LIBERALISING INDIA'S INSURANCE INDUSTRY

R. N. MALHOTRA

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THE A. D. SHROFF MEMORIAL TRUST

"Piramal Mansion", 235, Dr. D. N. Road,
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OBJECTIVES

(i) Publication of one or more books in English, Hindi, and regional languages annually on some of the great builders of Indian economy aimed primarily at educating the younger generation in high standards of building the national economy as practised by those great entrepreneurs and placing the example of their lives for emulation by India's youth.

(ii) Organising one or more memorial lectures annually on subjects which were of interest to the late Mr. A. D. Shroff, namely, banking, insurance, and industrial finance, the subjects to be chosen in rotation, and the lectures to be delivered by persons eminent in these fields.

(iii) Awarding annual scholarship or scholarships to outstanding student or students in the field of management.

(iv) Instituting a prize to be known as The A.D. Shroff Memorial Prize for the student standing first in Banking at the Sydenham College of Commerce and Economics, Bombay.

(v) Doing all such acts, matters and things as are incidental or conducive to the attainment of the above aims or objects or any one or more of them, and

(vi) Without prejudice to the above charitable objects or any of them, the TRUSTEES shall have the power to spend, utilise and apply the net income and profits for the charitable object of education or such of the TRUST FUND for the TRUST FUND for the charitable object of education or such other objects of general public utility not involving the carrying on of any activity for profit as the Trustees may think proper, it being the intention of the SETTLOR that the income and/or corpus of the aforesaid charitable objects without any distinction as to caste, creed, or religion.

A. D. SHROFF (1899-1965)

A. D. Shroff's achievements in the field of business, industry and finance were many and varied. A large number of enterprises owe their origin and development to him. As an economist, his predictions have proved right over the years. Through the Forum of Free Enterprise, which he founded in 1956, as a non-political, educative organisation, he sought to educate the public on economic affairs. It was his firm conviction that a well-informed citizenry is the foundation of an enduring democracy.

George Woods, former President of the World Bank, paid the following tributes to A. D. Shroff:

> "In every age and in every society men must express anew their faith in the infinite possibilities of the human individual when he has freedom to develop his creative talents. For this is in large part how the message of freedom is passed from generation to generation. A. D. Shroff spoke eloquently in a great tradition, and thanks to him we can be sure that other great men of India will continue to speak this message in the unknown context of our future problems."

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INTRODUCTION

The Indian economy is in a crucial stage of transformation with liberalization and globalization as the goals of the new national economic policy. Competition is changing the face of the economy and consumer primacy is being established in various sectors such as aviation, banking and telecommunications.

Against this background, the proposed changes in the insurance industry which is still a **state monopoly,** have evoked considerable public debate and interest. Therefore, the annual public lecture delivered this year under the auspices of the Trust on "Liberalizing India's Insurance Industry", by no less a person than Mr. R. N. Malhotra, the former Governor of the Reserve Bank of India and Chairman of the Government of India Committee on Insurance Reforms, assumes great significance. It is a brilliant analysis of basic concepts. It merits a detailed study by the general public as well as the policy-makers.

The Trust, which arranges by turn public lectures annually on banking, industrial finance and insurance — areas in which the late Mr. A. D. Shroff distinguished himself — is privileged to present the text of Mr. Malhotra's thought-provoking and informative lecture through this booklet to the country.

N. A. PALKHIVALA
Chairman
The A. D. Shroff Memorial Trust

Bombay,
September 29, 1995

LIBERALISING INDIA'S INSURANCE INDUSTRY*

By

R. N. MALHOTRA

I feel highly honoured to have been invited by my eminent friend, Shri N. A. Palkhivala, Chairman, A. D. Shroff Memorial Trust, to deliver this public lecture. Shri A. D. Shroff is remembered as a man of great public spirit and an advocate of free enterprise. A highly regarded expert in business, industry and finance, he conceived and nurtured many successful enterprises. Among other high offices, he held with distinction the Chairmanship of the Bank of India and the New India Assurance Company. His faith in a well informed citizenry led him to found the Forum of Free Enterprise, a non-political organization, for promoting public debate on economic issues. It is indeed a privilege to pay homage to his memory through this public lecture.

