7	66.4	3.3	1.1	0.6	100.0
1995-96	26.5	69.0	2.9	1.2	0.5	100.0
1996-97	24.8	71.2	2.6	0.9	0.5	100.0
1997-98	23.1	73.3	2.4	0.8	0.4	100.0
1998-99	21.7	75.4	1.8	0.8	0.3	100.0
1999-00	19.8	77.9	1.4	0.6	0.3	100.0
2000-01	18.3	79.8	1.1	0.5	0.3	100.0

Source: Life Insurance Corporation of India.

Life products before and after deregulation
In the past, the LIC had three commonly sold policies in the market for life insurance: whole life, endowment and money-back policies. The number of new policies sold each year went from about 0.95 million a year in 1957 to 26.97 million in 2003. The total number of in-force policies went from 5.42 million in 1957 to 141 million by March 2003. There are presently several dozen life products offered by the LIC. However, they are small variations on the three products mentioned above. In addition, even though term life policies were available, they were not actively promoted.[17] LIC also has several pension products.

Following the entry of the private insurers, there was a proliferation of products. According to the Annual Report of the IRDA, 116 life products were offered by life insurance companies in India as of 31 March 2002. Of course, they were not all distinct products. Many products across different companies were very similar, if not identical. Some of the more popular products launched recently include creditor protection products like mortgage life, and unit-linked products.

Non-life business
Non-life insurance was not nationalised in 1956 along with life insurance. The reason was addressed by the then Finance, Minister C. D. Deshmukh, in his budget speech of 1956.

"I would also like to explain briefly why we have decided not to bring in general insurance into the public sector. The consideration which influenced us most is the basic fact that general insurance is part and parcel of the private sector of trade and industry and functions on a year to year basis. Errors and omission in the conduct of its business do not directly affect the individual citizen. Life insurance business, by contrast, directly concerns the individual citizen whose savings, so vitally needed for economic development, may be affected by any acts of folly or misfeasance on the part of those in control or be retarded by their lack of imaginative policy."

Sixteen years later, in 1972, non-life insurance was finally nationalised (with effect from 1 January 1973). At that time there were 107 general insurance companies. They were mainly large city-oriented companies catering to the organised sector (trade and industry). They were of different sizes, operating at different levels of sophistication. Upon nationalisation, these businesses were assigned to the four subsidiaries (roughly of equal size) of the General Insurance Corporation of India (GIC).

There were several goals in setting up this structure. Firstly, the subsidiary companies were expected to set up standards of conduct, sound practices and provision of efficient customer service in general insurance business. Secondly, the GIC was to help control the expenses of the subsidiaries. Thirdly, it was to help with the investment of funds for its four subsidiaries. Fourthly, it was to bring general insurance to the rural areas of the country, by distributing business to the four subsidiaries, each operating in different areas in India. Fifthly, the GIC was also designated the national reinsurer. By law, all domestic insurers were to cede 20% of their gross direct premium in India to the GIC. The idea was to retain as much risk as possible domestically. This was in turn motivated by the desire to minimise the expenditure on foreign exchange. Sixthly, all four subsidiaries were supposed to compete with one another.

17 This was noted by the Malhotra Committee Report in 1994.

After the passage of the 1999 IRDA Act, the GIC was de-linked from its four subsidiaries. Each subsidiary, with their headquarters based in the four largest metropolitan areas, became independent. The only function the GIC retained was that of national reinsurer. However, the government still remains the sole owner of the four former GIC subsidiaries.

Non-life products before and after deregulation

Before deregulation in 1999, non-life products that were available in the market were rather limited and similar across the four GIC subsidiaries. They could also be classified by whether they were regulated by tariffs: fire insurance, motor vehicle insurance, engineering insurance and workers' compensation etc that came under tariff; and burglary insurance, Mediclaim, personal accident insurance etc that did not. In addition, most specialised insurance (eg racehorse insurance) did not fall under tariff regulations. After the opening of the sector to private players, more new products were introduced. To take an example, one joint-venture non-life insurer introduced 29 different products during the year, according to the IRDA. They included products liability, corporate cover, professional indemnity policies, burglary cover, individual and group health policies, weather insurance, credit insurance, travel insurance and so on. Some of these products were completely new (eg weather insurance) while others were already available through the public insurance companies.

Investment portfolio of the GIC

GIC's investment in central government securities hovered at around 20% between 1980 and 2000 (Table 4.4). Investment in state government securities remained much closer to the target of 10% throughout the period.[18] Soft loans (loans at below market rates) for housing rose from 8% in 1980 to a high of 29% in 1994, only to fall again to a low of 14% at the final stage. The Malhotra Committee (1994) recommended that the mandated investment of funds in government securities of the non-life insurance companies should be reduced to 40%. In April 1995, the government relaxed the investment policies of GIC and its subsidiaries. Therefore, in the later half of the 1990s, there was a jump in the other approved market investment categories (bonds and stocks of large public and private sector companies). It can also be discerned that the investment portfolio of GIC differs significantly from that of LIC, not least due to the very different nature of their liability structures. Given the more short-term liabilities of GIC, it was less willing to carry more long-term government securities.

18 There have been regulatory targets/restrictions on investment of insurance companies since 1938. Please refer to Section V for details.

Table 4.4: Distribution of the General Insurance Corporation's investment portfolio 1980-2000 (in per cent)

Year	Central government bonds	State bonds	Soft loans*	Market investment	Other loans	Total
1980	21	9	8	34	27	100
1989-90	19	11	29	34	8	100
1990-91	18	11	28	31	12	100
1991-92	17	10	26	33	14	100
1992-93	17	10	26	36	11	100
1993-94	17	10	27	35	11	100
1994-95	17	10	29	35	9	100
1995-96	17	5	23	42	13	100
1996-97	18	6	20	42	15	100
1997-98	18	7	18	40	17	100
1998-99	18	8	16	42	16	100
1999-00	19	9	14	43	14	100
2000-01	21	11	14	44	10	100

Note: Data for 1980 are as at end-December and for the other years as at end-March.
** Loans at below market rates.*
Source: General Insurance Corporation of India.

Recent privatisation and foreign partnerships

Recent privatisation has brought in new players in the market – almost all of them with foreign partners. Table 4.5 below lists the equity share capital of insurance companies in the financial years 2001-02 and 2002-03. There was a substantial injection of equity capital in the private sector in life insurance. In non-life business, the change was marginal. Notice that the equity share capital for LIC was relatively small.

Table 4.5: Equity share capital of insurance companies (in millions of rupees)

Insurer	2001-02	2002-03	Foreign	Indian	Foreign equit share (%)
Life insurers					
HDFC Standard Life	1 680	2 180	405	1 775	18.6
ICICI Prudential Life	1 900	4 250	1 105	3 145	26.0
Max New York Life	2 500	2 550	663	1 887	26.0
Om Kotak Mahindra Life	1 010	1 313	341	972	26.0
Birla Sun Life	1 500	1 800	468	1 332	26.0
Tata AIG Life	1 850	1 850	481	1 369	26.0
SBI Life	1 250	1 250	325	925	26.0
ING Vysya Life	1 100	1 700	442	1 258	26.0
MetLife	1 100	1 100	286	814	26.0

Allianz Bajaj Life	1 500	1 500	390	1 110	26.0
AMP Sanmar	1 250	1 250	325	925	26.0
Aviva Life		1 548	402.5	1 146	26.0
Sub-total	*16 640*	*22 291*	*5 634*	*16 657*	
LIC	50	50		50	
Total (life)	***16 690***	***22 341***	***5 634***	***16 707***	
Non-life insurers					
Royal Sundaram Alliance	1 300	1 300	338	962	26.0
Reliance	1 020	1 020	0	1 020	
Bajaj Allianz	1 100	1 100	286	814	26.0
IFFCO-Tokio	1 000	1 000	260	740	26.0
Tata AIG	1 250	1 250	325	925	26.0
ICICI Lombard	1 100	1 100	286	814	26.0
HDFC Chubb	-	1 010	263	747	26.0
Cholamandalam	495	1 050	0	1 050	
Subtotal	***7 265***	***8 830***	***1 758***	***7 072***	
National	1 000	1 000	0	1 000	
New India Assurance	1 000	1 000	0	1 000	
United India	1 000	1 000	0	1 000	
Oriental	1 000	1 000	0	1 000	
Subtotal	***4 000***	***4 000***	***0***	***4 000***	
ECGC	3 900	4 400	0	4 400	
Total (non-life)	***15 165***	***17 230***	***1 757***	***15 472***	
Reinsurer					
GIC	2 150	2 150	0	2 150	

Source: Annual Report, IRDA, 2003.

V. Regulatory regime

After the release of the Malhotra Committee report in 1994, changes in the insurance industry appeared imminent. Unfortunately, changes in the central government slowed down the process. The dramatic climax came on 7 December 1999 when the government finally passed the Insurance Regulatory and Development Authority (IRDA) Act. This Act repealed the monopoly conferred to the Life Insurance Corporation in 1956 and to the General Insurance Corporation in 1972. The authority created by the Act is called the Insurance Regulatory and Development Authority (IRDA). Table 5.1 below summarises some of the milestones in India's insurance regulation.

Table 5.1: Milestones of insurance regulations in the 20th Century

Year	Significant regulatory event
1912	First piece of insurance regulation promulgated – Indian Life Insurance Company Act, 1912
1928	Promulgation of the Indian Insurance Companies Act
1938	Insurance Act 1938 introduced, the first comprehensive legislation to regulate insurance business in India
1956	Nationalisation of life insurance business in India
1972	Nationalisation of general insurance business in India
1993	Setting-up of the Malhotra Committee
1994	Recommendations of Malhotra Committee released
1995	Setting-up of Mukherjee Committee
1996	Setting-up of an (interim) Insurance Regulatory Authority (IRA)
1997	Mukherjee Committee Report submitted but not made public
1997	The Government gives greater autonomy to LIC, GIC and its subsidiaries with regard to the restructuring of boards and flexibility in investment norms aimed at channelling funds to the infrastructure sector
1998	The cabinet decides to allow 40% foreign equity in private insurance companies – 26% to foreign companies and 14% to non-resident Indians (NRIs), overseas corporate bodies (OCBs) and foreign institutional investors (FIIs)
1999	The Standing Committee headed by Murali Deora decides that foreign equity in private insurance should be limited to 26%. The IRA Act was renamed the Insurance Regulatory and Development Authority (IRDA) Act
1999	Cabinet clears IRDA Act
2000	President gives assent to the IRDA Act

Sources: Various.

Features of the 1999 IRDA Act

The Insurance Regulatory and Development Act of 1999 set out "to provide for the establishment of an Authority to protect the interests of holders of insurance policies, to regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto and further to amend the Insurance Act, 1938, the Life Insurance Corporation Act, 1956, and the General Insurance Business (Nationalisation) Act, 1972." The Act effectively reinstituted the Insurance Act of 1938 with (marginal) modifications. Whatever was not explicitly mentioned in the 1999 Act referred back to the 1938 Act. The salient features of the 1999 IRDA Act are discussed below.[19]

Licensing

The IRDA Act, 1999, sets out details of registration of an insurance company along with renewal requirements. The minimum capital requirement for direct non-life and life insurance business is 100 crores (ie INR 1 billion). The IRDA regulates the entry and exit of players, capital norms, and maintains a strict watch on the equity and solvency situation of insurers. Should an application be rejected, the applicant will have to wait for a minimum of two years to make another proposal, which will have to be with a new set of promoters and for a different class of business.

For renewal, it stipulates a fee of one-fifth of one percent of total gross premiums written direct by an insurer in India during the financial year preceding the renewal year. It also seeks to give a detailed background for each of the following key personnel: chief executive, chief marketing officer, appointed actuary, chief investment officer, chief of internal audit and chief finance officer. Details of the sales force, activities in rural business and projected values of each line of business are also required. Further, the Act sets out the reinsurance requirement for (general) insurance business. For all general insurance a compulsory cession of 20%, regardless of the line of business, to the General Insurance Corporation (the designated national reinsurer) is stipulated.

Currently, India allows foreign insurers to enter the market in the form of a joint venture with a local partner, while holding no more than 26% of the company's shares (Table 5.2). Compared to the other regional markets, India has more stringent restrictions on foreign access.

19 The following discussions incorporate changes to the Insurance Act effective from 1 January 2004.

Table 5.2: Market access regimes in Asia

	Majority ownership in existing domestic companies	Establishment of subsidiaries	Establishment of branches	Expected changes
Australia	no restrictions	no restrictions	no restrictions	none
China	not allowed (maximum 25% foreign shares)	no restrictions (mandatory joint venture for foreign life insurers)	no restrictions (mandatory joint venture for foreign life insurers)	none
Hong Kong	no restrictions	no restrictions	no restrictions	none
Taiwan	no restrictions	no restrictions	no restrictions	none
Japan	no restrictions	no restrictions	no restrictions	none
South Korea	no restrictions	no restrictions	no restrictions	considering lowering the minimum capita requirement to attract more new establishments
India	not allowed (maximum 26% foreign shares)	not allowed	not allowed	49% foreign shares being considered
Indonesia	no restrictions	not allowed	not allowed	more flexible approach to foreign shares in joint ventures
Malaysia	not allowed (exceptions are noted)	not allowed	not allowed	none
Philippines	no restrictions	no restrictions	no restrictions	none
Singapore	no restrictions	no restrictions	no restrictions	none
Thailand	not allowed	not allowed	no restrictions	raise foreign share to 49% from 25%
Vietnam	no restrictions	no restrictions	no restrictions	liberalisation under the US-Vietnam bilateral trade agreement

Source: National insurance regulators.

Solvency controls

General insurance business lines that are subject to tariffs include fire, motor, marine hull, tea crop, engineering, industrial all risks, business interruption, personal accident and workers' compensation. Tariffs are managed by the Tariff Advisory Committee.

In addition, insurers have to observe the required solvency margin (RSM).[20] For general insurers, this is the higher of RSM-1 or RSM-2, where

- RSM-1 is based on 20% of the higher of (i) gross premiums multiplied by a **factor A**,[21] or (ii) net premiums;
- RSM-2 is based on 30% of the higher of (i) gross net incurred claims multiplied by a **factor B**, or (ii) net incurred claims;
- there is also a lower limit of INR 500 million for the RSM.

Life insurers have to observe the solvency ratio, defined as the ratio of the amount of available solvency margin to the amount of required solvency margin:

- the required solvency margin is based on mathematical reserves and sum at risk, and the assets of the policyholders' fund;
- the available solvency margin is the excess of the value of assets over the value of life insurance liabilities and other liabilities of policyholders' and shareholders' funds.

Business conduct

As well as licensing and solvency regulations, the IRDA Act also prescribes guidelines and regulations on business conduct. It specified the creation and functioning of an Insurance Advisory Committee that sets out relevant rules and regulation.

20 *For general insurers, there are also stipulations on reserving for unexpired risks and outstanding claims. On reserves for unexpired risks, these shall be*
- *50% (for fire, marine business other than marine hull, and miscellaneous businesses);*
- *100% (for marine hull business) of premiums, net of reinsurance, received or receivable during the preceding 12 months.*

For reserves for outstanding claims, these shall be determined as such:
- *where the amounts of outstanding claims of the insurers are known, the amount is to be provided in full;*
- *where the amounts of outstanding claims can be reasonably estimated, the insurer may follow the "case-by-case method" after taking into account the explicit allowance for changes in the settlement pattern or average claim amounts, expenses and inflation.*

21 *The detailed factors are listed below for each major line of business:*

Line of business	***Factor A***	***Factor B***
Fire	*0.5*	*0.5*
Marine: marine cargo	*0.7*	*0.7*
Marine: marine hull	*0.5*	*0.5*
Miscellaneous:		
Motor	*0.85*	*0.85*
Engineering	*0.5*	*0.5*
Aviation	*0.9*	*0.9*
Liability	*0.85*	*0.85*
Rural insurance	*0.5*	*0.5*
Other	*0.7*	*0.7*
Health	*0.85*	*0.85*

An important point is that it stipulates the role of the "appointed actuary". He/she has to be a Fellow of the Actuarial Society of India. For life insurers, the appointed actuary has to be an internal company employee, but he or she may be an external consultant if the company happens to be a general insurance company. The appointed actuary is responsible for providing a detailed account of the company to the IRDA.

Further, all insurers are required to provide some coverage for the rural sector.[22] This is known as the Obligations of Insurers to Rural Social Sectors. In respect of a life insurer, the share of premiums from the rural social sectors shall be (a) 5% in the first financial year; (b) 7% in the second financial year; (c) 10% in the third financial year; (d) 12% in the fourth financial year; and (e) 15% in the fifth year (of total policies written direct in that year). In respect of a general insurer, (a) 2% in the first financial year; (b) 3% in the second financial year; and (c) 5% thereafter (of total gross premium income written direct in that year). In addition, each company is obliged to service the social sector[23] as follows. In respect of all insurers, (a) 5000 lives in the first financial year; (b) 7500 lives in the second financial year; (c) 10,000 lives in the third financial year; (d) 15,000 lives in the fourth financial year; and (e) 20,000 lives in the fifth financial year.

