A STUDY OF FDI IN INSURANCE SECTOR IN INDIA

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India is no doubt a growth economy and many consider it an attractive country to invest in, particularly in its rapidly growing and changing insurance market. Indian insurance industry is one of the sunrise sectors with huge growth potential. Foreign direct investment plays an important role in the economic development of the country. However, Foreign Direct Investment (FDI) is released in the insurance industry, and despite many years of debate, the regulations are still not altered and there are still lots of restrictions. Foreign Investors are watching India, ready for a piece of the action in the insurance market, but there are still plethora of uncertainties, restrictions and potential socio-economic risks. However, the Government is gradually taking steps to open the sector. The first major reform initiative by the new Indian government led by the increasing the FDI limit in the Indian insurance sector from 26% to 49% – will be a welcome move for many companies wishing to enter the market or expand the ownership of their current operation. We expect the legislation, once approved, to trigger new M&A and an inflow of capital as insurers take up the option to increase their stake to 49%. Due to economic liberalization started few years ago have started bringing in new investments from global giants and the government was hard pressed to facilitate global integration by lowering trade barriers for the free flow of technology, intellectual and financial capital. Thus liberalization of insurance creates an environment for the generation of long term contractual funds for infrastructural investments. This paper’s objectives are to investigate the Indian insurance industry and review current policy and regulations with a viewpoint of foreign investors so as to gain an understanding of the current position on FDI, as well as an overview of the Indian Policy and Regulatory Environment.

Keywords: Insurance sector, FDI, Policy regulations

INTRODUCTION

A milestone was achieved when the nation decided to privatize the industry along with requisite regulations. The industry functioned under a monopoly for several decades thereafter. However, other problems surfaced such as limited reach and penetration of enterprise and deteriorating servicing standards. Indian insurance sector was liberalized in 2001. Liberalization has led to the entry of the largest insurance companies in the world, who have taken a strategic view on India being one of the...
top priority emerging markets. The Insurance industry in India has undergone transformational changes over the last 12 years. FDI in insurance remains a widely debated and heated issue in India’s economic and political environment. Changes in the regulatory environment had path-breaking impact on the development of the industry. While the insurance industry still struggles to move out of the shadows cast by the challenges and uncertainties of the last few years, the strong fundamentals of the industry augur well for a roadmap to be drawn for sustainable long-term growth.

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

FDI IN INSURANCE – A HISTORICAL PERSPECTIVE
Insurance in India started without any regulations in the nineteenth century. After the independence, the Life Insurance Company was nationalized in 1956, and then the general insurance business was nationalized in 1972. The LIC had monopoly till the late 90s when the insurance sector was reopened to the private sector. In 1998 the cabinet decides to allow 40% foreign equity in private insurance companies and 26% to foreign companies and 14% to non-resident and investors (FIIs) but again in 1999 the committee decides that foreign equity in private insurance should be limited to 26%. In 1999, the Insurance Regulatory and Development Authority (IRDA) were constituted as an autonomous body to regulate and develop the insurance industry. Since end of 2000; While Life insurance has been privatized. Indian Government has opened the entry door for foreign players with a maximum of 26% of foreign holding and private companies in Life insurance sector (World Bank Economic Review, 2000). At present there are 44 private
insurance companies authorized by the IRDA operating in the country. These comprise of 23 life insurance, 17 general insurance and four health insurance companies, since the insurance sector was opened for private sector in the year 2000. These are all joint ventures between the Indian promoters who hold up to 76% and foreign insurance companies who hold up to 26% as mandated by the law. The government created a specific Board to deal with promotion of FDI in India and to be the sole agency to handle matters related to FDI. The ‘Foreign Investment Promotion Board’ (FIPB) as it is known, is chaired by the Secretary Industry (Department of Industrial Policy & Promotion or DIPP) within the office of the Prime Minister. Its key objectives are to promote FDI in India with investment promotion activities both domestically and internationally by facilitating investment in the country via international companies, NRIs (non-resident Indians) and other forms of foreign investors.

A. Opportunities for foreign investors in life insurance
   - Government has approved FDI from 26% to 49% limit.
   - Market is still dominated by one Public Sector player, providing opportunities for private sector players to target specific growth opportunities.
   - As distribution moves towards open architecture, licensed distributors of insurance services could provide a one stop solution for all financial services needs of the consumer.
   - The pension segment has a very low contribution to the overall life insurance sales as of now and is expected to increase substantially with growth and ageing of the private sector work force.
   - More capital infusion.
   - Insurance company will work on upgrading infrastructure.
   - Better training and development of insurance professionals.