Introduction

The topic of my talk this evening is Liberalising India's Insurance Industry. There are several reasons which have prompted me to select this subject. First,

* The text is based upon the Annual Public Lecture delivered under the auspices of the Trust in Bombay on 13th September 1995. The author is a former Governor of the Reserve Bank of India and Chairman of the Government of India Committee on Insurance Reforms.

the possible liberalization of the insurance industry would be very much a part of the ongoing economic reforms. Despite official statements to the contrary, there is a growing public perception that, of late, the pace of reform has slowed down, probably on account of the outcome of recent elections in several States and the approaching elections to the Lok Sabha. In this context, it is useful to attempt a brief assessment of the extent of success of the reforms implemented so far in order to see whether the present mood of official hesitancy is really warranted. Secondly, government decisions on important recommendations contained in the Report of the Committee on Reforms in the Insurance Sector have been withheld pending the development of a national consensus on the subject. Apparently, a major impediment to the evolution of such a consensus is the opposition of insurance employees to exposing the existing insurance companies to competition. Besides, reservations have been expressed in official quarters about the extent of 'privatization' of these companies as recommended by the Committee. Some of the issues concerning such consensus building and privatization call for a public debate.

Thirdly, strange as it may seem to this knowledgeable audience, one still comes across a view that competition is undesirable since it can lead to adoption of irregular practices. Recently, when I was addressing a seminar on life insurance at the National Insurance Academy, Pune, one of the seminar participants opposed the very idea of competition on the ground that it encourages unhealthy practices such as the illegal use of steroids by some athletes or lowering of standards by certain businesses, presumably for reducing costs and prices of goods and services. I countered the argument by pointing out that simply because some participants in a competitive market adopt questionable means, this was no reason to avoid competition, that such deviant behaviour is best handled by enforcing the rules of the game, and that competition normally improves the quality and pricing of goods and services and is a time tested remedy for the ills of public and private monopolies. I am not at all sure whether I carried conviction to the gentleman. In fact, I gathered the impression that his view was probably shared by many of his colleagues and was representative of a mindset engendered by functioning in a monopoly organization over an extended period of time. I, therefore, thought that the competition issue should be explored not at the theoretical level, but with reference to cases where erstwhile monopolies have been exposed to competition.

Economic Reforms Experience

Let me consider first the economic reforms experience. Even though the pace and quality of implementation of economic reforms which generally aim to deregulate and liberalize the economy and improve its productivity, has varied as between different sectors, the reforms have already shown some good results. The balance of payments has strengthened dramatically in response to measures that have promoted exports, liberalized trade, made the rupee convertible on current account and encouraged inflow of foreign capital. The current account deficit of the balance of payments has dropped sharply and foreign currency reserves stand at the equivalent of eight months imports. As a result, the acquisition of external debt whose outstanding stock at US$95 billion is viewed with considerable concern, has slowed down markedly.

Following liberalization of the policy regarding foreign investment, inflows of foreign direct and portfolio investment have increased manifold. The composition of external capital inflows has been changing in favour of equity and away from debt. While all capital resources have costs, the increase in foreign direct investment has special advantages due to associated technological, management and marketing inputs. Portfolio investments have activated the capital markets and put pressures for improvement in trading, settlement and share transfer practices. Indian corporates with good track records have also been able to raise large funds through global depository receipts and Euro-convertible bonds. Thus the process of integrating the Indian capital market with its counterparts abroad is well under way.

Delicensing of most industries and elimination of constraints on the growth of so-called large industrial houses has speeded up market driven investment. The industrial environment is becoming increasingly competitive. The growing volume and variety of goods has reduced scarcities relative to demand and improved consumer choices. What of the fears about the concentration of wealth and power in a few hands if market forces are allowed free play? While the well established companies and groups are growing, the number of relatively new entrepreneurs that are joining the medium and big leagues of industrialists is also rising. In 1994-95, 74% of capital issues that came to the market were made by companies previously unlisted in any stock exchange and, between them, they garnered Rs. 16,571 crore out of the total raised capital of Rs. 27,532 crore. This is indeed a heartening phenomenon.