Investment allocation and norms

The Insurance Act of 1938 required life insurance companies to hold 55% of their assets in government securities or other approved securities (Section 27A of the Insurance Act). In the 1940s, many life insurance companies were part of financial conglomerates. With a 45% balance to play with, some life insurance companies used these funds for other enterprises or even for speculation. In 1958, Section 27A of the Insurance Act was modified to stipulate the following investment regime:

(a) Central government market securities of not less than 20%;
(b) Loans to National Housing Bank including (a) above should be no less than 25%;
(c) In state government securities including (b) above should be no less than 50%; and
(d) In socially oriented sectors including the public sector, cooperative sector, house building by policyholders, own-your-own-home schemes including (c) above should be no less than 75%.

For General Insurance, Section 27B of the Insurance Act of 1938 was amended in 1976. The guideline for investment was set out as follows: (a) central government securities of no less than 25%; (b) state government and public sector bonds of no less than 10%; and (c) loans to state governments, various housing schemes of no less than 35%. The remaining 30% investment could be in the market sector in the form of equity, long-term loans, debentures and other forms of private sector investment.

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22 *The formal definition of rural sector used is as follows. "Rural sector" shall mean any place as per the latest census which has: (i) a population of not more than five thousand; (ii) a density of population of not more than four hundred per square kilometre; and (iii) at least seventy-five percent of the male working population is engaged in agriculture. Readers should refer to Section VIII for details on rural insurance.*

23 *"Social sector" includes the unorganised sector, informal sector, economically vulnerable or backward classes and other categories of persons, both in rural and urban areas.*

Tables 5.3a and 5.3b below show the norms of investments after the passage of the IRDA Act.[24] Perhaps the most striking features of these norms is that they still operate in the same form of quantitative restrictions imposed on different types of business as they did in earlier periods.

Table 5.3a: Investment regulations of life business

	Type of investment	Percentage
I	Government securities	At least 25%
II	Government securities or other approved securities (including (I) above)	Not less than 50%,
III	Approved investments as specified in Schedule I	
	a) Infrastructure and social sector Explanation: for the purpose of this requirement, infrastructure and social sector shall have the meaning as given in Regulation 2(h) of Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations, 2000, and as defined in the Insurance Regulatory and Development Authority (Obligations of Insurers to Rural and Social Sector) Regulations, 2000, respectively	Not less than 15%
	b) Others to be governed by exposure/prudential norms specified in Regulation 5	Not exceeding 20%
IV	Other than in approved investments to be governed by exposure/ prudential norms specified in Regulation 5	Not exceeding 15%

Source: Gazette of India Extraordinary Part III Section 4. Insurance Regulatory and Development Authority (Investment) Regulations, 2000.

24 *On 1 January 2004, the IRDA amended the investment regulations in a number of ways. Firstly, it explicitly prohibited both life and general insurance companies from investing more than 5% of the aggregate assets in the group of funds controlled by the promoters. Secondly, downgrading of investment portfolios is to be reported quarterly (within 21 days of the end of the quarter). Thirdly, financial derivatives can be used as long as they are used for hedging risk. Given the preponderance of investment by insurance companies in bonds, interest-rate risk is the most important risk carried in their portfolios. Thus, the use of interest-rate hedging instruments by insurance companies is expected to pick up .*

Table 5.3b: Investment regulations of general insurance business

	Type of investment	Percentage
I	General government securities being not less than	20%
II	State government securities and other guaranteed securities including (I) above being not less than	30%
III	Housing and loans to state government for housing and fire fighting equipment, being not less than	5%
IV	Investments in approved investments as specified in Schedule II	
	a) Infrastructure and social sector Explanation: for the purpose of this requirement, infrastructure and social sector shall have the meaning as given in Regulation 2(h) of Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations, 2000, and as defined in the Insurance Regulatory and Development Authority (Obligations of Insurers to Rural and Social Sector) Regulations, 2000, respectively	Not less than 10%
	b) Others to be governed by exposure/prudential norms specified in Regulation 5	Not exceeding 30%
V	Other than in approved investments to be governed by exposure/ prudential norms specified in Regulation 5	Not exceeding 25%

Source: Gazette of India Extraordinary Part III Section 4. Insurance Regulatory and Development Authority (Investment) Regulations, 2000.

At least half of the investment has to be either directly in government securities (bonds) or in infrastructure. These investment options are "safe" as they are fully backed by the government. Of course, it also means they earn the lowest rate of return in the Indian market. The government (both at the federal and state levels) has used the insurance business as a way of raising capital. The actual investment patterns are shown in Tables 5.4a and 5.4b below.

Table 5.4a: Investment by life companies as of 31 March 2003 (in crores of rupees)

	Government securities and other approved	Infrastructure	Investment subject to norm	Total	(Other than approved)
LIC	167 513.04	30 998.16	60 221.02	258 732.22	1 119.38
HDFC Standard	169.89	39.2	45.98	255.07	9.11
Max New York	104.1	27.12	20.83	152.05	5
ICICI Prudential	286.76	63.56	318.38	668.7	41.37
Birla Sun Life	70.17	15.14	89.95	175.26	2.98
Tata AIG	103.6	24.93	26.51	155.04	4.39
OM Kotak Mahindra	79.79	26.49	37.57	143.85	18.25
SBI Life	122.99	31.29	47.34	201.62	17.96
Allianz Bajaj	105.14	37.68	48.41	191.23	0.38
Met Life	57.17	15.18	18.06	90.41	7.54
AMP Sanmar	65.69	18.8	10.02	94.51	0
ING Vysya	58.8	15.25	24	98.05	0
Aviva Life	66.55	23.08	36.43	126.06	3.51

Source: IRDA Annual Report, 2002-2003.

Table 5.4b: Asset allocation of life insurance companies as of 31 March 2003 (in per cent)

	Government securities and other approved	Infrastructure	Investment subject to norm	Total	Other than approved
LIC	65	12	23	100	0
HDFC standard	67	15	18	100	4
Max New York	68	18	14	100	3
ICICI Prudential	43	10	48	100	6
Birla Sun Life	40	9	51	100	2
Tata AIG	67	16	17	100	3
OM Kotak Mahindra	55	18	26	100	13
SBI Life	61	16	23	100	9
Allianz Bajaj	55	20	25	100	0
Met Life	63	17	20	100	8
AMP Sanmar	70	20	11	100	0
ING Vysya	60	16	24	100	0
Aviva Life	53	18	29	100	3

Source: Calculated from the IRDA Annual Report, 2002-2003.

It can be observed that public and private companies do not differ tangibly in their asset allocations. The LIC has 65% invested in government securities and other approved securities. For the private sector it ranges from 40% (Birla Sun Life) to 70% (AMP Sanmar). Infrastructure investment for LIC was 12%. For the private companies it ranges from a high of 20% for AMP Sanmar and Allianz Bajaj to a low of 9% for Birla Sun Life. In the "other approved" investment category, LIC has invested 23%. The average for the private sector in this category is 30%. In the unapproved category, the LIC has no investment whatsoever, whereas the private sector has 5% of the total in this category. It should be noted that different investment portfolios could be the result of the different liability structure of the LIC and the other private sector companies. In particular, most private companies' liabilities are of shorter duration, given that many of them have just started their operations.

In the general insurance sector, public sector companies invested 37% in government securities whereas the private sector has 45% in that category (Tables 5.5a and 5.5b). For public-sector companies, it ranges from a low of 22% by the ECGC to a high of 43% by National. For the private sector it varies from a low of 36% by IFFCO Tokio to a high of 77% by HDFC Chubb. The other big category is a catch-all "investment subject to norm". In that category, the public sector has 52% whereas the private sector only has 39%.

Table 5.5a: Investment by general insurance companies as of 31 March 2003 (in crores of rupees)

	Govt and other approved	Housing	Infrastructure	Investment subject to norm	Total
GIC	2 699.62	688.94	686.8	4 388.51	8 463.87
New India	2 539.72	421.11	446.92	3 955.21	7 362.96
National	1 573.95	212.5	270.02	1 622.06	3 678.52
United India	2 168.95	371.14	713.4	2110.6	5 364.09
Oriental	1 345.81	279.4	436.23	1 898.34	3 959.78
Reliance	105.44	12.06	20.33	43.67	181.5
Royal Sundaram	74.55	19.8	21.66	54.86	170.87
IFFCO Tokio	71.86	12.46	26.73	88.71	199.75
Tata AIG	113.67	15.92	30.18	70.22	229.99
Bajaj Allianz	107.51	24.39	34.56	128.35	294.81
ICICI Lombard	94.6	18.56	29.39	75.26	217.81
ECGC	2.28	0.6	1.15	6.45	10.49
Cholamandalam	81.82	5.06	11.4	10.6	108.88
HDFC Chubb	69.8	5.27	10.45	5.46	90.98

Source: IRDA Annual Report, 2002-2003.

Table 5.5b: Asset allocation of general insurance companies as of 31 March 2003 (in per cent)

	Govt and other approved	Housing	Infrastructure	Investment subject to norm	Total
GIC	32	8	8	52	100
New India	34	6	6	54	100
National	43	6	7	44	100
United India	40	7	13	39	100
Oriental	34	7	11	48	100
Reliance	58	7	11	24	100
Royal Sundaram	44	12	13	32	100
IFFCO Tokio	36	6	13	44	100
Tata AIG	49	7	13	31	100
Bajaj Allianz	36	8	12	44	100
ICICI Lombard	43	9	13	35	100
ECGC	22	6	11	61	100
Cholamandalam	75	5	10	10	100
HDFC Chubb	77	6	11	6	100

Source: Calculated from the IRDA Annual Report, 2002-2003.

Investment returns

For the Indian market, the table below shows the distribution of nominal and real rates of return across different assets like stocks, bonds and real estate. Not surprisingly, equity investment appears at the top. It also carries the highest volatility (standard deviation). Long-term mortgages carry a surprisingly high rate of return with low risk. Government of India (GOI) bonds in the past (when the interest rate was not determined by market forces) produced a number of years with negative real interest rates.

Table 5.6: Rates of return of various assets in India

	Period		Nominal	Standard deviation	Real
Equity	1979 - 80 to 2002 - 03		16.73%	29.80%	8.41%
Bank deposits	1970 - 71 to 2002 - 03				
		1 - 3 years	8.58%	1.87%	0.43%
		3 - 5 years	8.51%	1.33%	0.36%
		> 5 years	9.99%	1.68%	1.84%
Call money	1970 - 71 to 2002 - 03	9.61%	3.33%	1.46%	
T-bills	1996 - 97 to 2002 - 03				
		14 days	7.15%	1.21%	0.92%
		15 - 91 days	8.04%	1.38%	1.81%
		92 - 182 days	8.64%	1.65%	2.41%
		183 - 364 days	9.06%	1.88%	2.83%
GOI dated	1970 - 71 to 2001 - 02				
Short term			5.74% - 1.64%	1.86% - 6.54%	(2.57%) - 3.23%
Medium term			6.60% - 10.07%	2.03% - 3.70%	(1.81 %) - 1.76%
Long term			8.05% - 9.96%	2.26% - 2.96%	(0.36%) - 1.55%
US – 64(MF)	1970 - 71 to 2000 - 01		11.53%	3.24%	3.12%
Loan – long-term mortgage	1970 - 71 to 2001 - 02		12% - 13%	2% - 3%	4 % - 5%
Corporate bonds	Jan 2001 - June 2003				
		AAA	1.12% + GOI	Higher than GOI	Higher than GOI
		AA+	1.60% + GOI	Higher than	Higher than GOI
		AA	2.00% + GOI	Higher than GOI	Higher than GOI
Property	1999 - 2002		11% - 18%	Unknown	7% - 9%

Source: *Jim Thompson and Gautam Kakkar, "Investment sectors and their potential for life insurance companies", Paper presented at the Sixth Global Conference of Actuaries, 18-19 February 2004.*

Other regulatory developments

The following are a few new features of the regulatory regime introduced by the IRDA:

- Insurance agents are governed by the *Licensing of Insurance Agents Regulations 2000* and the *Licensing of Insurance Regulations (amendment) 2002*. Importantly, to ensure professional standards, the IRDA has mandated minimum educational qualifications for all agents, together with training and examination requirements.
- Through a Government of India Notification dated 11 November 1998, the Insurance Ombudsman was created to address grievances of the insured customers and protect the interest of policyholders. Twelve Ombudsmen have been appointed across the country to expedite disposal of complaints. They have jurisdiction in respect of personal lines of insurance where the contract value does not exceed INR 20 lakhs. The Ombudsman is bound to pass a judgement within three months from the receipt of the complaint. It should be noted that the system is monitored and operated through a governing body of Insurance Council comprising of representatives of insurance companies. The IRDA deals with other disputes that fall outside the Ombudsman's jurisdiction.
- Policyholder protection was enhanced through the enactment of the *Protection of Policyholders' Interests Regulations, 2002*. It stipulates the responsibility of insurance companies to spell out clearly the terms and conditions of insurance policies as well as other details. For example, in life insurance, details of any riders attaching to the main policy have to be given to the policyholders.

Future changes in insurance law

Changes to the insurance law in India became enormously complicated during the twentieth century. Just a few years ago it would have been difficult to anticipate that the Insurance Act, 1938, would be re-enforced through the IRDA Act, 1999. This juxtaposition of laws produced some important anomalies. In order to streamline regulations and eliminate these anomalies, the Law Commission was entrusted with examining these matters for future amendments.[25] A key proposal of the Law Commission is to merge some of provisions of the IRDA Act and the Insurance Act. This will facilitate market practitioners in understanding the role of IRDA while putting all the provisions in one place. This will also help to make revisions easier in future, in accordance to changes in market conditions. The main suggestions of the Law Commission are summarised below.[26]

(1) The Insurance Act, 1938, is a piece of colonial legislation. Therefore, it contains terminology like "provident societies" and "mutual insurance companies" that are not relevant in the modern context. Such terminology has to be deleted.

(2) The IRDA Act, 1999, inserted some provisions into the Insurance Act, 1938, to nullify existing provisions. The latter have not been deleted, thus giving rise to anomalies.

(3) References in the Insurance Act, 1938, to older enactments have to be replaced by references to the corresponding new legislations that have replaced such enactments. For example, references to the Indian Companies Act, 1913, have to be replaced by references to the Companies Act, 1956.

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25 *Over 80% of current law refers to the 1938 Act. Law Commission of India, "Consultation Paper on Revision of the Insurance Act, 1938 and the Insurance Regulatory and Development Act, 1999", June 2003.*

26 *Subhedar, S.P., "ASI Submission to the Law Commission of India," Paper presented at the Fifth Global Conference of Actuaries, New Delhi, February 2004.*

(4) Insurance companies have developed a wider range of products with more riders. Hence, a reclassification of insurance businesses is necessary. For instance, insurance business may broadly be classified as 'life' and 'non-life' or 'short-term' and 'long-term' insurance business. For this purpose, the definition of the term 'insurance' and 'insurer' would have to be amended.
(5) The IRDA, while regulating the business activities of insurers, exercises quasi-judicial powers, in addition to its administrative powers, eg issue, renewal and cancellation of registration certificates to insurers, order with regard to investigation of the affairs of the insurers, making applications to the court for the winding-up of the insurance companies etc. It is felt necessary that there must be a provision of appeal against the decisions of the IRDA to an independent body constituted under the Act itself.
(6) When consumers are dissatisfied with an insurance company, particularly in the area of claims settlement, they can go to the Ombudsman under the Redressal of Public Grievances Rules, 1998. They can also appeal under the Consumer Protection Act, 1986. Consumer courts are called upon to interpret the provisions of the Insurance Act 1938, which is a complex piece of legislation. If a special body of law develops, then a special tribunal is necessary to deal with insurance cases. This provision would parallel the Securities Appellate Tribunal functioning under the SEBI Act, 1992.
(7) The principle of *uberrimae fidei* (of absolute good faith) governs both parties to a contract of insurance. Specific statutory enumerations are required for protecting the interest of policyholders so that unintended minor mistakes in disclosure do not lead to a loss of coverage. Such a provision is missing.
(8) Provisions regarding investments, loans and management need constant review and revision. The IRDA has devised detailed investment regulations, hence provisions will need to be revised so as to eliminate inconsistencies and duplication. For example, the term "approved securities" requires revision in the context of new economic policy and business practices.
(9) IRDA has defined regulations for the determination of the amount of liabilities, solvency margin and valuation of assets. But the provisions regarding solvency margins still have to address the extent of appropriate matching of assets and liabilities.