B. Opportunities for foreign investors in general insurance
   - Government has approved FDI from 26% to 49% limit.
   - Low penetration, especially in health insurance provides significant room for growth.
   - Opportunity to forge partnerships with healthcare providers to provide a seamless value chain.
   - State governments are aggressively promoting universal health insurance and are aiming to provide minimum levels of health.
   - Insurance cover to all citizens leading to rapid growth opportunities, improving performance of motor insurance.
   - Conformity in product structures provides opportunities for differentiation in a fast growing, but crowded market.

C. Job opportunities
   - With the Parliament ratifying the new 49% cap for FDI in insurance from 26%, the placement market has been excited, with the industry set to add as many as 1,18,000 new jobs in 2015.
   - 200,000 fall in agent work force from 2.4 mn in 2011 to 2.2 mn in 2013. After approval of FDI insurance by cabinet it is expected to increase the agent work force.
   - Two million number of jobs estimated to be added in banking and insurance sector by 2021.
GROWTH DRIVERS

Rising Income and Growth of Middle Class

Post liberalization reforms and growth in service sector has significantly increased the purchasing power of people. The income pyramid is changing with a large number of families entering into higher income group and much more families moving into middle-income group. Currently out of over 247 million households, 76% comprises the humongous middle class. This would create new pockets of fresh demand for affordable and innovative insurance products and services.

Societal Changes and Urbanization

It’s anticipated that by 2031, 40% of Indian population will reside in urban centers and there would be at least 10 cities with a population more than 140 million. This rapid urbanization and fast paced economic growth has significantly altered the family structures. The concept of joint family is fast diminishing in India, especially in urban India where during the last two decades average size of family has reduced to four from six. This trend will continue further where there is negligible dependency on extended family, more and more families are going nuclear way. As such these families would be increasing looking for adequate risk cover which in turn will further drive the demand for new insurance products and services.

Financial Sophistication

India has oldest stock market in Asia and the financial services market is quite evolved and relatively stable. In the recent years consumers are getting more comfortable in doing online business and are rapidly adopting internet as a way to do financial transactions. Riding on the success of online banking and e-commerce, Insurance companies are also exploring to leverage the online platform to reach and acquire new customers. While the companies can have a low acquisition cost, the prospective customers now have an improved access to information about various insurance products and services. Such information abundance and ease to buy insurance cover online would further increase the insurance penetration in India.

CURRENT STATUS OF FDI REFORMS IN INDIAN INSURANCE INDUSTRY

2004: Then finance minister P Chidambaram proposes to raise FDI cap in private insurers from 26% to 49% in the first Budget of UPA-I.

2008: UPA-I tables the Insurance Laws (Amendment) Bill to this effect.

2011: Standing committee on finance, headed by former finance minister Yashwant Sinha, recommends against raising FDI cap from 26%.

2012: Cabinet clears a revised Bill to raise FDI cap to 49%.

2014: Bill is referred to a select committee, headed by BJP MP Chandan Mitra.

2015: Cabinet approves amendments in line with select committee recommendations.

2015: Ordinance issued to this effect, as Parliament isn’t in session.

2015: Old Bill withdrawn in RS; new Bill passed.
CONCLUSION

Despite the current policy and regulatory environment not being ‘perfect’ for foreign investors, there are clearly moves towards improving the current position and facilitating FDI inflows without having a detrimental impact on various sectors of the economy. 26% insurance FDI limit in India is lowest in world that’s why most of India’s 24 insurance companies have lost money in the past decade, hit by restrictions on foreign holding and by regulatory changes. The Cabinet has approved FDI from 26% to 49% in insurance is definitely a very positive sign. In addition, it adds the advantage of more hiring to improve penetration in less developed local markets and the widening current account deficit being financed through greater capital account, non-debt, FDI inflows. The benefits of the increased FDI would be seen more in the long term than in the short term. Most prominent insurance companies have a presence in India and will be able to augment their shareholding. This is also a window for Indian promoters to exit the insurance business if they feel it is not a part of their core growth strategy. Broadly, this would tend to create an environment, which consists of shareholders who are willing to invest and to stay committed to the Indian insurance growth story. Many international studies have estimated that the insurance industry in India can grow by over 125% in the next ten years. In fact, India has been identified as one of the fastest growing insurance markets. The current policy is trying to encourage Joint Ventures in insurance industry so as to boost the domestic insurer’s growth in this area. However; there is also the risk that some foreign insurers will not be interested in investing unless they have 100% ownership and that the current policy will prevent them from choosing India as an Insurance destination.

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