With the opening up of several industries previously reserved for the public sector, private business interest (including that of foreign investors) in crucial infrastructural sectors such as power, telecommunications, oil development and refining, highways and ports has been growing. Despite occasional hiccups, this process should provide a handsome and sorely needed supplement to public sector investment in infrastructure.

Trade liberalization through reduction of import licensing requirements and sharp (and continuing) declines in customs tariffs have cut production costs, virtually eliminated import bottlenecks, encouraged technological upgradation and gradually exposed Indian industry to external competition. The mentality engendered by import substitution policies pursued over several decades is changing and there is growing emphasis on product quality and exports. The fears that import liberalization would destablise the balance of payments or harm India's capital goods industry have not proved correct. Indeed, in face of the large net inflow of external capital, the problem in the recent past has been how to absorb such foreign savings through larger imports for higher investment and growth.

Following the payments crisis of 1991, there was a steep decline in GDP growth to 1.2 per cent in 1991-92 due to fiscal contraction, a severe squeeze on imports, tightening of monetary policy to control inflation, and adverse weather conditions. However, the growth rate picked up to 4.3% in each of the two subsequent years and then rose to 5.6% in 1994-95. The projected growth in the current fiscal year is 5.5 to 6 per cent. Thus, unlike most other reforming economies, the costs of economic reforms in terms of lower growth have been relatively modest in India.

The reform of the financial sector has aimed at reducing and eliminating monetization of the budget deficit by the Reserve Bank of India, ameliorating policy constraints on bank profitability, auctioning government paper at market related interest rates; developing secondary markets for government and other debt instruments; largely freeing interest rates; enforcement of strengthened prudential norms for banks regarding capital adequacy, income recognition, loan loss provisioning and transparency of balance sheets; partial disinvestment of government equity in profitable public sector banks, recapitalization of financially weak banks; stronger supervision of banks and non-bank financial companies and enhancing competition through entry of new private sector, including foreign, banks.

The capital market has been considerably liberalized and has shown remarkable growth in terms of capital raised, market capitalization, trading in securities, and the number of investors and market intermediaries. Mutual funds, resources have burgeoned. Corporates have been free to issue and price capital for some time. Over 300 foreign institutional investors have been permitted entry into the market. Indian companies are selling equities and bonds abroad. Regulation of the capital market has been strengthened. Three important stock exchanges have moved over to screen-based electronic trading and steps have been initiated for setting up a national depository system. Despite the vast scope and complexity of the agenda for reform of the banking sector and the capital market, substantial progress has already been registered and the financial scenario today is characterized by considerable dynamism.

The record of success in improving the balance of payments, deregulating industry including the opening up of infrastructural areas to private investment, liberalising external trade, reforming the financial sector, and reviving growth has been impressive even though further progress is still necessary. Considering this positive experience, there is little reason to develop inhibitions and reluctance regarding the future course of reform. In any case, in view of several far-reaching reforms implemented in the financial sector without running into any serious problems, the case for reforming the insurance sector is very strong.

There are other areas where progress has been less than satisfactory. For instance, though the fiscal deficit of the Central Government has declined by the equivalent of 2 per cent of GDP between 1990-91 and 1994-95; its borrowing requirements, particularly those for covering large deficits on revenue account, are still too high for comfort. There has been very little progress in reduction and refocusing of explicit and implicit subsidies at the Centre and in the States. Though tax rates are being brought down to more rational levels, the improvement in tax enforcement is insufficient, and the tax ratio is not rising. High fiscal deficits create inflationary pressures and push up interest rates. Inflation averaged around 10 per cent in the first half of the 1990s due to budgetary imbalance, excessive money creation associated with large net capital inflows, rupee devaluation, increases in administrative prices and occasional shortages of some commodities. Even though the annual inflation rate has now declined to around 8 per cent, there is no room for complacency, particularly because high inflation hurts the poor the most.