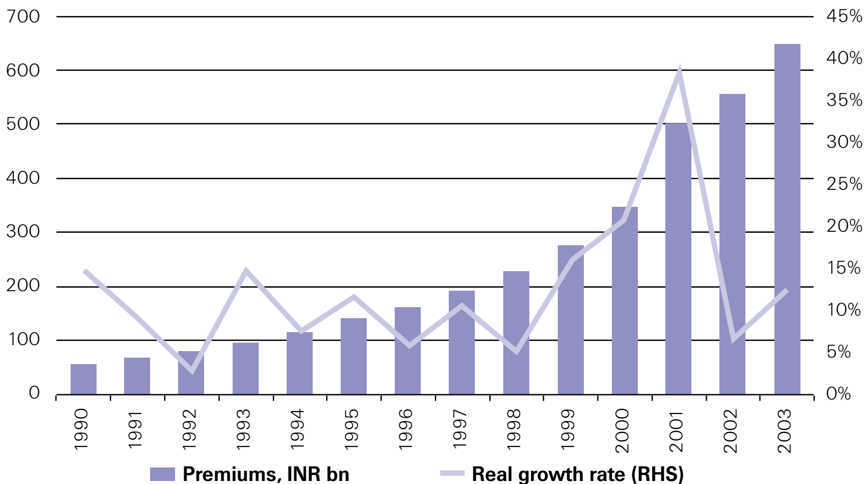
The legal framework of insurance regulation in India is still evolving. Issues regarding compulsory insurance, non-life tariffs and foreign equity shareholdings could see further realignments in the future. Nevertheless, the IRDA has successfully established itself as a progressive and efficient regulator, while remaining unbiased even with its wide, sometimes potentially conflicting, spectrum of responsibility.

VI. Life and health insurance

Market development

Economic fundamentals continue to suggest that there is huge potential for the life insurance sector to attain further growth. India is one of the world's fastest growing economies, with real GDP rising by an average annual rate of 6.1% over the last decade. Along with strong economic growth, the life insurance market has also expanded rapidly – direct life insurance premiums grew by an annual real rate of 13.1% between 1993 and 2003 (Figure 6.1). However, life insurance penetration remains modest at slightly over 2%. Considering that life insurance accounts for more than three-quarters of total insurance business, reaching these untapped markets thus holds the key to realising the growth potential of the insurance industry.

Figure 6.1: Development of life insurance premiums



Source: National regulatory statistics, LIC.

The life insurance landscape in India is undergoing major change. Closed to foreign competition since nationalisation in 1956, the life insurance industry had been protected from competitive pressures until the market was opened again in late 1999/early 2000. The initial years of liberalisation have continued to see the former monopoly Life Insurance Corporation of India (LIC) retaining a dominant position in the market.

Nevertheless, the latest statistics show a decline in LIC's share of new business from 98% in 2001 to 87% in 2003. In contrast, companies like ICICI Prudential Life and Birla Sun Life, which were among the first batch of private entrants, have shown the greatest success in securing new business. This is

an indication that the industry's private sector is establishing itself in the market, and is turning into a competitive force.[27]

It is possible to get an indication of where the market is heading by examining the new business written in the 2003 financial year. Direct new life business grew by 10.5% in nominal terms over the year. The distribution of premium is given in Table 6.1. The LIC has slightly more than 87% of the market, leaving the rest for the twelve private companies.[28] The high share means that LIC is able to defend its dominant position in the face of heightening competition. Among the private companies, ICICI Prudential Life has the biggest market share at 4%, followed by Birla Sun Life at 2.4%. HDFC Standard Chartered and SBI Life are the only two other companies with more than a 1% market share.

Table 6.1: First year and single premium – 2003-04 financial year (provisional)

Company	Market share (%)
Public sector	*87.04*
Life Insurance Corporation of India	87.04
Private sector	*12.96*
Allianz Bajaj Life	0.96
ING Vysya Life	0.39
AMP Sanmar	0.15
SBI Life	1.05
Tata AIG Life	0.96
HDFC Standard Life	1.12
ICICI Prudential Life	4.01
Aviva Life	0.41
Birla Sun Life	2.40
Om Kotak Mahindra Life	0.68
Max New York Life	0.70
MetLife	0.12

Source: IRDA Journal, May 2004, p 10-11.

Competition

Competition between the LIC and the private sector insurers is intensifying. While innovative products have been underpinning private insurers' premium growth, the threat of losing market share has also led to more aggressive pushes by the LIC to stay competitive and to develop new distribution channels like bancassurance. Such an increase in competition is likely to translate into faster premium growth as well as deeper penetration for the entire market.

27 *It should be noted that market share based on new business shows only part of the picture. For example, the popularity of unit-linked products among new entrants could have significantly bolstered their gains in market shares, while in terms of risk premiums the contribution will be less.*

28 *Sahara India Life is not included as it was licensed only in March 2004.*

Life product development

Before the opening of the insurance sector, the state-owned LIC sold insurance as a tax-efficient savings instrument rather than just offering protection. Most customers were underinsured with little flexibility or transparency in their policies. With the entry of the private insurers, consumers are now turning to the private sector for new innovative products.

The market is already beginning to witness a wider range of products from players whose numbers are set to grow. As a result, the differentiating factors among the different players will be products, pricing and service. The twelve private sector insurers in the life insurance market have already captured nearly 13% of the market in terms of new business written. This should be welcome news to an industry that is in need of a better product mix to sustain further growth. This is especially true as the sale of traditional products suffered from lowering interest rates – new business premiums fell by 18.6% during the 2002 financial year partly as a result of the withdrawal of tax benefits on single premium products, which has been instrumental in fuelling growth in preceding years. Such sensitivity of premium growth to interest-rate cycles reflects the focus on savings products in the Indian life insurance market.

It is the high level of innovation that has been the basis of private insurers' growing market share over the past years. Products like critical illness riders have helped to strengthen the risk attributes of life insurance policies and broaden their appeal to previously untapped customer segments. While state-owned companies still dominate segments like endowments and money-back policies, private insurers have already wrested a significant share of the annuity and pension products market. Furthermore, in the popular unit-linked insurance sector, they have over 90% of customers. In addition, private sector insurers have been able to persuade people to take out policies on larger sums insured. The average sum insured of life policies provided by private sector insurers is around INR 110,000–INR 120,000, which is far higher than the industry average of around INR 80,000.

It should be noted that the proliferation of new insurance products has also led to concerns about "regulatory arbitrage". Unit-linked products are distributed by both insurance companies and mutual fund companies but different players are subject to different operational regulations regarding commission ceiling, information disclosures, accounting standards etc. This has sometimes given rise to competitive frictions between the life insurance and asset management subsidiaries of conglomerates.

At the same time, the profile of Indian consumers is also evolving. Consumers are more actively managing their financial assets, and are increasingly looking to integrated financial solutions that can offer stability of returns along with more comprehensive protection. Insurance has emerged as an attractive and stable investment alternative that offers total protection for life, health as well as wealth. In terms of returns, insurance products offer competitive returns ranging between 7% and 9%.

These factors have contributed to changes in demand for insurance products. Sales of traditional life insurance products like individual, whole life and term life remain popular, whereas sales of new products such as single premium, investment-linked, retirement products, variable life and annuity products are growing. Insurers will need to constantly innovate in terms of product development to meet the ever-changing consumer needs.

Price dispersion of life products

Life insurance products like whole life, endowment or money-back policies have two components: savings and protection. Hence, it is somewhat difficult to compare the pricing of such products, particularly if the product also contains riders. The simplest product to compare across insurers is term life. It only contains one element – it pays the beneficiary in the case where the policyholder dies within a specific period of time. When the LIC was still a monopoly, there was nothing else to compare with its term life policy. However, consumers now have an array of options. Table 6.2 shows a comparison of life policy premiums across major life insurers in India.

Table 6.2: Comparison of premiums as of 31 October 2002 for pure term life insurance for ordinary males

Insurer	LIC	HDFC	ICICI Prudential	Tata AIG	Allianz Bajaj	Birla Sun Life	Max New York		
Age	**30**	**30**	**30**	**35**	**30**	**30**	**30**		
Sum assured (INR)	**500 000**	**500 000**	**1 000 000**	**500 000**	**500 000**	**500 000**	**500 000**		
Term (yrs)	**Yearly premium (INR)**								
5	NA	NA	2 455	2 575	1 655	1 875	1 190		
10	1 140	NA	2 504	2 585	1 805	1 875	1 225		
15	1 285	1 510	2 553	3 010	2 050	1 875	1 265		
20	1 528	1 535	2 680	3 450	2 440	1 905	1 375		
25	NA	NA	NA	4 160	NA	1 980	1 600		
30	NA	1 790	NA	NA	NA	NA	NA		
Sum assured (INR)	**100 000**	**100 000**	**100 000**	**100 000**	**100 000**	**100 000**	**100 000**	**Best deal**	**Max/min (ratio)**
Term (yrs)	**Yearly premium (INR/ 100 000 sum assured)**								
5	NA	NA	246	515	331	375	**238**	238	2.16
10	**228**	NA	250	517	361	375	245	228	2.27
15	257	302	255	602	410	375	**253**	253	2.38
20	306	307	**268**	690	488	381	275	268	2.57
25	NA	NA	NA	832	NA	396	**320**	320	2.60
30	NA	**358**	NA	NA	NA	NA	NA	358	NA

Notes: 1. Tata AIG quotes are for 35-year-old males. Their quotes for a 30-year-old will be lower.
2. SBI Life and ING Vysya do not offer a pure level term plan.
3. No data are available for Om Kotak Mahindra and AMP Sanmar.
4. The premium per INR 100,000 assured is likely to be higher for ICICI Prudential as they are based on quotes for a sum assured of INR 1,000,000.

Source: R. Rajagopalan, "Valuing the Term Insurance Products in the Indian Market", Paper presented at the Fifth Global Conference of Actuaries, 25 January 2004, New Delhi.

The table compares policies of 5, 10, 15, 20 and 25 years for a 30-year-old ordinary male for LIC, HDFC Standard Life, ICICI Prudential Life, Tata AIG Life, Allianz Bajaj Life, Birla Sun Life and Max New York Life per sum assured of INR 100,000. The first striking observation is that the ratio of the maximum and the minimum premium is 2.16 for a five-year term and 2.60 for a 25-year term. This implies that the dispersion in price is strikingly high for very similar products. Such big differences are not normally observed in mature markets. However, if Tata AIG Life is excluded (quotes are based on a 35-year-old male instead of 30-year-old), the dispersion in prices is much narrower, ranging from 1.24 to 1.82. The second striking feature is that it is not the same company (excluding Tata AIG Life) that quotes a consistently low or high price. In fact, increasing competition resulting from the opening-up of the life insurance industry is likely to see reduced variation in pricing, with most premium rates hovering within a narrow band.

Distribution

The LIC has traditionally sold life business using tied agents (in-house sales forces are not a traditional feature of the Indian life market). All life insurers have tied agents working on a commission basis only, and the majority of private-sector insurers have followed this approach in distributing life products. Nevertheless, as banks are now able to sell insurance products, bancassurance has made a major impact in life sales. Almost all private sector insurers have formed alliances with banks, with a few of the insurers using bancassurance as their major source of new business.

Tied agents

Tied agents have traditionally been the primary channels for insurance distribution in the Indian market. The LIC has branches in almost all parts of the country and has attracted local people to become their agents. The agents come from various segments within society, collectively covering the entire spectrum of society. Traditionally, a person who has lived in a locality for many years sells the products of the insurance company with a local branch nearby. While these agents may not have been sufficiently knowledgeable about the different products offered and may not have sold the best possible product to customers, the customers trusted the company and the agents as locals. While tied agents continue to be the prime channel for insurance distribution in India, they are increasingly being supplemented by other channels in the face of tougher competition.

Brokers

The Insurance Regulatory and Development Authority (Insurance Brokers) Regulations of 2002 set out the requirements for the licensing and operation of insurance brokers in India. The Regulations stipulate a minimum capital requirement of INR 5 million for direct brokers, and at the same time a 26% cap on foreign equity shares. As of November 2003, there were 70 registered direct insurance brokers in India. While there are no official statistics on premiums generated by brokers, their short span of operation and the market's reliance on other channels suggest their contribution to be relatively limited so far.

Direct marketing

Direct marketing in the past was mainly in the form of direct mailing by banks to their accountholders marketing insurance products provided by their allied life insurers. However, only the insurers were allowed to sell these products. As banks and brokers are now allowed to sell life business direct, these types of direct mailings are likely to increase. Moreover, as the range of products available widens, sales contributed by direct mailing are expected to increase. At the same time, expenditure on advertising by insurers has also grown significantly as insurers attempt to gain attention from the public on a wide range of products and services, as well as educating them on the benefits of life insurance, and in particular, protection-type products.

E-commerce

The Internet has not been a major source of distribution for insurers. Of the population of over one billion in India, around 9.5 million people were estimated to be Internet users by 2001.[29] Some of the life insurers have a website, where the services provided are mainly confined to accessing product information and rate quotes etc. Nevertheless, premium payments can now be made via credit card, the Internet, e-transfer, direct debit and bankers' draft, and this should allow insurers to better develop an e-strategy.

Bancassurance

Bancassurance is emerging as an important new avenue of distribution of insurance in India. Some insurance companies like SBI Life are heavily devoting their resources to and successfully implementing bancassurance. According to the Reserve Bank of India (RBI), banks with at least INR 5 billion net worth and a three-year profit record may set up insurance companies subject to a 50% shareholding limit. A higher shareholding may be permitted by the RBI subject to the regulations set out in the Insurance Regulatory and Development Authority Act, 1999, where Indian promoters must gradually reduce shareholdings to 26% after the insurer has been in operation for ten years.

In the 2001 "Report on Currency and Finance", the RBI laid down its views on bancassurance in more concrete terms.

"The Reserve Bank, in recognition of the symbiotic relationship between banking and the insurance industries, has identified three routes of banks' participation in the insurance business, viz., (i) providing fee-based insurance services without risk participation, (ii) investing in an insurance company for providing infrastructure and services support and (iii) setting-up of a separate joint-venture insurance company with risk participation. The third route, due to its risk aspects, involves compliance to stringent entry norms. Further, the bank has to maintain an "arms length" relationship between its banking business and its insurance outfit. For banks entering into insurance business with risk participation, the prescribed entity (viz., separate joint-venture company) also enables to avoid possible regulatory overlaps between the Reserve Bank and the Government/IRDA. The joint-venture insurance company would be subjected entirely to the IRDA/Government regulations."[30]

Table 6.3 shows a list of all the insurance companies and the individual banking partners with which they have bancassurance arrangements.

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29 EIU Country Indicators, 2001 estimates.

30 Reserve Bank of India, "Report on Currency and Finance", Chapter IV, Financial Market Structure, page IV-31.

Table 6.3: Existing relationships between insurance companies and banks

	Banking partner
Life insurance company	
HDFC Standard Life	Union Bank of India, Indian Bank, HDFC Bank
ICICI Prudential Life	Federal Bank, ICICI Bank, Bank of India, Punjab & Maharashtra Cooperative Bank, Allahabad Bank, South Indian Bank, Citibank, Lord Krishna Bank, Goa State Co-operative Bank, Indore Paraspar Sahakari Bank, Manipal State Co-operative Bank and Jalgaon People's Co-operative Bank, Shamrao Vithal Co-operative Bank.
Birla Sun Life	Citibank, Deutsche Bank, IDBI Bank, Development Credit Bank, Bank of Rajasthan, Bank Muscat, Catholic Syrian Bank Ltd, Andhra Bank, Karur Vysya Bank Ltd
Tata AIG Life	HSBC, Citibank, IDBI Bank, Union Bank of India
Om Kotak Mahindra	None
SBI Life	SBI , BNP Paribas
ING Vysya Life	Vysya Bank, Bharat Overseas Bank
Allianz Bajaj Life	Standard Chartered Bank, Syndicate Bank
MetLife	Dhanalakshmi Bank , J&K Bank, Karnataka Bank
AMP Sanmar	Manjeri Cooperative, Perunthalmanna Bank, Nilambur Bank (all Kerala based).
Aviva Life	ABN Amro, American Express, Canara Bank, Lakshmi Vilas Bank
LIC	Corporation Bank, Oriental Bank of Commerce, recently signed MoU with Nedungadi Bank, Central Bank of India, Indian Overseas Bank, and Bank of Punjab, Vijaya Bank, Centurian Bank, The City Union Bank Ltd, Repco Bank
Non-life insurance company	
Bajaj Allianz	Bank of Punjab, Bank of Rajasthan, Jammu & Kashmir Bank, Karur Vysya Bank, Lord Krishna Bank, Punjab & Sind Bank, Shamrao Vithal Co-operative Bank, Karnataka Bank.
Royal Sundaram Alliance	Citibank, ABN Amro, Standard Chartered, American Express, Repco Bank, SBI-GE, Karur-based Lakshmi Vilas Bank
Tata AIG	HSBC, IDBI, Development Credit Bank, Union Bank of India
IFFCO-Tokio	Not formally linked up with any banks as yet.
ICICI Lombard	ICICI Bank and others in the pipeline.
Reliance	Not formally linked up with any banks as yet.
United India	Punjab National Bank; Andhra Bank, Dhanalakshmi Bank Indian Bank, South India Bank, Federal Bank,
New India	Union Bank of India, SBI, Corporation Bank, and United Western Bank.
Oriental	Department of Posts, Oriental Bank of Commerce, State Bank of Saurashtra

Sources: Information updated from newspaper sources and websites of the respective banks and insurance companies (11 March 2004).

Several features can be observed from this list of partnerships:

The first feature of Table 6.3 is the "natural partnerships". Specifically, HDFC Standard Life is linked to HDFC Bank, ICICI Prudential Life with ICICI Bank, and so on.

The second striking feature of the table is the proliferation of banks partnering with single insurance companies. Given that there are only two dozen insurance companies and hundreds of banks[31], this outcome is to be anticipated. Moreover, insurance companies are targeting different market segments by affiliating with banks that focus on niche banking. An example is Aviva Life. It has developed a three-layered strategy. The first layer is an affiliation with ABN Amro and American Express which cater to high net-worth urban customers. The second layer is an affiliation with Canara Bank. Through this nationalised bank with 2400 branches, it reaches customers across the length and breadth of the country. The third layer, at a regional level, is an affiliation with Lakshmi Vilas Bank focusing on region-specific customers. This affiliation helps them to reach customers in rural and semi-urban centres in Tamil Nadu and Andhra Pradesh.

The third feature is best illustrated by an example. Allianz Bajaj does not have the same banking partners in the life sector as in the non-life sector. The same is true for several other companies.

Fourthly, some banks have affiliations with several insurance companies. For example, Citibank appears in the lists of a number of life and non-life insurance companies. . In fact, it might be the case that the bank has only Referral Arrangements with several insurance companies but not acting as corporate agents for them. This fact will become more important as a warning by the RBI that banks should not adopt any restrictive practice of forcing its customers to choose a particular insurance company becomes an issue in the future Couple with concerns over privacy of customer data, it is known that the regulators prefer banks to have exclusive corporate agency relationship with only one insurer.

Share of bancassurance sales

Bancassurance has been growing very rapidly in India. Within two years, the share of insurance business distributed through bancassurance has gone from zero to 20% of new business in the private sector. Table 6.4 provides a snapshot of the rapid growth of bancassurance in India.

Table 6.4: Bancassurance business conducted by companies

Company	% of policies
ICICI Prudential Life	15% in 2002, 22% in 2003
SBI Life	15% in 2002, 50% in 2003
Birla Sun Life	25% in 2002, 40% in 2003
ING Vysya Life	10% in 2002
Aviva Life	50% in 2002, 50% in 2003
Allianz Bajaj Life	25% in 2003
HDFC Standard Life	10% in 2002, 30% in 2003
MetLife	25% in 2002

Source: Newspaper reports, various dates.

31 There were 292 commercial banks in India as of March 2003. Source: Reserve Bank of India

The importance of banks

The penetration of commercial banks in India has been quite extensive. There are around 68,500 branches of scheduled commercial banks (Table 6.5). Each branch serves an average of around 16,000 people. The only other national institution with a bigger reach is the postal service. Banks have expanded not only in urban areas; they have also grown in semi-urban and rural areas. Of the total number of branches of commercial banks, 32,600 branches are in rural areas and 14,400 are semi-urban branches.

Table 6.5: Commercial banking in India (in INR millions)

Indicators	June 1969	June 1980	March 1991	March 2000	March 2003
Number of commercial banks	73	154	272	298	292
Number of bank offices	8 262	34 594	60 570	67 868	68 561
Of which rural & semi-urban bank offices	5 172	23 227	46 550	47 693	47 496
Population per office (000's)	64	16	14	15	16
Deposits of SCBs	46 460	404 360	2 011 990	8 515 930	12 808 530
Per capita deposit (INR)	88	7 38	2 368	8 542	12 253
Credit of SCBs	35 990	250 780	1 218 650	4 540 690	7 292 140
Per capita credit (INR)	68	457	1 434	4 555	7 275
Share of priority sector advances in total non-food credit of SCBs (percent)	15	37	39.2	35.4	33.7
Deposits (percent of national income)	15.5	36	48.1	53.5	51.8

Source: Reserve Bank of India, www.rbi.org.in.

Products sold through bancassurance

Interviewing some of the private-sector insurance companies made it possible to identify the kinds of products they sell through banks. The general response shows a sharp difference between the products sold in urban areas and those sold in semi-urban and rural areas. In urban areas, they offer the entire range of products through banks. In other words, there is no distinction between what they are able to sell through other channels and what they sell through banks.

In semi-urban and rural areas, the story is very different. First, the minimum sum assured of well-sold policies is only 20% of that in urban areas. To take an example, if a company has the most popular product in urban areas with a face value of 100,000 rupees, their rural/semi-urban segment tends to sell products with a face value of 20,000 rupees. They also find that products with guaranteed values tend to sell well in the rural/semi-urban areas. On the other hand, any product that requires no medical examination is also popular when sold through banks. Furthermore, while a number of companies do not allow the use of voter ID card as a proof of date of birth in the urban areas, banks in rural/semi-urban areas do accept the voter ID card as the sole proof of the date of birth when selling insurance products. This tends to simplify the purchase of life insurance products from banks in the rural areas.

Outlook of bancassurance development

Despite bancassurance being a totally new feature to the Indian insurance market, it is becoming a key channel for the distribution of insurance products. One major catalyst has been the flexibility of IRDA in prescribing the relevant regulatory framework. The previous restriction requiring all corporate agencies (such as a bank) to undertake 100 hours of agency training has been criticised as impractical. Revisions to regulations have seen this requirement narrowed to be applicable only to designated persons within the corporate agencies, thus meaningfully removing one of the key obstacles to the proliferation of bancassurance in India.

In April 2004, insurance companies in India were interviewed by this author on the outlook of their share of distribution through bancassurance over the next five years. For private life insurance companies, the average response was that they expect 35% of their products to be sold through banks within five years. As can be expected, there is a wide variation among the responses from different insurance companies, ranging from as low as 20% to as high as 75%. These findings suggest that the development of bancassurance will largely accelerate.

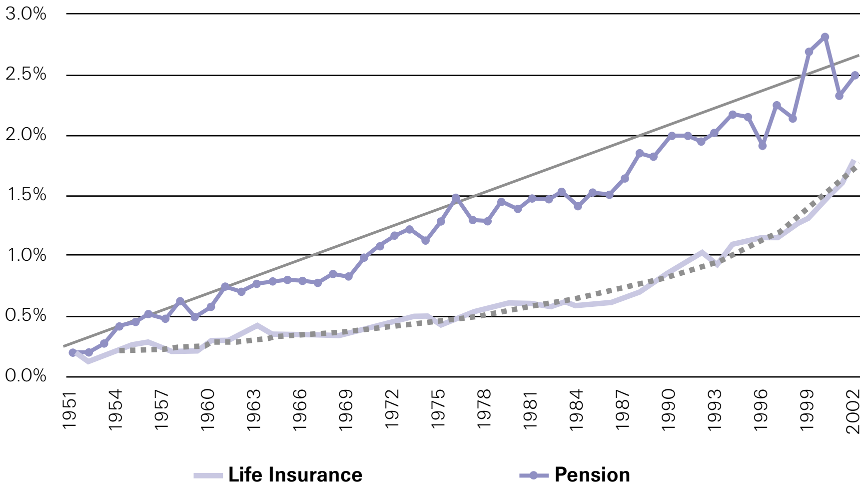
Other key challenges

Apart from the main challenges, such as product innovation and distribution, the two other issues that urgently need to be addressed are the escalating burden of the unfunded government pension and the challenge of increasing investment in the health insurance sector.

Pension

One issue that urgently needs to be addressed is the escalating burden of the unfunded government pension and the building-up of retirement income for the non-salaried workforce. Figure 6.2 shows the development trends of pension contributions in India since 1951. In the initial years, pension contributions were modest at a quarter of a percentage point of GDP – the same order of magnitude as life insurance savings. Pension savings then grew faster than life insurance savings in the subsequent years. They also exhibited a higher variability than life insurance savings. By 2000, pension savings had reached 2.5% of GDP per year whereas insurance savings remained below 2% of GDP. However, as suggested by the trend lines in the figure, the growth rate of life insurance savings has been accelerating over the past decade whereas pension savings are hovering around a linear trend.

Figure 6.2: Pension savings and life insurance savings as a percentage of GDP from 1951-2002



Sources: National regulatory statistics, LIC.

Employees' Provident Fund Organisation (EPFO)

In India, the biggest social security programme is the Employee Provident Fund Organisation (EPFO). Under the EPFO, there are two separate schemes: (1) the Employees' Provident Fund (EPF), based on legislation enacted in 1952; and (2) the Employees' Pension Scheme (EPS, replacing the Employees' Family Pension Scheme), based on legislation enacted in 1995. The EPF is a defined-contribution programme where the worker receives a lump-sum at retirement. By law, membership is mandatory even if the worker is employed on the basis of a casual, part-time, daily-wage contract. Both employers and employees contribute 12% of basic wages to the EPF. For establishments with less than 20 employees, the contribution rate is reduced to 10%. The EPS is a defined-benefit programme where benefits depend on the worker's salary during the final year of employment and the number of years of employment. Individual members are not required to contribute to the EPS but 8.33% of basic wages contributed by employers to the EPF is diverted to fund the EPS, together with a government contribution of 1.16% of basic wages. As of March 2003, the schemes covered 344,508 establishments with 39.5 million members. The sources of contributions to the two plans are listed in Table 6.6.

Table 6.6: Sources of contributions to EPF and EPS (as % of basic wages)

Source	EPF	EPS
Individual	12.00	-
Employer	4.77	8.33
Government	-	1.16
Total	16.77	9.49

Source: Shah, Ajay, "Issues in pension system reform in India," IGIDR, Mumbai, 2000.

EPFO registers the employers. Employers provide the details of contributions by their employees to the EPFO annually. Therefore, the accounts are not portable across employers. At the same time, employees can withdraw large chunks of their savings during their working years, thus there is the problem of premature withdrawal. As at 31 March 2002, EPFO had INR 1,127 billion (5.9% of GDP) in the portfolio. It is allowed to invest only in public sector bonds and securities (quasi-bonds) but not in equities (or stocks). The annual real rate of return was 2.7% during 1986-2000. EPFO is thus the administrator of a defined-contribution fund (EPF) and administrator of a defined-benefit fund (EPS). It also has the authority to decide which companies are to be exempt from the EPF scheme. Thus, in case of a potential conflict of interest, it is an administrator as well as a regulator. It also lacks transparency and accountability. The EPS scheme is widely believed to be underfunded.

Unfunded government pension schemes

The central government of India, along with the state governments, also runs an unfunded pension scheme for employees. The funding comes from general revenue. In 1997, there were 4.6 million central government employees and 3.6 million central government pensioners. For the state governments, there were 7.6 million employees and 3.7 million pensioners. Thus, it is clear that these plans have little possibility of becoming self-funding as a pay-as-you-go scheme. The dependency ratios are too high. Therefore, in the foreseeable future, they will have to be subsidised by the government.

Not surprisingly, more than 30% of the central government wage bill goes to pension payments. Similarly, more than 20% of the state government wage bill is used for paying current pensioners. The pension amount for a retiree is at least 40% of the last drawn salary (with a cap). The pension amount is also indexed to rises in the salaries of current employees as well as to the consumer price index.

National Social Assistance Programme (NSAP)

At the same time, the central government has introduced a National Social Assistance Programme (NSAP) for the poor and the elderly. It has three components: (1) National Old Age Pension Scheme (NOAPS); (2) National Family Benefit Scheme; and (3) National Maternity Benefit Scheme. Under NOAPS, people over 65 (who are destitute in the sense of having no regular means of subsistence from their own source of income or through financial support from family members or other sources) get a direct grant of INR 75 per month. Some state governments may add to this amount from their own resources. The amount allocated in the 2001-02 financial year was INR 5,700 million. The benefits were distributed to about 6 million people.

Problems with government -funded pension schemes
Given that the government is running budget deficits, it is going to be increasingly difficult to subsidise all these programmes. The number of people below the poverty line was estimated at 260 million in 2000. For people below the poverty line, there has to be a free pension provision paid for by the government. However, it is estimated that at best all the schemes reach some 15 million persons over the age of 60,[32] while there were 77 million Indians aged over 60 in 2000. These programmes do not reach more than 20% of the target population.

Moreover, the need for pensions is increasing as the population is living longer and becoming more aware of the need for a greater amount of income in old age. Of the total population of 1027 million in 2001, 28% was urban and 72% was rural. If India could reduce the total fertility rate to the replacement rate by 2010, it will have a stable population by 2045. The number of people above 60 will rise from 72 million (7% of the total) in 2001 to 177 million (13% of the total) in 2025. Moreover, as the family-focused culture is slowly beginning to move towards a Western-style family unit, the elderly will not always be cared for by their family, and will need to make provisions for their own retirement.

In addition, the majority of workers in India belong to the informal sector which is not covered by the pension system.[33] Table 6.7 shows the employment profile of the labour force in India. Of the 400 million people employed, 93% are in the informal sector, with a huge proportion working in the agricultural sector. Public sector employment accounts for 19 million workers. Formal private sector employment accounts for another 9 million.

Table 6.7: Employment profile in India, 2000 (in millions)

	Men	Women	Total
Total employment	276	123	399
Total formal employment	24	5	29
Total public sector	17	3	20
Total formal private sector	7	2	9
Total informal employment	252	118	370
% employed in agriculture	58	78	64
% employed in non-agriculture	42	22	36

Note: Some totals may not match due to rounding.
Sources: Pension Reform for the Unorganised Sector in India, Asia Development Bank Document, November 2003, Employment in the Public Sector, Department of Labour, 2003.

32 *OASIS (Old Age Social and Income Security 2000), Report of the Project, Expert Committee prepared for Ministry of Social Justice and Empowerment, Government of India, New Delhi.*
33 *The informal sector includes self-employed (in own account activities and family businesses), paid workers in informal enterprises, unpaid workers in family businesses, casual workers without fixed employer, sub-contract workers linked to informal enterprises, and sub-contract workers linked to formal enterprises.*

LIC's Varishtha Pension Bima Yojana (VPBY)

In response to the increasing burden of a government-subsidised pension system, a new state pension scheme was introduced on 2 October 2003 in the central government's 2003-04 budget and is only sold by the Life Insurance Corporation of India (LIC). The new product, Varishtha Pension Bima Yojana, however, has been discontinued after a year. Individuals who are over the age of 55 could get benefits of between INR 250 and INR 2,500 per month in exchange for a one-time lump sum payment to the LIC. There is a guaranteed 9% annual nominal rate of return. If the actual yield of the LIC for the fund is below 9%, the central government guarantees to pay the difference. Upon death of the annuity policyholder, the face value of the initial deposit will be returned to the spouse/ nominee. The maximum age for payment of the annuities under this scheme is 75.

New defined contribution scheme

The government has also established a new defined contribution pension scheme for state employees, to be administered by a new and independent Pension Fund Regulatory and Development Authority (PFRDA). The present pension fund authority is an interim one set up by an executive order. New legislation must be approved by parliament to give it statutory authority but thus far there is still no final decision on the establishment of a separate pension regulator.

The new pension system regulated by the PFRDA would be based on defined contributions, which will use the existing network of bank branches (along with other non-bank financial institutions) and post offices to collect contributions. It explicitly allows for portability – transferring benefits in case of change of employment. There would be limited choices of investment.[34] The new system will also be available to the state governments. While mandatory programmes under the EPFO and other special provident funds would continue to operate as per the existing system, individuals under these programmes could voluntarily choose to additionally participate in this new scheme.

The challenges

The system is, however, far from a comprehensive pension system for the entire population. A vast majority of the population work in the informal sector. They do not necessarily have a steady stream of income. Thus, any pension reform would have to take this into account by allowing for irregular payments into the system. A unique person identification system is also crucial for the system to function properly if it is to accommodate the population in the formal system. In other countries, such problems have also been observed. In Mexico, an ill-planned private pension plan put in place in 1992 resulted in 65 million accounts for 11 million workers. A decade later, the problem has yet to be resolved.[35]

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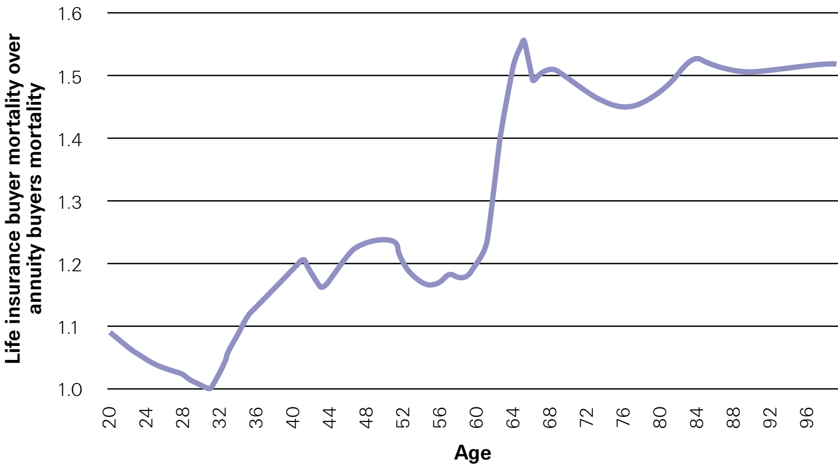
34 *There will be different investment choices such as option A, B and C. Option A would imply predominant investment in fixed income instruments and some investment in equities. Option B will imply greater investment in equities. Option C will imply almost equal investment in fixed income instruments and equities.*
Pension fund managers would be free to invest in international markets subject to regulatory restrictions and oversight in this regard. Proposed market mechanisms (without any contingent liability) through which certain investment protection guarantees can be offered for the different schemes are also under consideration.