The other areas where progress has been slow include the restructuring of the public sector enterprises, reduction of labour market rigidities and exit of non viable sick industrial units. Besides, the scope of reforms has not covered agriculture adequately. Admittedly, some of these areas present special difficulties which have to be tackled cautiously. It is to be hoped, however, that the need for caution and sequencing would not entail indefinite postponement of crucial reforms without which the economy may not attain its full potential.

Towards Reform of Insurance Sector

Having set out this backdrop of the reforms experience, I now come to the main topic of my talk. The insurance industry has been a state monopoly for several decades. Life insurance business of 245 Indian and foreign insurers and provident societies was nationalized on 1st September 1956 when the Life Insurance Corporation (LIC) was established by the LIC Act, 1956. Later, with effect from January 1973, 107 non-life insurers were nationalized, amalgamated and grouped into four subsidiaries of the General Insurance Corporation (GIC). Since nationalization, life and general insurance business has grown considerably in spread and volume reflecting the increase in population, economic growth and inflation as well as the success of insurers in selling insurance covers.

The LIC now has a network of 1906 branches, 93 divisions and 7 zonal offices spread all over the country. Its marketing force consists of about 18000 development officers and around half a million full-time and part-time agents. Compared with a "new business" of Rs. 339 crore sum assured under 9.5

lakh policies procured in India during 1958, LIC secured "new business" of Rs. 53,228 crore sum assured under about one crore policies in fiscal 1994-95 (April-March). The LIC has built up a large life fund of the order of Rs. 49,400 crore.

The 4 subsidiary companies of the GIC have 3151 branch offices, 1124 divisional offices and 77 regional offices. Their net premium income has grown from Rs. 222 crore in 1973 to Rs. 4,427 crore in fiscal 1993-94, with investments rising from Rs. 354 crore to Rs. 8,657 crore over the same period. GIC and its subsidiaries have representation directly or through associates in 32 countries.

Apart from being the holding company for its subsidiaries, the GIC was designed as the Indian reinsurer to which all domestic insurers were obliged to cede 20% of gross direct premium in India. In order to ensure retention of maximum business in the country and to secure the best terms from foreign reinsurers, GIC and its subsidiaries have a common programme for reinsurance cessions. The percentage of retained premium within the country was 86 per cent in 1992-93.

In April 1993, the Government of India appointed the Committee on the Reform of the Insurance Sector (hereafter referred to as the committee). The committee was to assess the strengths and weaknesses of the insurance industry and make recommendations for changes in its structure, functioning and the general policy framework keeping in mind the reforms under way in other parts of the financial sector and the economy. In addressing these tasks the committee conducted several internal studies, consulted a large number of interest groups and opinion leaders to ascertain their views on the present status and future development of the insurance sector, and also considered results of a survey which it had entrusted to a market research agency, MARG, to elicit popular perceptions about the industry.

The committee's characterization of the background against which it formulated its recommendations can be briefly summarized:

> Over the years, the nationalized insurance companies have considerably expanded their business and established an extensive presence throughout the country. They have developed financial strength and large reservoirs of trained manpower. However, the lack of competition has engendered complacency in the insurance industry which is reflected, among other things, in insufficient responsiveness to customer needs, high costs, instability of marketing networks, excessive lapsation of life policies, over-staffing, growth of restrictive staff practices and serious lags in technology. Despite overall growth of insurance, several lines of business have not been sufficiently developed and there is a vast untapped potential. Since nationalization, regulation of insurance industry has atrophied. High levels of directed investment of the funds of insurance companies have affected rates of insurance premia, as well as bonuses on most life policies.