35 *Sinha, Tapen, 2002, "Retrospective and Prospective Analysis of the Mexican Pension System", Society of Actuaries Monograph.*

All pension products will have a contingent annuity component: at least a part of the payment would depend on the policyholder being alive. Thus, it becomes important to know if there is a *fundamental difference in the mortality* of life insurance buyers and annuity buyers. This difference has been well documented in the literature for developed countries.[36] Using the data published by the IRDA Annual Report 2002-2003, Figure 6.3 shows the excess mortality of life insurance buyers over annuity buyers in India. The horizontal axis measures the age of the person, while the vertical axis shows the ratio between the mortality of life insurance buyers and the mortality of annuity buyers. It shows that, at all ages, the ratio is greater than 1. This means for all ages the annuitants have a lower probability of dying than their corresponding counterparts who buy life insurance policies. This observation confirms the trend observed in developed countries: there is adverse selection among annuity buyers. To hedge against such selection, it would be useful for insurance companies to sell both life insurance policies and contingent annuities. The pattern of excess mortality shows that in the age range of 20 to 31, the difference is small (in fact, they coincide at age 31). The excess mortality rises between age 31 and 41 from 0% to about 20%. It then stabilises until age 60. After that, the differential takes a steep jump to 50%. While it would be important to explore the reasons behind this change, any further investigation depends on data availability to see if this is a transitory phenomenon.

36 *For a thorough discussion on this issue, see Mitchell, O. & McCarthy, D., "International Adverse Selection in Life Insurance and Annuities," Pension Research Council Working Paper, Wharton School, University of Pennsylvania, 2002.*

Figure 6.3: Excess mortality of life insurance buyers over annuity buyers in India



Source: IRDA Annual Report 2002-2003, author's own calculation using the data of LIC 94-96 Assured Lives Ultimate and LIC 96-98 Annuitants Ultimate.

Health care and health insurance

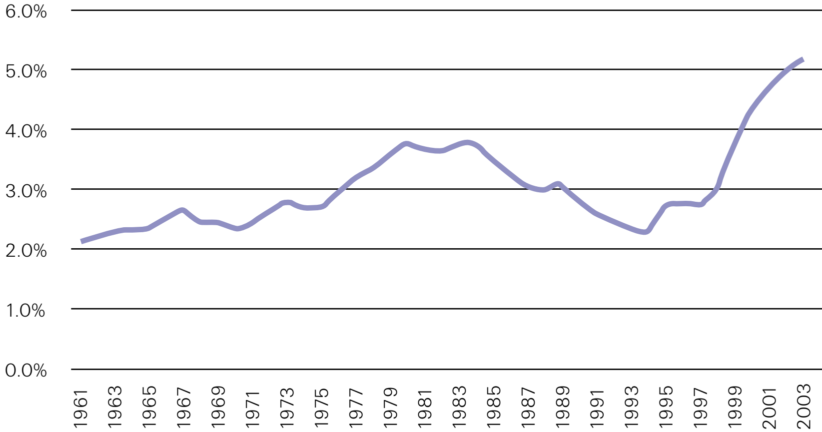
Health insurance in India has shown little development. It has not been able to evoke enthusiasm among Indian insurers. In 2002, the Confederation of Indian Industries together with the McKinsey Company jointly produced a report on private health insurance in India. The report argued that to stimulate the growth of private health insurance the government should recognise health insurance as a separate line of business and distinguish it from other non-life insurance. It also suggested that the capital requirement for health insurers to enter the market should be reduced to INR 300–500 million from the present INR 1,000 million. The study pointed out that a number of players are reluctant to enter the market at present because of the high capital requirements and unattractive market conditions.

Health care in India

In India, healthcare expenditure in the private sector went from just over 2% of GDP in 1961 to close to 4% of GDP in the mid-1980s. It then dropped to below 2.5% of GDP in the mid-1990s, only to rise sharply again to around 5.5% of GDP to date (Figure 6.4). Total healthcare spending in the country is well over 7% of the total GDP, higher than that of many other developing countries.

Figure 6.4: Private consumption expenditure on health care as a percent of GDP

Source: India national statistics.



This is puzzling for two reasons. Firstly, such a high level of expenditure is not common among the developing countries in the region. In Malaysia, private expenditure on health care is 1% of GDP, in Sri Lanka 1.8% of GDP and in China 1.9% of GDP.[37] Secondly, all of these countries mentioned above have a far superior health outcome than India (eg lower infant mortality, life expectancy, incidence of communicable diseases). This suggests that, despite high healthcare expenditure, India is unable to improve the health outcome of its citizens.

In Table 6.8, the three largest killers in India are infectious and parasitic diseases, respiratory infections and cardiovascular diseases.[38] A large proportion of the infectious diseases are either water borne or are caused by water bodies (the main ones are cholera, diarrhoea, typhoid, hepatitis A, malaria and filaria). It is primarily the poor who are most affected by infectious diseases. About half of all villages in India do not have any source of protected drinking water. The need for public sector expenditure on improving the situation is clear.

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37 *World Development Report, 2004, Table 3, Expenditure on Education and Health.*

38 *A looming concern is AIDS. The UNAIDS estimated the adult HIV prevalence rate to be 0.8% at the end of 2001, with 3.8 million HIV-infected individuals between age 15 and 49. Source: UNAIDS/WHO Epidemiological Fact Sheet: India 2002 update.*

Table 6.8: Causes of death in India by category

Cause of death	Number of deaths (000's)	Percentage
Communicable	***4 059.7***	***43.3***
Infectious and parasitic	2 188.4	23.4
Respiratory infections	1 096.1	11.7
Maternal causes	129.4	1.4
Prenatal causes	645.9	6.9
Non-communicable*	***4 700.0***	***50.2***
Malignant neoplasm	775.8	8.3
Diabetes	144.5	1.5
Nutritional endocrine	187.5	2.0
Neuro-psychiatric	178.9	1.9
Cardiovascular diseases	2 385.9	25.5
Respiratory	272.4	2.9
Digestive	353.3	3.8
Genito-urinary	144.5	1.5
Musculo-skeletal	24.4	0.3
Congenital	181.3	1.9
Injuries	***611.3***	***6.5***
Unintentional	506.6	5.4
Intentional	104.7	1.1
Total	**9 371**	**100**

** Sub-items do not add up to total due to the exclusion of some other minor causes.*
Source: "Health Care in India", Foundation for Research in Community Health, 1997.

The level of health care in India also varies substantially between rural and urban areas. The supply of hospital beds, doctors and other facilities is often ten times as high in urban areas as it is in rural areas. To promote health insurance in the rural areas, the government introduced some special plans over the past decade which will be discussed in the next section.

Health insurance in India

Health insurance schemes of different types cover approximately 15% of the population.[39] Government employees at various levels of government are covered systematically by their associated schemes. For example, the Central Government Health Scheme covers 4 million people and the Railways Health Scheme covers 1.2 million people. The single largest scheme is the Employees' State Insurance Scheme (ESIS). It covers employees (mainly) in the organised sector.

Unlike most other insurance markets, health insurance is classified under general (non-life) insurance in India. Starting in 1986, four subsidiaries of the General Insurance Corporation introduced a plan called Mediclaim for the general population. Under Mediclaim, a person between 5 and 70 years of age can buy a policy. The total sum assured can be up to INR 500,000 against accident and

39 IRDA Annual Report, 2002-03, p 211.

sickness. There are exclusion clauses for pre-existing medical conditions. The premium paid is tax-deductible up to a maximum of INR 10,000. Mediclaim covered some 2 million people in 2003. Mediclaim policies sold in 2003 collected over INR 10 billion or 0.04% of GDP. In recent years, some of the nationalised companies have shown a claims ratio above 100% for their health insurance business segment.[40]

Private sector non-life companies offer health insurance policies similar to Mediclaim. They offer policies for critical illness where the insurer pays the sum assured on the diagnosis of any of ten critical diseases identified. Further, private sector insurers are selling hospital cash policies where they pay a pre-determined amount of cash regardless of the money spent on treatment. Life insurers have started to provide health-cover riders to their regular life insurance policies. Recently, life insurance companies have also been issuing health insurance coverage in the form of critical illness or dread disease riders to the basic policies. The LIC attempted to adopt this strategy back in the early 1990s with limited success.

Apart from Mediclaim and health insurance schemes for government employees, the government also introduced a government-subsidised policy for the poor called Jan Arogya Bima Policy (Healthcare Policy for the People) in 1996. It covers the poor for hospitalisation with a 1%–1.5% premium (that is, for annual premiums of INR 1/1.50, it will pay a maximum of INR 100 per year). It has over one million people covered around the country. In July 2003, the central government also introduced a Community-Based Universal Health Insurance Scheme for people below the poverty line.

Cost of running health insurance operations

There is usually a substantial difference in the cost of running a private health insurance scheme and a public health insurance scheme. The difference in cost can be five to ten times lower in the case of public systems (Table 6.9). The main reason for such difference is that public systems are compulsory. People cannot opt out of them. The cost of acquisition is thus lower.

Table 6.9: Administrative costs of operating health insurance programmes: a comparison of private and public insurers

Country	Private	Public
Chile	18.5	1.8
Sweden	NA	1.5-5.0
United Kingdom	NA	10.0 (GP fund holdings)
United States	5.5-40.0	2.1 (Medicare)
India	20.0-32.0	5.0-14.6

Note: Costs of administering insurance is expressed as a percent of expenditures.
Source: Ajay Mahal, "Assessing Private Health Insurance in India," Economic and Political Weekly, 9 February 2002, 559-571.

There are also a range of NGOs and self-help groups that operate their own health insurance

40 *United India Annual Report, 2003-03.*

schemes. Probably the most famous of them all is the Self-Employed Women's Association (SEWA). For members of the group, it charges an annual premium of INR 30 for a maximum of INR 1,200 per year for hospitalisation. There is also a fixed deposit option. The actual healthcare scheme is run (on a group basis) by the government-owned insurer New India Assurance. There are a number of plans along the line of SEWA.

Another related development is the emergence of third-party administrators (TPAs). In September 2001, the IRDA started issuing licences for TPAs. This will facilitate the provision of cashless health services to their customers and offer back-up services to the insurance companies. There are 23 TPAs with licences but only 11 are actually operational. The IRDA has expressed clearly the rationale behind licensing the TPAs as follows:

"It is expected that, with the benefits of cashless services being fully appreciated by the insured, the concept of health insurance would get popularised. In addition, with the onus of service shifting from the insurer to the service provider, access to health services should become that much easier - thereby giving a quantum jump to the spread of health insurance."[41]

TPAs organise healthcare providers by establishing networks with hospitals, general practitioners, diagnostic centres, pharmacies, dental clinics and physiotherapy clinics, among others. The agreement between the TPAs and the healthcare facilities provides for monitoring and collection of documents and bills. Documents are audited, processed and sent to the insurance companies for reimbursement. TPAs manage claims, get reimbursements from the insurance company and pay the healthcare provider. TPAs have in-house expertise of medical doctors, hospital managers, insurance consultants, legal experts, information technology professionals and management consultants. By bringing all these elements "in-house", they are able to contain costs.

The introduction of the TPAs has not been smooth. The function of the TPAs has been problematic. They have received various complaints.[42] Until reliable data across different diseases in India are available, TPAs will be limited to mainly large urban pockets.

Bottleneck: lack of health statistics

An important requirement for health insurance is the availability of good health statistics. It has been explained clearly in the National Health Policy 2002 (NHP-2002) of the Government of India:

"Statistical database is a major deficiency in the current scenario. The health statistics collected are not the product of a rigorous methodology. Statistics available from different parts of the country, in respect of major diseases, are often not obtained in a manner which make aggregation possible or meaningful."

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41 RDA Annual Report, 2002-03.

42 The IRDA Annual Report of 2002-03 noted that TPAs have received various complaints including: (1) repudiation of claims due to conditions/exclusions in the policy; (2) non-settlement of claim/delay in settlement of claim; (3) cancellation of policy without giving any notice; (4) settlement of claim for lesser amount; (5) refusal to renew policy in case of adverse claims experience; (6) no issuance of the list of hospitals; (7) improper guidance by 24-hour help lines; (8) inaccessibility of toll-free numbers; (9) no receipt of settlement cheques within the stipulated time; (10) no receipt of photo identity cards; (11) wrong insertion of photos/names in the identity cards; (12) loading at the time of renewal (whether claim/no claim); and (13) hike in premium rates due to introduction of TPAs.

To address this problem, the government declared that NHP-2002 had committed itself to a programme for putting in place a modern and scientific health statistics database as well as a system of national health accounts. The IRDA Annual Report 2002-03 echoed the concern described by the National Health Policy. It says:

"Amongst the issues facing the health insurance industry, absence of credible data in the health insurance market in the country is critical. Steps need to be initiated to generate meaningful statistics, which could be the starting point for scientific pricing of health insurance premium."[43]

Estimating future health insurance expenditure

A government commission has estimated earlier future health insurance expenditure. It was assumed that 10% of India's population would remain in poverty by 2016. The desirable coverage for health insurance should be 50% of the population, in line with China and Korea. The cost of government insurance is assumed to be INR 400 per year per person for the population below the poverty line. The cost of private insurance is thus estimated at INR 1,200 per year per person for all persons other than those below the poverty line.

Based on these assumptions, health insurance expenditure is estimated to be INR 645,320 million per year, of which INR 49,640 million comes from the public sector and INR 595,680 million from the private sector, assuming 40% coverage instead of 50% (Table 6.10). This will amount to slightly over 1% of GNP in 2015.

Table 6.10: Estimated health insurance expenditure

Particulars	Value	Unit
Population below poverty line in 2015 (10%)	124.1	million
Desired coverage 50% of population	620.5	million
Spending for poor @ INR 400/year – public	4964	INR crore
40% @1200	59568	INR crore
Total	64 532	INR crore
GNP for 2015	5 910 468	INR crore
% of GNP in 2015	1.09	%

Source: Prime Minister's Council on Trade and Industry, "A Policy Framework for Reform in Healthcare," Chapter 7, Table 7.8, Commission headed by K. Birla and M. Ambani, 2000, http://indiaimage.nic.in/pmcouncils/reports/health/health-chap7.htm.

43 *IRDA Annual Report 2002 - 03, p 213.*

Life reinsurance

Life insurers in India do not reinsure amongst each other, and life reinsurance is mainly placed with international professional reinsurers. The regulations also require that any reinsurer used must have a minimum rating of BBB from Standard & Poor's, or a similar international rating organisation. Moreover, insurers cannot have a reinsurance arrangement with companies to which they are linked by shareholding, unless the arrangement is regarded as competitive and the IRDA has given its approval to such an arrangement. LIC is the only life insurer that currently accepts inward reinsurance from its operations outside of India. There is no life reinsurer in India and GIC is the only domestic reinsurer who can underwrite life reinsurance. While the GIC has little life reinsurance expertise, it is lobbying the government to compel Indian insurers to give it more business. At present, LIC gives around 10% of its reinsurance to GIC, a ratio that is likely to increase in the future.

The level of reinsurance premiums has been relatively low in India due to LIC's high retention, and it is estimated that only 1% of LIC's premiums are reinsured. The regulations issued in December 2000 stipulate that each life insurer "shall retain the maximum premium earned in India commensurate with the financial strength and volume of business". Nevertheless, the entry of private insurers has increased the amount of reinsurance available, as they have much smaller retentions. However, considerable time will be needed for the life reinsurance market to grow by any significant amount.

Reinsurance is generally on a surplus basis and the regulations state that reinsurance must be on a risk premium basis, unless the IRDA has given its approval for an original terms arrangement. Profit-share arrangements are also quite common in the market. Facultative business is primarily business in excess of treaty limits, as well as a small amount of substandard cases. This business is also reinsured on a risk premium basis.

While the life reinsurance premium income from India has been relatively small due to maximum retention requirements, the business is likely to grow with rising premium volumes and the rising numbers of cases with large sums insured. Looking forward, an important area of reinsurers' involvement will be facultative support for large and substandard risks. Reinsurers, with experience in facultative underwriting, can be useful business partners for life insurers in assessing and accepting large risks. In fact, reinsurance will be a valuable instrument in helping to further develop the India life insurance market.