One of the important issues considered by the committee was whether the insurance industry should be opened up to competition. It concluded that it would be very desirable to do so for several reasons. First, competition would result in better customer service and help improve the range, quality and price of insurance products. Secondly, though the nationalized insurance industry has built up large volumes of business, overall insurance penetration is still quite low. Entry of new players should speed up the spread of life and general insurance. Thirdly, as there is growing competition in the non-insurance financial sector, including commercial banks, mutual funds, merchant banks, leasing companies and other non-banking financial institutions, there is little reason for keeping insurance as a state monopoly. Fourthly, though employees' unions and some others are opposed to the idea of introducing competition in the insurance sector, there is a dominant body of opinion in its favour. Lastly, as the existing insurance companies are financially strong and have created extensive infrastructures in terms of professional talent and marketing and servicing net-works, they are in a position to face competition.

As some quarters still harbour doubts about the advisability of opening up the insurance industry, it would be useful to see how introduction of competition in some sectors of the economy has worked out in practice.

First, take the mutual funds business. From 1964 to 1986 the Unit Trust of India (UTI) was the only mutual fund operating in the country. It had a good record in selling and servicing its units. However, as of June, 1987, UTI's investible funds amounted to no more than Rs. 4,564 crore. From 1987 onwards, several public sector banks and insurance companies were permitted to set up mutual funds. In 1993, the private sector was also allowed entry into the mutual funds industry. As at end March, 1995, the investible resources of the mutual funds industry exceeded Rs. 74,000 crore, with UTI's share standing as high as Rs. 61,000 crore. Though there are several reasons for this exponential growth, competition in the industry has been a crucial contributory factor as different players innovated a host of income, growth, balanced, and equity linked savings schemes to meet a variety of investor preferences and established or strengthened their sales forces to reach out to investors all over the country. As a result, unit/share accounts in all mutual funds have multiplied manifold to about 60 million as at June 1995. Did the UTI lose as a result of the competition? Certainly not. Though its share of the industry's investible funds declined to 80 per cent, this constitutes a major part of a very much larger cake. How about the other mutual funds? Most of them are doing well. In a relatively short time, they have gained 20% of market share and now account for almost 12 million unit/share accounts. What about employment? It has increased as a consequence of the dramatic growth of business volumes and shows up not only in the establishments of recently set up mutual funds but also in the industry's marketing force and offices of registrars and share transfer agents. Who are the largest gainers? Of course, the millions of small investors who are putting their savings into mutual funds for high returns at low risks. Are there any spin-offs for the larger economy? Yes, mutual funds have conspicuously helped institutionalization of the capital market and wholesaling in securities, a development which is most welcome as large funds have to be mobilized in the capital market, especially for meeting the requirements of India's infrastructure. Are there any losers? Hardly any. True, infrastructural lags relative to explosive business growth have resulted in slower service to investors. Also, a small proportion of investors in closed end schemes who could not hold their units/shares to maturity had to sell them at substantial discounts. But a competitive industry is finding solutions to these problems.

Consider another example. Till quite recently, the public sector had a monopoly in domestic civil aviation. The Indian Airlines were finding it increasingly difficult to cope with the rising demand for air travel. There was inadequacy of available flights, with high incidence of unpunctuality. The monopoly status of the official airlines bred complacency resulting in inadequate customer service and numerous interruptions in operations due to strikes and go-slows, many of which lacked sufficient justification. The entry of private airlines has changed the situation for the better. They have supplemented the passenger carrying capacity of the public sector airlines, added to the number and destinations of flights, helped reduce long waiting lists and set fairly good standards for ground and in-flight services. The competition has improved the operational efficiency and standard of services in the Indian Airlines. Resort to strikes has declined. Employment in the civil aviation industry has increased. There is better capacity utilization of aerodromes. Consumers, including tourists, have gained. So has Indian Airlines' own image.