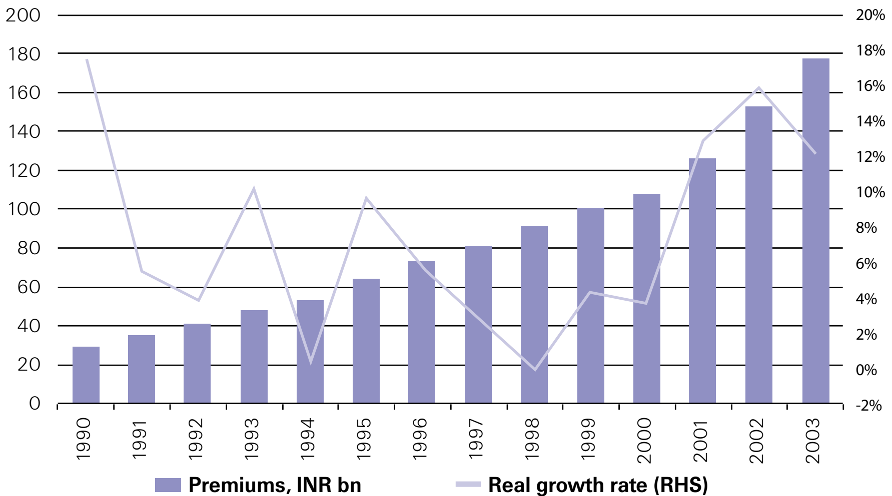
In addition, the absence of morbidity data in India has prompted many life insurers to rely on international experiences of reinsurance companies. Partly to redress this shortfall, the Life Council of the IRDA has formed a Mortality and Morbidity Investigation Bureau in cooperation with the Actuarial Society of India in 2004 to improve future provisions of underwriting data. This also illustrates another example of the regulator encouraging information sharing among market practitioners.

VII. Non-life insurance

Market developments

India's non-life insurance industry received gross premiums of INR 161 billion in 2003, which represented a five-fold increase from INR 28 billion in 1990 and an average 6% growth in real terms over the period (Figure 7.1). Nonetheless, non-life insurance penetration, measured as premiums as a share of GDP, remained at a stable low level of 0.6%. In comparison, penetration has increased at a far brisker pace in China, from 0.4% in 1998 to 0.7% in 2002. It is estimated that 90% of the Indian population are not covered by non-life insurance, which points to significant untapped growth potential.

Figure 7.1: GDP and non-life premium growth



Source: National regulatory statistics, Interlink.

Liberalisation has become the key to unlocking this potential. The Insurance Regulatory and Development Authority (IRDA) Act of 1999 puts an end to the monopolistic positions that had hitherto been assumed by the state-owned GIC group of subsidiaries, and makes way for private sector participation in the market. This, together with the establishment of the IRDA as the industry's prudential supervisor, has paved the way for India to fully realise the growth potential of its insurance sector.

India's non-life insurance industry was previously dominated by the state-owned GIC and its four subsidiaries. Since liberalisation, eight private sector insurers have entered the market, with all but one being joint ventures between overseas insurance companies and large Indian companies and institutions. These companies (including the Export Credit Guarantee Corporation Limited) received

premiums totalling INR 161 billion in the 2002 financial year, representing a 13% jump from the previous year[44] (Table 7.1). Preliminary data suggest that their premiums for the 2003 financial year should grow by another 13%.

Table 7.1: Gross premium underwritten within India in 2003-04 financial year, in INR m

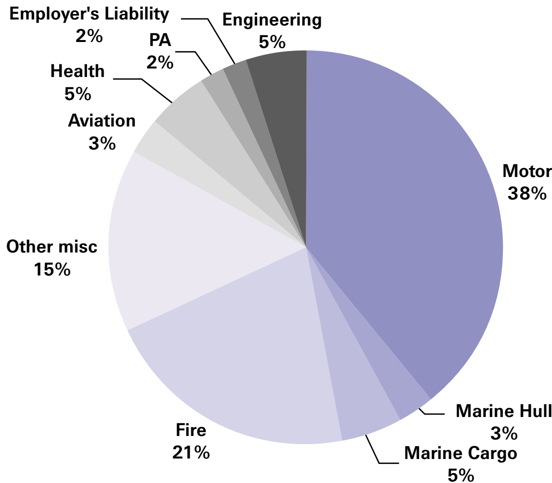
Company	Premiums 2003-4	Premiums 2002-3	Growth %	Market share %
Public sector				
National	34 170.0	28 635.8	19.33	21.20
New India	40 283.2	39 212.4	2.73	24.99
United India	30 681.7	29 680.7	3.37	19.04
Oriental	28 690.8	27 828.9	3.1	17.80
Export Credit Guarantee Corporation	4 451.3	3 746.5	18.81	2.76
Public sector total	*138 277.0*	*129 104.4*	*7.1*	*85.79*
Private sector				
Bajaj Allianz	4 763.1	2 892.8	64.65	2.96
ICICI Lombard	5 067.2	2 152.2	135.44	3.14
IFFCO-Tokio	3 253.0	2 133.3	52.49	2.02
Reliance	1 612.4	1 850.2	-12.85	1.00
Royal Sundaram Alliance	2 580.2	1 817.7	41.95	1.60
Tata AIG	3 547.6	2 408.7	47.28	2.20
Cholamandalam	966.8	147.8	554.24	0.60
HDFC Chubb	1 116.7	94.4	1 082.95	0.69
Private sector total	*22 907.0*	*13 497.2*	*69.72*	*14.21*
Grand total	*161 184.0*	*142 601.5*	*13.03*	*100.0*

Source: IRDA Journal, May 2004, p 42.

While the proliferation of private sector insurers is a clear response to the gradual market opening, the mix of products remains similar to the pre-liberalisation era. Motor, fire and marine continue to account for the bulk of the business, with respective shares of 38%, 21% and 8% of the total general insurance market (Figure 7.2). The 2002 financial year saw strong growth in all three main lines as the industry gained in overall competitiveness and capacity and demand conditions strengthened. Motor business is the growth leader, with premiums surging by 42% in the 2002 financial year.

44 Note that premiums refer to those collected within India as reported in the IRDA Journal. Elsewhere in this report premiums refer to total premiums as reported in the IRDA Annual Report.

Figure 7.2: Business mix of non-life insurance in the 2002 financial year



Source: Interlink Insurance Brokers Pvt. Ltd., Mumbai.

Competition

Market liberalisation is still in its infancy but has already produced significant changes on various levels of the industry, none more obvious than the strong growth among private sector companies. In the 2003 financial year, they collectively accounted for 14% of gross premiums, up from 9.5% in 2002 and 3% in 2001. In growth terms, the 70% surge in premiums received by private sector insurers also far exceeded the 7.1% registered by their public sector counterparts. Within private companies, both ICICI Lombard and Bajaj Allianz are the market leaders with market shares of around 3%, followed by Tata AIG.

Several factors account for the speed at which new private new entrants have penetrated the market. First is their ability to develop new distribution channels to rival the existing distribution network of the incumbents. They are having particular success in forging bancassurance alliances, through direct marketing, and online distribution has also become more popular. The IRDA also introduced new legislation that allows new forms of intermediaries like co-operative societies and brokers as viable distribution channels.

The private companies have also proved to be more innovative and have introduced competitive products with specialised features, especially for personal lines policies. For example, they have pioneered health insurance products similar to Mediclaim, including critical illness covers where the insurer pays the sum assured on the diagnosis of any one of the ten identified critical diseases. They are also selling "hospital cash policies" where they pay a pre-determined amount of cash regardless of the money spent on treatment. Companies also recently turned to agriculture-related products as they try to fulfil their mandated contribution to the rural sector.

Aside from outperforming the public sector in terms of overall business growth, private companies are also getting a more favourable business mix. This is because the public incumbents are not allowed to decline certain unprofitable business like motor. That has left private companies free to focus on more profitable lines of business like property and engineering lines, while limiting their exposure to motor insurance, especially third-party risks, where the claim histories are considerably worse.

Detariffication

Despite a promising start, rising competitive pressure has exposed weaknesses within the industry that will require stronger ongoing supervisory attention. Considerable rigidities still exist which adversely impact profitability and deter new initiatives. The prevalence of market tariffs and the cap on foreign ownership are two of the major liberalisation issues India will have to tackle. Various reasons have been put forward to justify these restrictions, including to protect consumers and to preclude capital outflows. However, international experience suggests that a liberal insurance regime caters to these concerns much better than a restrictive one, while at the same time helping the local economy to reap the full benefit of insurance.

One controversial aspect of India's non-life insurance industry is its tariff regime, which dates back to the 19th century and is still very much in evidence today. The Tariff Advisory Committee (TAC) was established in 1968, and in 1999 became the rating arm of the IRDA. At present, the tariff rates set by the TAC cover major lines like motor and fire insurance, and are applied to around 70% of general insurance premiums. While the tariff system has been praised on the grounds of market stability and consumer protection, it has also been blamed for market distortions. Where price competition is pre-empted by tariffication, the insurers engage in non-price forms of competition from which consumers do not benefit.

One example is the well-known underpricing of third-party motor risks which has undermined the industry's profitability and has led to cross-subsidisation across business lines. This is because the Motor Vehicles Act, 1938, not only mandated third party liability (TPL) but also made it illegal for insurers to refuse TPL cover for any automobile as long as it had a fitness certificate. Furthermore, a later amendment of the law made TPL an unlimited liability, yet political pressure from transporters has prevented a rise in premiums to reflect the higher risk from this change.[45]

As a result, despite the dominant position of the motor business, newly formed companies were until recently reluctant to enter this market, as the line had traditionally been loss-making under the previous tariff structure mandated by the TAC. The TAC adopted a more differentiated pricing scheme in July 2002 in an attempt to make the portfolio self-sustaining, yet it is clear that similar problems also prevail in other lines of business. At the same time, while detariffication as a further step is under consideration, it is not expected to materialise in the near to medium term. This may mean that the industry's performance will continue to be exposed to problems of cross-subsidisation and adverse selection.

45 Malhotra Committee Report, Chapter V, Section 5.26, p 41.

The controversy surrounding tariffication has not subsided with the introduction of private sector competition in recent years. Rather, the authority has come under criticism for its asymmetric approach that mandates the provision of motor insurance by public insurers but not their private sector counterparts.

While the industry is expected to move towards market-based pricing, it is proceeding at a very slow pace. A previous effort to detariff the marine business in 1994 was blamed for a sharp fall in premiums in the ensuing years. In the case of motor lines, the authorities would be equally worried, if not more so, about a sharp rise in motor premiums. A current recommendation is for a phased detariffication of motor lines that will start with the "own damage" category in 2005 but proceed to wide-range detariffication a year later.[46]

Nonetheless, managing the transition remains a challenging task in many respects. Firstly, the industry is believed to be grossly lacking in adequate and authentic motor statistics collection practice. A 2002 Rajagopalan Committee report noted that there is no existing mechanism for the industry to share related statistics. Four public-sector incumbent companies had refused to do so for fear of losing their advantages.[47]

Also, despite the fact that TPL coverage is mandated by law, there is evidence of gross evasion as the actual premiums collected of INR 11 billion in 2001 were far below the estimated INR 70 billion that should have been collected given the number of vehicles on the road. The problem is said to arise because, other than the first time purchase of a vehicle, there is no mechanism for ensuring renewal of TPL insurance, especially for two-wheelers. As a result, this failure to enforce universal participation implies a substantial adverse selection problem for the industry, whereby the renewal pool tends to be populated by drivers with higher risk.

As such, for the industry to benefit from detariffication, it will have to strengthen its operation over a wide range of parameters. On a policy level, there is also room for government involvement in pushing for greater data sharing among insurers and participation among motorists. Also, while it seems inevitable that motor premiums will be higher than they were after detariffication, one task of the IRDA will be to make sure that it is a product of competition and not collusion.

Back in 1994, the Malhotra Committee recommended a de-linking of the TAC from the GIC. It also recommended a gradual phasing-out of the TAC with the exception of a few areas. In 2002, the Ansari Committee recommended detariffication with a well-defined timetable. A recent report from a special committee set up by the IRDA proposes that the TAC withdraw from it pricing responsibility and individual insurers should price their own products under a "file and use" system.[48]

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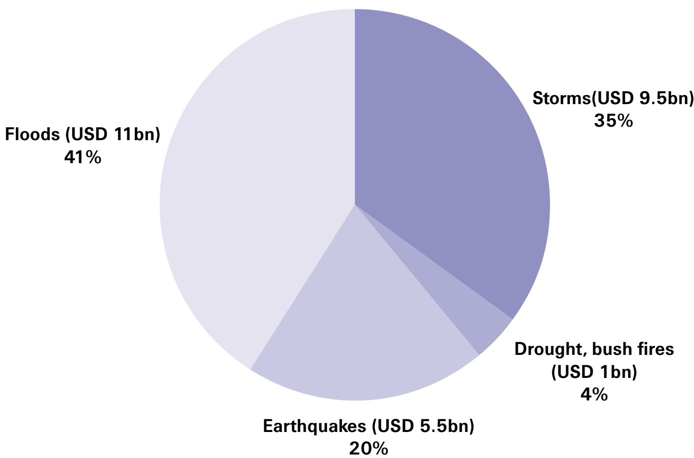
46 At the time of writing, there had still been no decision on the scope of detariffication.
47 Shah, Manubhai, "Blessing or Curse?", IRDA Journal, April 2004, p 26.
48 Report of the Group for motor own damage detariffing, IRDA, June 2004.

Other key challenges

Between 1985 and 2003, economic losses in India due to natural catastrophes averaged around USD 1.2 billion or 0.4% of GDP every year. Floods were the main peril, accounting for 40% of cumulative losses over the period, followed by storms (35%) and earthquakes (20%) (Figure 7.3). After adjustment for the effect of inflation, economic losses hit a recent peak in 1998 when a series of summer floods caused damages exceeding USD 6 billion (at 2003 constant prices) or 1.5% of GDP. The following three years continued to see substantial losses from natural disasters caused by other hazards, most notably the Gujarat earthquake in January 2001. Starting in 2002, however, there has been a lull in both the frequency and ferocity of such events, and related losses have fallen to a low for this historical range.

Figure 7.3: Cumulative catastrophic losses, 1985-2003 (at 2003 prices)



Source: Swiss Re sigma database.

Thus far, insurance products that are specifically linked to natural disasters have been targeted mainly at the agricultural sectors. The state-owned GIC used to be a key provider of crop insurance but has transferred its portfolio to the Agriculture Insurance Company of India, another newly-founded public entity. Of late, private sector players have also started offering their own solutions, with some companies like ICICI Lombard and IFFCO-Tokio said to be test-marketing their own weather-linked products.

Yet a broader challenge facing the industry is whether it can adapt itself to fill the changing and growing needs of a rapidly modernising economy. As India's recent successful foray into the technology industry demonstrates, its economy is moving from traditional sectors like agriculture to more capital- and knowledge-intensive industries. The implications for insurers are two-fold. First, this development requires significant fixed capital build-up and infrastructure investments that would be commercially feasible only with adequate and affordable protection against natural perils.

Furthermore, with growth comes a higher level of urbanisation and industrial specialisation that increases the potential economic value at stake in any one event. For example, the capital Delhi has seen its population grew from 6 million in the early 1980s to currently 14 million, yet it is also an area that suffers a high seismic risk, being classified as a Zone IV area. Poor urban planning as well as insufficient enforcement of construction standards and safety regulations could exacerbate the risk of a disproportionately high loss in the event of a major disaster in a densely-populated region.

As a result, while India's strong growth prospects pose opportunities for insurers, they also put pressure on the industry, and the economy at large, to better manage the exposure to natural perils. Currently, the industry relies heavily on reinsuring with the GIC, both under and beyond the compulsory cession programme, to manage its portfolio. Despite foreign insurers having entered the market in recent years, their participation is constrained by caps on their stakeholding as well as the tariff regime.

In response, the local authorities earlier this year unveiled a plan to form an earthquake pool. The proposal is expected to bring relief to the industry by promoting risk-sharing among domestic companies. As India's industrial development deepens, its catastrophe exposure is likely to further outgrow the capacity that can be provided by the domestic insurers. From this perspective, there is a clear need for allowing foreign (re)insurers greater access to the domestic market if the industry is to realise its full economic potential. The IRDA has explicitly stated that it will not limit the number of players in the market, but the mandatory requirement of foreign-domestic joint ventures has so far deterred international reinsurers from directly entering the Indian market.

Reinsurance

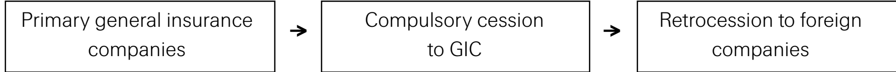
Reinsurance in India was defined for the first time in the Insurance Act of 1938[49]. Following the passage of the General Insurance Business (Nationalisation) Amendment Act in 2002, the GIC was designated the sole national reinsurer. Specifically, the government carved out the general insurance business from the reinsurance business of GIC and declared the GIC as the national reinsurer. As such, the GIC now undertakes only reinsurance business, while the four public sector general insurance companies continue to handle direct non-life insurance business. The GIC, aside from being the national reinsurer, is also the administrator of the crop insurance pool (recently handed over to the newly formed Agriculture Insurance Company of India) and the newly formed terrorism pool.

Despite these institutional changes, the government's policy to maximise domestic retention has led to considerable restrictions within the sector. In this regard, the Insurance Regulatory and Development Authority (General Insurance - Reinsurance) Regulations, 2000, stipulated the following:

"The Reinsurance Programme shall continue to be guided by the following objectives to:
(a) maximise retention within the country; (b) develop adequate capacity; (c) secure the best possible protection for the reinsurance costs incurred; (d) simplify the administration of business."

49 *Section 101A(8)(ii), Insurance Act, 1938: "Indian reinsurer" means an insurer specified in sub-clause (b) of clause (9) of section 2 (any body corporate carrying on the business of insurance, which is a body corporate incorporated under any law for the time being in force in India; or stands to any such body corporate in the relation of a subsidiary company within the meaning of the Indian Companies Act, 1913, as defined by sub section (2) of section 2 of that Act), who carries on exclusively reinsurance business and is approved in this behalf by the Central Government.*

Specifically, all general insurers are required to cede 20% of their business to the GIC, which retrocedes part of its portfolio to foreign companies. Schematically, this relationship can be expressed as follows:



The GIC also leads many of the domestic companies' treaty programmes and facultative placements. There are several lines with no upper limit on maximum liability per risk such as motor and aviation liability. There are other lines with specific upper limits of insurance covers. The details are listed in Table 7.2.

Table 7.2: Obligatory cessions received by GIC

Class	%	Maximum liability per risk	Reinsurance commission		Profit commission		Reserves
			oblig	*pool*	*oblig*	*pool*	
Fire	20%	INR 50 crs PML	30%	Nil		Nil	Nil
Marine cargo	20%	INR 10 crs S.I.	22.5%	Nil		Nil	Nil
War/SRCC	20%	No limit	10%	Nil		Nil	Nil
SRCC	20%	No limit	10%	Nil		Nil	Nil
Marine hull	20%	INR 16 crs S.I.	17.5%	17.5%	Profit commission shall be applicable on the aggregate results of statutory portfolio at 20%	*Rendered in 3rd year for 3 years preceding u/w years	Nil
Motor, WC	20%	No limit	25%	Nil		Nil	Nil
Aviation hull	20%	No limit	10%	Nil		Nil	Nil
Aviation liability	20%	No limit	15%	Nil		Nil	Nil
Oil & energy	20%	INR 2 crs	2.5%	Nil		Nil	Nil
Liabilities (public liability, products liability)	20%	No limit	25%	Nil		Nil	Nil
Other miscellaneous	20%	No limit	25%	Nil		Nil	Nil
MB/BE/LOP	20%	INR 15 crs PML or INR 45 crs S.I.	25%	Nil		Nil	Nil
CAR/EAR	20%	INR 30 crs PML or INR 90 crs S.I.	25%	Nil	Nil	Nil	Nil
ALOP/DSU							

Non-standard liability covers such as

- Product recall }
- D & O }
- E & O }
- Professional indemnity }
- Comp general liability }
- Other liability }

20% on case-by-case basis –
Maximum obligatory cession limit from INR 2 to 5 crores.

Source: Third Annual Report, IRDA, 2002-03, p197.

Aside from retrocession from the GIC, foreign reinsurers can also receive cessions from local companies, but only after all national capacity has been explored can domestic insurers resort to outward cessions. Also, cessions to any one foreign reinsurer may not exceed 10% of total overseas cessions. Moreover, similar to direct insurance, a foreign reinsurer can only participate in the market through joint ventures with local companies. As yet, no global reinsurer has taken up this offer.

As a result of the policy to maximise national retention, nearly all motor, general third party liability and workers' compensation business is fully retained in India. Marine and aviation lines, in comparison, have made extensive use of overseas capacity. The overall retention rate is estimated at over 70%.

There is thus, at this juncture, only a limited scope for foreign reinsurers to operate in India, which is a clear impediment to the industry's development in the long run. On a systemic level, the government's policy of maximising national retention runs the risk of exposing the industry to potentially huge natural peril losses. At the same time, the limits on the amount of cession to any one foreign reinsurer also reduce the appeal of the market to the latter. The costs to economic development will become increasingly obvious in the coming years as the country faces increasing need for infrastructure investments to sustain growth.

Bigger issue on branching of foreign reinsurers

The two largest reinsurers in the world, Munich Re and Swiss Re, have both made cases for allowing branches for reinsurance operation rather than the current option of joint ventures. They argue that branching will allow low-frequency, high-severity events to have the full financial backing of the parent companies. Financial backing will be limited with joint ventures. This view was put forward by Munich Re as follows:

"Issuing a branch licence to selected international reinsurers offers India's insurance industry the best of both worlds: on the one hand, an entirely unregulated market is not in India's best interest. On the other, a local (joint venture) reinsurance company – no matter how well capitalised – will always be only a part of an international reinsurer. The branch concept is tried-and-tested internationally, and has proven to be in the best interest of the insurance industry in many previously fully regulated countries around the world."[50]

For its part, Swiss Re noted that, even with a fully-owned subsidiary, the parent company will not be liable for the risk of the creditors. Thus, the only way to protect against the risk is to allow for branching of reinsurers.[51] In the region, China, Japan, Malaysia, Singapore, South Korea and Taiwan have allowed branching for reinsurers even in some cases where they have not allowed full nationwide branching facilities for primary insurers.[52]

50 *Choudhuri, Sanjib "Reinsurance in Shining India," IRDA Journal, March 2004, p 23.*
51 *Date, Dhananjay, "Derisking Reinsurers' Entry," IRDA Journal, December 2003, p 35.*
52 *Rajpal, Davinder, "Swiss Re's Strategic Outlook for India," presentation, Mumbai, 29 January 2004.*

At present, only a small fraction of natural catastrophes are insured. This scenario is likely to change over the next decade. When it does, it will become important for international reinsurance companies to be allowed to operate through branches. Only then will they be able to fully cover the losses. Otherwise, it will be the policyholders who will be the ultimate losers if they fail to receive full compensation when disaster strikes. Since such disasters with large insured losses are very infrequent, even a decade of "no large losses" scenarios does not tell the full story. A forward-looking government should take policy actions anticipating such a problem.

Pools

In response to the drying-up of the insurance cover after the 11 September 2001 terrorist attack, in April 2002 public and private insurance companies in India created a fund with the contributing share of each company directly related to its premium income. This Indian "terrorism pool" offers cover up to a sum assured of INR 3 billion. GIC currently manages the fund, while the TAC administers the rates charged for this cover. The entire premium charged for this cover is ceded to the pool after deducting 2% as service charges for the ceding company. The GIC is also a member of this pool and for this purpose a handling fee of 1% of the premium on the cessions is recovered from the participants.

On 25 May 2004, the IRDA announced that it was investigating a similar pool arrangement for earthquakes.[53] It is understood that a subsidised rate will be available for people with low income.

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53 *Leena, S. Bridget, "RDA weights earthquake pool," Business Standard, 25 May 2004.*

VIII. Rural insurance

The census of 2001 shows that the rural sector in India comprises 72% of the population and generates 26% of the GDP. Thus, the rural sector is important both politically and economically. Naturally, rural insurance has been emphasised since the nationalisation of life insurance business. The government followed a three-pronged strategy for life insurance. Firstly, it targeted the rural wealthy with regular individual policies. Secondly, it offered group policies to those who could not afford individual policies. Thirdly, for the very poor, it offered government-subsidised policies. For non-life insurance in the rural sector, the government has actively pursued specific strategies such as crop insurance and the insurance of farm implements such as tractors and pumps.

It was noted in the section on regulation that, after five years of operation, every private sector life insurance company has to achieve a certain proportion of their business in the rural sector. It is a variable and rising proportion, with at least 15% of business in the rural sector after five years. For the Life Insurance Corporation of India (LIC), the requirement is 18%.

What exactly is meant by the rural sector?

The term "rural sector" is confusing because not all government bodies use the same definition. Several distinct definitions (which are relevant for the insurance sector) have been used in the past.

- The Reserve Bank of India (RBI) defines four different entities. All definitions apply to the population size. The only relevant factor is the number of people living in a well-defined geographical boundary. Thus, the density of the population or the activity of the population is of no relevance for the definition of the RBI. The entities defined by the RBI are as follows. (1) A given geographical area is called rural if it has less than 10,000 people. (2) A given geographical area is called semi-urban if it has more than 10,000 but less than 100,000 people. (3) A given geographical area is called urban if it has more than 100,000 but less than 1,000,000 people. (4) A given geographical area is called metropolitan if it has more than 1,000,000 people.
- The Census of India recognises two areas: urban and rural. The only category it explicitly defines, however, is urban. Thus, the definition of a rural area is by default whatever is not covered by the definition of an urban area. The census of 1991 defined an urban area as an area that has all of the following three characteristics: (1) a minimum population of 5,000; (2) at least 75% of the male workers engaged in non-agricultural pursuits; and (3) a population density of at least 400 persons per square kilometre.
- Under the "Obligations of Insurers to Rural Social Sectors" of the Insurance Regulatory and Development Authority Act, 1999, the IRDA defines the rural sector as follows. "Rural sector" shall mean any place as per the latest census which has: (i) a population of not more than 5,000; (ii) a density of population of not more than 400 per square kilometre; and (iii) at least 75% of the male main working population[54] is engaged in agriculture.

54 Main workers are those who had worked for the major part of the year (183 days or more) preceding the census.

It may seem like a matter of semantics to see the differences in definition between rural and urban areas. It is not. For example, suppose an area has 35% of males working in agriculture. According to the Census definition, the area will be classified as rural. However, according to the IRDA definition, it will be classified as urban. This has resulted in pragmatic problems for insurers planning to fulfil the rural sector obligations. The rural population, according to the census definition in 1991 was 629 million. However, according to the IRDA definition, it was only 377 million – a reduction of over 40%. For the number of policies sold by the Life Insurance Corporation (LIC), the reduction due to the change in definition is even more dramatic. In the 2001-02 financial year, the LIC sold 10,791,316 policies (or 55.53% of the total policies sold) in the rural areas according to the census definition. However, according to the definition used by the IRDA, the LIC only sold 3,533,694 policies (or 18.18% of the total policies sold).[55] This represents a reduction of over 66%.

These anomalies have caught the attention of law reformers. In 2003, an Expert Committee was set up by the IRDA to examine the remuneration system for insurance brokers and agents. The Report of the Expert Committee[56] also made suggestions on some broader issues. One of the suggestions it made was to change the definition of the term rural area as follows: "The definition of what constitutes a rural area should be based on the census and should be revised to an area with a population up to 30,000".

Drivers of rural insurance development

Demand side

The main economic drivers for general insurance are growth in income, savings and education. The same drivers apply in the rural sector. A survey was conducted by Forte Group in 2003 of 1172 rural households to examine the characteristics of insurance-buying households in the rural sector.[57] Some of the findings are highlighted in Table 8.1. Firstly, the survey divided the households into three different groups based on the educational achievements of the chief wage earners (including women). Group A represents households where the chief wage earner has 10 or more years of education, B 5 to 9 years and C no more than 4 years. Education of the chief wage earner was highly correlated with the income of the households.

55 *Banerjee, T.K., 2001, "Rural Insurance: The Present Experience of LIC," Sixth International Conference on Insurance, FICCI, New Delhi, October 2001.*

56 *Report of the Expert Committee, 2003, "To Examine Remuneration System for Insurance Brokers, Agents etc in General Insurance Business" , Insurance Regulatory and Development Authority, December 2003.*

57 *Forte Group, "Rural Insurance: Issues, Challenges and Opportunities", 2003.*

Table 8.1: Distribution of insurance buyers in rural India, 2002

	Group A	Group B	Group C
Percent with life insurance policies	44%	23%	15%
Percent with non-life policies	26%	12%	5%
Percent of non-buyers considering buying insurance	20%	33%	29%
Percent of non-buyers NOT considering buying insurance	20%	38%	51%
Percent saving in institutions	78%	49%	43%
Percent saving in some form	85%	78%	72%
Savings income ratio (those who saved)	38%	35%	35%
Savings insurance ratio (those who bought insurance)	28%	32%	49%

Note: Group A represents people with 10 or more years of education; B represents people with 5 to 9 years of education; and C represents people with no more than 4 years of education. The total number of respondents was 1172 from three geographical areas in Uttar Pradesh and Andhra Pradesh.

Source: Forte Group, "Rural Insurance: Issues, Challenges & Opportunities", 2003.

Not surprisingly, in Group A, 44% of the households had some life insurance policies, whereas in Group C, only 15% did. The incidence of buying non-life insurance was less than half in all groups. Among the group of people who did not buy insurance, almost a third of the low-education group did consider buying insurance, even though some 51% confessed no intention to purchase any insurance at all. This points to a large disposition towards buying insurance in all income groups. For Group A households, 78% saved in formal institutions (mainly in Post Office savings accounts and in banks). In Segment B and C, the proportion of households saving in institutions was 49% and 43% respectively. When other forms of saving are included, the proportion tops 70% in all groups. In terms of the proportion of income saved (among the households that did save), it is above 35% in all groups. Surprisingly, the savings rates are high for all households regardless of their level of education. These findings demonstrate that the key economic elements driving insurance buying in the rural sector are in place.

What did people save for in the past? The most often-quoted reason (18% of savings) was for a daughter's wedding. In India, the daughter's family is expected to pay a dowry to the groom's family (even though the practice is illegal). Upgrading housing was done with another 10% of the savings. Buying land and medical expenses ate up another 7% each.

Awareness is another important factor driving demand for insurance. The results in Table 8.2 below show that the awareness of the need for life insurance is high across all segments. Awareness of the need for motor and accident insurance follows the same pattern: more than 70% of the respondents in Group A are well aware of the need for them, more than 60% in Group B and 45% in Group C. For other kinds of insurance, the levels of awareness are somewhat lower. In general, the rural population is much more aware of life insurance than non-life insurance. It is quite common to refer to a life insurance policy as an "LIC" in the rural areas.

Table 8.2: Spontaneous and aided awareness of insurance

	Group A	Group B	Group C
Life insurance	96%	95%	88%
Motor insurance	71%	63%	45%
Accident insurance	73%	66%	45%
Cattle insurance	55%	46%	36%
Tractor insurance	70%	42%	24%
Property insurance	63%	38%	30%
Health insurance	44%	37%	32%
Crop insurance	44%	34%	24%
Insurance of agricultural implements	34%	21%	15%

Note: Group A represents people with 10 or more years of education; B represents people with 5 to 9 years of education; and C represents people with no more than 4 years of education. The total number of respondents was 1172 from three geographical areas in Uttar Pradesh and Andhra Pradesh.

Source: Forte Group, "Rural Insurance: Issues, Challenges & Opportunities", 2003.

Supply side

There are two critical elements to success on the supply side of insurance in rural areas: products that are suitable for the rural population and an adequate distribution mechanism. These will be discussed in turn.

The development of rural insurance products should have the specific needs and capacity of the rural population in mind. Firstly, the income pattern in rural areas is different from in urban areas. Specifically, income follows crop cycles. There are two main crops during a calendar year. Thus, in many parts of rural India, a semi-annual payment of premiums is preferred. However, this pattern of income is not universal across all regions. Therefore, policies have to be region-specific. Secondly, the general buying capacity is lower in the rural areas. Consumer goods have been marketed very successfully in the rural markets by lowering the "unit size". For insurance products, this means selling life insurance with a lower minimum face value. Thirdly, the level of education is lower in the rural areas. Therefore, simplified products would be preferable for most customers. Fourthly, verification of age and fixed address may be cumbersome in the rural areas. Using wider age bands for life insurance policies would simplify the procedure. A number of insurance companies are already following one or more of these avenues.

Traditional agents are still the most effective means to penetrate rural areas, although the use of bank branches is on the rise. There is a great variation in rural distribution of insurance among life insurers. Table 8.3 below lists the distribution of rural versus urban agents for different insurance companies both in the life and in the general insurance sectors. For life insurance, the LIC has roughly the same number of agents in the rural and the urban sectors. Not surprisingly, the total number of agents in the LIC is far higher than for any other provider. For all private life insurers, the number of urban agents outnumbers the number of rural agents by a factor of four or more. For private non-life insurers, the proportion of agents in urban areas is five to ten times more. For public companies, there is a two- to three-fold difference.

Table 8.3: Distribution of urban and rural agents as of 31 March 2003

Insurer	Urban	Rural
Life insurer		
Allianz Bajaj Life	13 632	570
ING Vysya Life	3 870	44
AMP Sanmar Life	1 282	326
SBI Life	2 152	72
Tata AIG Life	15 539	20
HDFC Standard Life	10 803	509
ICICI Prudential Life	23 619	342
Birla Sun Life	6 233	85
Aviva Life	1 566	304
Om Kotak Mahindra Life	3 426	359
Max New York Life	5 735	42
MetLife	1 447	17
Life Insurance Corporation	468 133	479 432
Subtotal	***557 437***	***482 122***
Non-life insurer		
Royal Sundaram Alliance	201	25
Tata AIG	769	41
Reliance	256	4
IFFCO-Tokio	343	41
ICICI Lombard	580	147
Bajaj Allianz	898	92
HDFC Chubb	13	1
Cholamandalam	190	8
New India	15 259	5 407
National	14 410	4 834
United India	11 002	5 278
Oriental	11 502	3 274
Subtotal	***55 423***	***19 152***
Grand total	***612 860***	***501 274***

Source: IRDA Annual Report, 2002-2003.