Yet another public sector monopoly which is in the process of opening up is telecommunications. The inadequacy and poor quality of basic telecom services in India have been notorious. Per capita telephone availability is one of the lowest in the world. Telephones go dead with annoying frequency and often take days to revive. A wag who talked of half a nation waiting for telephone connections and the other half for the dial tone was not very much off the mark. In some cities, including the nation's capital, these scarcities and inefficiencies are sometimes negotiated through illegal consideration. Till the other day, little thought was given to value added telecom services. But witness the tremendous response of Indian and foreign companies to invitations to bid for basic and value added telecom services. Newspapers report that the highest bids received for basic services in respect of various circles aggregate an unbelievable amount of Rs. 1,11,000 crore to be paid over a period of 15 years as licence fees. The average annual licence fees payable by the successful bidders for value added services is placed at well over Rs. 2000 crore. That is the market's judgement of the pent up and prospective demand for these services. Accordingly, the targets for provision of basic services are being sharply raised. Technology is expected to make a quantum leap. Vast opportunities are opening up for manufacturers of telecom equipment. Indeed, a revolutionary change in the entire scenario of telecom services is underway. This is good for the consumer, good for government revenue, and good for the economy.

These instances can be multiplied. At the heart of the successful ongoing external trade reform is the idea that competition would improve the quality and price competitiveness of Indian products and services and would benefit the domestic consumers as well as the country's exports. I have already mentioned that several infrastructural areas previously reserved for the public sector have been opened up to the private sector. In the face of all these developments, it is not at all clear why competition would be bad for the insurance industry.

A justification sometimes advances for retaining the state monopoly in insurance is that contracts between insurers and the insured involve special fiduciary obligations which are best guaranteed by state ownership of insurance companies. The contention implies that insurance is a natural state monopoly. This is cearly untenable as a dominant part of insurance business in the world is handled by the private sector. Besides, though each category of financial institutions has its special characteristics, fiduciary relationships are quite common in the world of finance and are by no means exclusive to insurance. Commercial banks which are the largest depositories for the community's savings, mutual funds and asset management companies, and a host of other financial intermediaries have fiduciary relations with their clients. These relations are typically sustained through mutual trust and effective regulatory oversight.

Here, a reference to the issues relating to consensus building for reform of the insurance industry would be appropriate. As indicated earlier, the committee had consulted numerous opinion makers, experts and interest groups, and considered the findings of the survey commissioned by it. The results of its consultations and the survey are set out in some detail in the committee's report.* In general, both life and general insurance policy holders would welcome the entry of the private sector into the insurance industry. They were of the view that this would improve the efficiency of the insurance services and enhance financial benefits such as higher bonus and lower premium, for the insured. A section of individual life policy holders had, however, some apprehensions regarding the safety of their money

* See Annexure

in the hands of private companies though they also recognized that good private companies would improve customer service. These concerns have been taken care of by the committee through its recommendations regarding capital requirements for prospective entrants into the industry, strengthening of the insurance regulatory setup, and investment of insurance companies' funds. The representatives of the insurance employees and LIC agents were, however, in favour of maintaining government monopoly in insurance.

Some target groups, namely, LIC corporate policy holders, GIC corporate policy holders, LIC agents, GIC agents and GIC's surveyors were asked to visualize their ideal insurance industry scenario for the future. They were given three options:

(i) Only public sector

(ii) Only private sector

(iii) Public and private sector

In most cases, the clearly preferred choice was a mixed scenario with both public and private sector companies competing in the market. For all these categories, except LIC agents, the "only private sector" scenario was the second choice. Except in the case of LIC agents, the support for the "only public sector" scenario ranged from 9 to 17 per cent; it was 42 per cent for LIC agents. This is as good a consensus as any.

I would venture to suggest that a very wide range of consultations and ascertainment of views have already been undertaken by the committee and its findings clearly point the way in which official policy should move. Since the vast majority of users of insurance services want that both the public and the private sectors should operate side by side, that dominant view must be respected. I have no doubt *that all political parties have the interest of consumers* of insurance services uppermost in their thoughts and would endorse the consensus that has already emerged.

Insurance employees undoubtedly are an important constituent of the industry and their legitimate interests have to be taken care of. There is, however, nothing in the committee's recommendations which militates against such interests. Of course, a competitive environment will pose new challenges to existing insurance companies and their employees, challenges which they should be able to meet.

One would hope that in light of the positive experience with the opening up of several monopolies, the insurance employees' representatives would get over their present reservations. I understand, they now have a constructive approach to further computerization in the insurance industry. In fact, perceptions within several trade unions on the benefits of introducing information technology are changing. A few months back, two national level leaders of important trade unions (outside banking and insurance) stated in a management training seminar in Delhi that, in retrospect, they were convinced that the prolonged resistance to computerization in banking and insurance was counterproductive. While I was touched by this refreshing candour, I could not help thinking of the high costs suffered by these industries in terms of technological backwardness, and inadequate housekeeping and customer service. Happily, there was not much staff resistance to opening up the telecom and civil aviation sectors. Probably, it was realized that the pursuit of sectional interests should not be pushed to a point where policies aimed at wider public good are stymied. Otherwise, the large benefits that are accruing to the Indian public and the economy might have been unduly delayed.

In making specific recommendations for liberalization of the insurance industry, the committee was mindful of the need for securing a smooth transition from a state monopoly situation to a competitive environment. While suggesting that the private sector be allowed to enter insurance business, it recommended that the minimum paid-up capital for a new entrant should be Rs. 100 crore, that no single company should be permitted to transact both life and general insurance, that the number of new entrants should be controlled, that promoters' holding in a private insurance company should be limited to 40 per cent of total equity, that foreign companies which may be permitted to enter the market should be required to float Indian companies, preferably in joint ventures with Indian partners, and that before the industry is opened up to competition, an effective insurance regulatory authority should be in place.

Recommendations have also been made with a view to ensuring level playing fields as between the existing companies and future entrants into the insurance business. There is a suggestion that life insurers should not neglect rural business and that general insurers should have balanced portfolios.

After the report of the committee was submitted to the government in January 1994, a lively debate ensured in the course of which some quarters questioned the rationale for the minimum capital of Rs. 100 crores, the suggestion that a company should not undertake both life and general insurance business, the limit of 40 per cent on the promoters' equity, and insistence on life insurers doing specified parts of their business in rural areas. A brief reiteration of the rationale of each of these recommendations should be in order.

The minimum capital of Rs. 100 crore has been proposed mainly with a view to ensuring that only serious players enter the business. This should reassure the insuring public about the financial viability of private companies. Prior to nationalization, it was mainly the small, undercapitalized insurers whose financial position was a cause for concern. Even otherwise, considering the present high costs in establishing new organizations, the stipulated amount is not excessive.

The recommendation that a company should not take up both life and general insurance business is essentially prudential in nature. The two businesses are different and it is considered prudent to prevent any mixing of their funds. Such prohibition exists in several countries. However, where promoters of a life insurance company might wish to set up a general insurance business or vice versa, they could possibly establish another company for that purpose.

As regards the limitation of promoters' equity to 40 per cent of the total, the committee has broadly followed a similar condition governing new private sector banks. Since the non-promoter equity is to be widely held with no single investor holding more that one per cent of the total, the promoters would have effective control over their company. At the same time, considering the possible difficulty of new entrants in raising 60 per cent of the equity from the public, it has been suggested that they may initially be permitted a higher portion of the equity which could later be brought down to 40 per cent. This could be done either through disinvestment of excess holding or, possibly, by issue of additional capital. The time for such lowering of promoters' excess equity would presumably be settled by the insurance regulatory authority in light of the period needed by an insurer to break even.

The suggestion regarding life insurers doing a part of their business in rural areas is necessary for ensuring level playing fields for existing and new companies and is also eminently feasible. LIC at present writes 45 per cent of new policies in the rural areas. These rural policies account for about 40 per cent of LIC's sum assured for all new business. LIC finds the rural business quite profitable.

The committee has considered several other aspects and implications of introducing competition in the insurance sector. Some of these deserve mention.