Key hurdles

Despite government promotion, rural insurance has remained a small part of the total market. Most insurance companies see rural business as an obligation rather than an opportunity. This problem has been recognised by the IRDA. In its Annual Report of 2002-2003, the IRDA stated the following.

"While on the one hand, on account of social considerations, the need for spreading insurance throughout the country is a necessity, on the other, with the purchasing power parity of the rural population steadily growing, the rural market offers a vast potential for the insurance sector, which

has essentially remained untapped so far. In order to tap these markets, there is a need to understand the psyche of the rural populace, their perception towards the importance of different types of insurance, and their willingness to purchase policies. Studies have shown that the rural market holds tremendous potential for growth of the insurance business, particularly due to the prevalence of strong saving habits. Even the relatively low-income families tend to save about a third of their annual earnings. In the agrarian belts, the savings are high around harvest time. The various channels of savings include banks, post offices and informal institutions like local lenders, and jewellers. This, of course, is in addition to the agent force. Similarly, auto dealers financing vehicles create awareness for motor vehicle and tractor insurance. It is, however, a matter of concern that, other than in cases of mandatory requirements, spontaneous awareness levels are low, particularly for general insurance products. In addition, there is no felt need for insurance."

Data for private life insurance companies show that, on average, 13% of new private life insurance policies were sold in the rural sector in 2001-2002. There are a few exceptions. For example, ING Vysya Life and MetLife are well ahead of their legal requirements in their rural coverage. They have been able to do this with a surprisingly small number of rural agents (see Table 8.4). This high penetration is achieved with the help of regional rural banks and local self-help groups. At the same time, insurers have simplified their products to reduce the paperwork necessary to buy a policy.

Table 8.4: Rural sector performance in the life sector, 2002-2003

Insurer	Year count	New policies in rural areas	% in rural policies	Social sector lives covered (headcount)
Private sector				
HDFC Standard Life	III year	15 352	12.3	10 490
ICICI Prudential Life	III year	29 376	12.02	17 964
Max New York Life	III year	9 345	12.05	15 669
Om Kotak Mahindra Life	II year	5 169	15.78	32 499
Birla Sun Life	III year	10 422	16.09	12 033
Tata AIG Life	II year	9 137	9.99	11 825
SBI Life	II year	2 700	15.21	37 478
ING Vysya Life	II year	3 800	34.62	7 500
MetLife	II year	2 916	25.97	851
Allianz Bajaj Life	II year	19 368	16.70	11 111
AMP Sanmar Life	II year	1 510	9.24	8 192
Aviva Life	I year	96	0.56	2 370
Subtotal		***109 191***	***13.43***	***167 982***
Public sector				
LIC		4 546 148	18.52	761 752
Grand total		***4 655 339***	***18.35***	***929 734***

Notes: Private insurers are required to underwrite 7, 9 and 12 percent of the policies in the rural sector direct policies in years I, II and III of their operations. LIC is required to underwrite rural business not less than that underwritten in the 2001-02 financial year, and has done so. Private insurers are required to underwrite 5,000, 7,500 and 10,000 lives in the social sector in years I, II and III of their operations. LIC is required to insure a number of lives not less than that underwritten in the 2001-02 financial year, and has done so.

Source: IRDA Journal, July 2003, p 41.

For non-life insurance companies, the story is somewhat different. Listed below are the rural market penetration rates of all non-life insurance companies (Table 8.5). This list shows a far lower penetration of rural business for non-life companies.

Table 8.5: Rural sector performance in the non-life insurance sector, 2002-2003

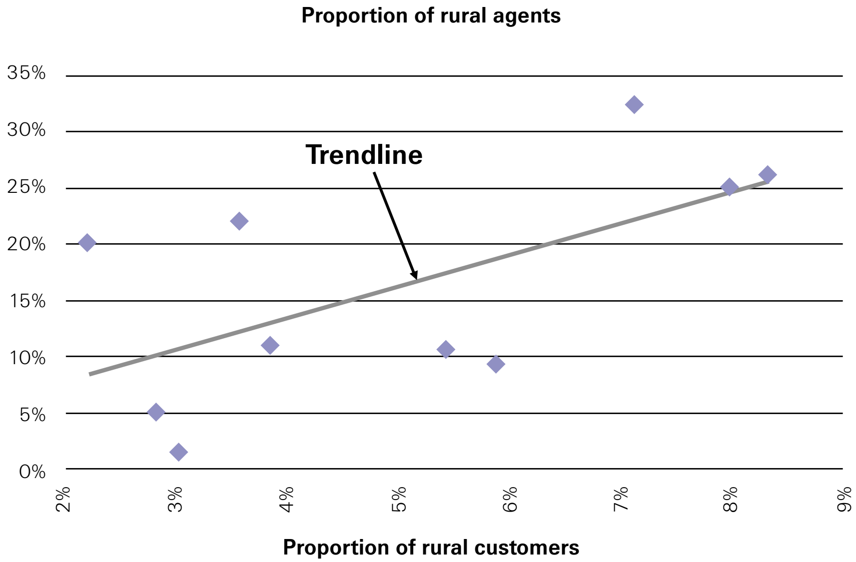
Insurer	Year count	Policies in rural areas	Gross premium in rural areas (INR 100,000)	% of rural sector business (GPI)	No. of lives covered in social sector
Private sector					
Royal Sundaram	III year	45 512	709.18	3.85	10 902
Reliance General	III year	3 029	563.07	3.03	8 797
Bajaj Allianz	II year	53 014	1 697.11	5.87	14 053
IFFCO-Tokio	III year	450	1 160.71	5.42	827 334
Tata AIG	III year	42 203	657.62	2.82	8 617
ICICI Lombard	II year	147	475.34	2.21	16 660
HDFC Chubb	I year				
Subtotal		***144 356***	***5 264.63***	***3.9***	***886 363***
Public sector					
National		1 594 197	23 191.00	7.98	1 648 480
Oriental		422,212	9 960.00	3.58	3 619 274
New India		1 783 445	32 679.00	8.32	27 539 481
United India		2 529 057	21 145.00	7.12	3 256 984
ECGC	I year	NA	NA	NA	NA
Subtotal		***6 328 911***	***86 975***	***6.7***	***36 064 219***
Grand total		***6 473 267***	***92 239***	***6.4***	***36 950 582***

Notes: *Private insurers' obligation in the rural sector in years I, II and III is 2, 3 and 5 percent of gross premium income respectively. Public-sector insurers are required to exceed the performance in the previous year, and have done so. Private insurers' obligation in the social sector in years I, II and III is 5,000, 7,500 and 10,000 lives respectively. Public insurers are required to exceed the performance in the previous year, and have done so.*

Source: *IRDA Journal, July 2003, p 39*

One of the key features of non-life insurance is the clear relationship between the proportion of rural agents deployed and the proportion of policies sold by companies. This is demonstrated in Figure 8.1. There is a very clear positive relationship; however, the same clear relationship does not exist in life insurance. This could be due to the fact that bancassurance is being pursued more aggressively in the life insurance sector. This has helped some life insurance companies to reduce their reliance on traditional agents.

Figure 8.1: Relationship between the proportion of rural agents and rural customers in non-life insurance



Sources: IRDA Annual Report.

IX. Conclusion

India is among the most promising emerging insurance markets in the world. Its current premium volume of USD 18 billion has the potential to increase to USD 90 billion within the next decade. In particular, life insurance, which currently makes up 80% of premiums, is widely tipped to lead the growth. The major drivers include sound economic fundamentals, a rising middle-income class, an improving regulatory framework and rising risk awareness.

The groundwork for realising potential was arguably laid in 2000 when India undertook to open the domestic insurance market to private-sector and foreign companies. Since then, 13 private life insurers and eight general insurers have joined the Indian market. Significantly, foreign players participated in most of these new companies – despite the restriction of 26% on foreign ownership. Incumbent state-owned insurance companies have so far managed to hold their own and retain dominant market positions. Yet, their market share is likely to decline in the near to medium term.

Important steps have thus been already taken, but there are still major hurdles to overcome if the market is to realise its full potential. To begin with, India needs to further liberalise investment regulations on insurers to strike a proper balance between insurance solvency and investment flexibility. Furthermore, both the life and non-life insurance sectors would benefit from less invasive regulations. In addition, price structures need to reflect product risk. Obsolete regulations on insurance prices will have to be replaced by risk-differentiated pricing structures.

In the life sector, insurers will need to increase efforts to design new products that are suitable for the market and make use of innovative distribution channels to reach a broader range of the population. There is huge untapped potential, for example, in the largely undeveloped private pension market. At the moment, less than 11% of the working population in India is eligible for participation in any formal old-age retirement scheme. Private insurers will have a key role to play in serving the large number of informal sector workers. The same is true for the health insurance business.

In addition, the rapid growth of insurance business will put increasing pressure on insurers' capital level. The current equity holding ceilings, however, could limit the ability of new companies to rapidly inject capital to match business growth.

A key challenge for India's non-life insurance sector will be to reform the existing tariff structure. From a pricing perspective, the Indian non-life segment is still heavily regulated. Some 75% of premiums are generated under the tariff system, which means that they are often below market-clearing levels. Price liberalisation will be needed to improve underwriting efficiency and risk management. It is also the responsibility of non-life insurers to help manage India's high exposure to natural catastrophes. To do this, technical know-how and financial capability are imperative. International reinsurance could provide both, but there is currently only a limited scope for global reinsurers to transfer risk efficiently in India at the moment. Reinsurance in India is mainly provided by the General Insurance Corporation of India (GIC), which receives 20% compulsory cessions from other non-life insurers.

As far as reinsurance is concerned, policymakers have to recognise that insurance and reinsurance cannot be treated in the same manner. Due to the unique nature of reinsurance, it is necessary to delink the sector from regulations governing direct insurance companies. To allow branching of foreign reinsurers, for example, would make the market more attractive for international players and secure cover for natural catastrophe risks which, today, are mainly uninsured.

Finally, the largely underserved rural sector holds great promise for both life and non-life insurers. To unleash this potential, insurance companies will need to show long-term commitment to the sector, design products that are suitable for the rural population and utilise appropriate distribution mechanisms. Insurers will have to pay special attention to the characteristics of the rural labour force, like the prevalence of irregular income streams and preference for simple products, before they can successfully penetrate this sector.

Appendix 1 – India macroeconomic indicators

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
GDP											
GDP, USD bn	281.8	322.8	366.4	386.1	419.3	422.0	449.8	464.9	483.6	508.0	595.1
Real GDP, USD bn (2003 prices)	326.2	350.6	377.4	405.3	423.5	448.8	480.8	499.8	525.5	549.7	595.1
- average growth rate	4.9%	7.5%	7.6%	7.4%	4.5%	6.0%	7.1%	3.9%	5.2%	4.6%	8.3%
GDP per capita, USD	317.9	357.1	397.4	411.5	439.2	434.7	455.9	463.7	474.9	491.2	567.0
- average growth rate	-4.3%	12.3%	11.3%	3.6%	6.7%	-1.0%	4.9%	1.7%	2.4%	3.5%	15.4%
Savings, Government Balance and Current Account											
Gross National Saving, USD bn	49.8	75.4	89.6	79.2	84.4	87.9	95.6	98.2	109.6	122.0	151.3
- % of GDP	17.7%	23.4%	24.5%	20.5%	20.1%	20.8%	21.3%	21.1%	22.7%	24.0%	25.4%
- average growth rate	-12.5%	51.4%	18.8%	-11.6%	6.6%	4.2%	8.7%	2.7%	11.6%	11.3%	24.1%
Government balance, USD bn	-18.0	-18.4	-18.3	-18.3	-19.8	-21.3	-23.8	-24.1	-22.9	-26.5	-28.4
- % of GDP	-6.4%	-5.7%	-5.0%	-4.7%	-4.7%	-5.1%	-5.3%	-5.2%	-4.7%	-5.2%	-4.8%
Current account balance, USD bn	-11.9	-3.4	6.1	-4.6	-5.8	-4.1	-4.7	-3.6	0.8	4.1	8.5
- % of GDP	-4.2%	-1.0%	1.7%	-1.2%	-1.4%	-1.0%	-1.0%	-0.8%	0.2%	0.8%	1.4%
Inflation, Interest Rate and Exchange Rate											
Consumer price index, base 2000	57	63	70	76	81	92	96	100	104	108	112
- average growth rate	6.3%	10.1%	10.3%	8.9%	7.1%	13.3%	4.6%	4.1%	3.7%	4.3%	3.9%
Government 10-year bond yield	0.1	0.1	0.1	0.1	0.1	12.2	11.2	10.9	8.2	6.1	5.1
INR/USD, period average	30.5	31.4	32.4	35.4	36.3	41.3	43.1	44.9	47.2	48.6	46.6

Source: Swiss Re Economic Research & Consulting

Appendix 2– India non-life insurance statistics

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Non-life Insurance Premiums										
Direct premiums written										
USD m	1,563	1,680	1,967	2,074	2,227	2,220	2,318	2,397	2,673	3,136
INR m	47,664	52,712	63,774	73,479	80,856	91,575	99,822	107,719	126,115	152,449
Real premiums, INR m (2002 prices)	90,162	90,531	99,286	105,025	107,874	107,817	112,391	116,552	131,588	152,449
- average growth rate	10.1%	0.4%	9.7%	5.8%	2.7%	-1.0%	4.2%	3.7%	12.9%	15.9%
Premiums as % of GDP	0.6%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.6%	0.6%
Premiums per capita, USD	1.8	1.9	2.1	2.2	2.3	2.3	2.3	2.4	2.6	3.0
Non-life Insurance Premiums by Business Lines										
Direct premiums, INR m										
Non - life total	47,664	52,712	63,774	73,479	80,856	91,575	99,822	107,719	126.115	152,449
Fire	11,639	13,227	15,776	17,993	19,972	21,828	24,099	21,991	29,102	32,725
Marine	8,324	8,269	9,613	9,904	10,548	10,248	10,243	10,152	10,612	12,653
Loss Ratio*, %										
Non - life total	64.0%	81.4%	69.4%	69.5%	69.6%	70.5%	76.0%	62.5%	55.4%	45.5%

* Loss ratio is the percentage of claims incurred over gross direct premiums written

Source: IRDA, Interlink, Swiss Re Economic Research & Consulting

Appendix 3 – India life insurance statistics

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Life Insurance Premiums										
Direct premiums written										
USD bn	3.2	3.7	4.4	4.6	5.3	5.5	6.4	7.8	10.6	11.5
INR bn	96.9	114.7	141.2	162.8	192.7	229.0	277.6	349.0	500.9	557.4
Real premiums, INR bn (2002 prices)	183.3	197.0	219.8	232.7	257.1	269.6	312.6	377.6	522.7	557.4
- average growth rate	14.7%	7.5%	11.6%	5.9%	10.5%	4.8%	15.9%	20.8%	38.4%	6.6%
Premiums/GDP (%)	1.1%	1.1%	1.2%	1.2%	1.3%	1.3%	1.4%	1.7%	2.2%	2.3%
Premiums per capita, USD	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Life Insurance Premiums by Business Lines										
Direct premiums, INR bn										
Life Total	96.9	114.7	141.2	162.8	192.7	229.0	277.6	349.0	500.9	557.4
Individual	88.2	104.4	121.4	146.5	172.1	204.6	248.1	311.9	447.7	498.1
Group	8.7	10.3	19.8	16.3	20.6	24.4	29.5	37.1	53.3	59.3
Sum insured										
INR bn	2,554	3,056	3,604	4,092	4,755	5,371	6,128	7,344	9,408	11,185
- average growth rate	15.4%	19.7%	17.9%	13.5%	16.2%	12.9%	14.1%	19.8%	28.1%	18.9%
Real sum insured, INR bn (2002 prices)	4,830	5,249	5,611	5,849	6,345	6,324	6,900	7,946	9,816	11,185
- average growth rate	8.6%	8.7%	6.9%	4.2%	8.5%	-0.3%	9.1%	15.2%	23.5%	14.0%
Individual	2,086	2,546	2,958	3,446	4,007	4,592	5,365	6,428	8,235	9,791
- average growth rate	17.1%	22.0%	16.2%	16.5%	16.3%	14.6%	16.8%	19.8%	28.1%	18.9%
Group	467	510	647	646	748	779	764	915	1,173	1,394
- average growth rate	8.5%	9.2%	26.7%	-0.1%	15.8%	4.2%	-2.0%	19.8%	28.1%	18.9%

Source: LIC, IRDA, Swiss Re Economic Research & Consulting