First, the controller of insurance who had wide powers under the Insurance Act of 1938 had been progressively deprived of effective control through transfer of many of his functions to the GIC and LIC. Presumably, it was considered that either the nationalized companies themselves or, where necessary, the government could regulate and supervise the industry, with the controller exercising a few residual functions. This dispensation was flawed even in the context of a state monopoly and would, in any case, have to change in a competitive environment. It has, therefore, been proposed that a strong and autonomous insurance regulatory authority should be established on the lines of the Securities and Exchange Board of India and should be enabled to finance itself through levy of a small fee on insurance premia. It would be for the insurance regulatory authority to ensure, inter alia, that insurance companies maintain adequate solvency at all times, invest their funds prudently and in conformity with the law, appoint 'fit and proper' persons as managers, maintain high standards of transparency in company accounts, and deal fairly with the insured. As you are well aware, the Finance Minister had announced in his 1995-96 budget speech that such a regulatory authority would be established. The Union cabinet has recently approved his proposals in this behalf.

Second, there was the question whether for promoting competition, it would be prudent to abolish the tariff regime governing general insurance business. The committee concluded that in light of the current state of the Indian insurance market, its likely evolution in the near future, and the prevalence of tariffs in many mature markets, abolition of the present tariff regime would be inadvisable at this stage; however, the area under tariffs should be progressively reduced, with personal lines of covers being taken out of the tariff regime at the earliest. Market agreements between general insurers regarding non-tariffed areas have the effect of informal tariffs. It has been suggested that such market agreements should be scrapped.

The Tariff Advisory Committee is at present a set-up within the GIC. It has been recommended that it be delinked from the GIC and should function as a separate statutory body under such supervision of the insurance regulatory authority as may be necessary.

Third, the scope for competition within the public sector was considered. The conclusion was that the GIC should cease to be the holding company of its four subsidiary companies and these should thereafter function as independent insurers on their own; further, that GIC should in future function exclusively as a reinsurance company and as the Indian reinsurer under the Insurance Act in whose favour general insurers would statutorily cede 20 per cent of their insurance business written in India. At present GIC manages fire and marine hull business pools, promotes inter-company cessions, negotiates excess loss treaties, places facultative cessions in respect of very large risks abroad, and accepts inward reinsurance business on behalf of itself and its subsidiaries. Subject to such changes that competition may necessitate, several such arrangements could continue.

Fourth, there is the need for the present nationalized life and general insurers to gear themselves up for confronting a competitive situation. To that end, several suggestions have been made.

(a) With their total equity held by government, the nationalized companies are regarded as 'state' and thus experience several constraints in their operations. This could be a serious handicap in a competitive setting. It has accordingly been recommended that government should disinvest 50 per cent of its shareholding in nationalized insurance companies. This would take the companies out of the definition of 'state' and make them truly board run institutions capable of responding quickly to competitive challenges through, for instance, internal reorganization, changes in business focus, and strategic alliances.

(b) The nationalized insurance companies are at present undercapitalized. It has, therefore, been suggested that they enhance their capital in accord with the scale of their operations. The need for the LIC to build its own reserves out of its net surplus has also been emphasized.

(c) Insurance is an information driven industry and requires collection, collation and analysis of vast amounts of data as well as management information systems. This calls for comprehensive computerization and development of softwares for systems support. Technological upgradation should improve customer service and help the nationalized insurance companies to effectively face competition.

(d) Competition will put pressures on company margins. This would necessitate reduction in costs and promotion of loss control and risk minimisation measures. Several suggestions have been made for improving the training and cost effectiveness of marketing and service personnel.

(e) Considering its massive size, recommendations have been made for reorganization of business in the LIC for improving its operational efficiency. Inter alia, these envisage that except for a few policy functions to be reserved for the head office, LIC zones should, for all intents and purposes, be the head offices for insurance business in their respective jurisdictions; and that the role of LIC branches as the single point of service and contact for customers be strengthened.

(f) Proposals have been made for enhancing the thrust, quality and relevance of both life and general insurance business in rural areas.

The committee had also suggested a sharp reduction in the level of insurance companies' mandated investments. This process has already begun. Besides, government securities which account for a substantial part of the industry's investments are now being placed in the market through periodical auctions and carry market clearing rates of interest. This should have beneficial effects on premia and bonuses as well as on the financial performance of the insurance industry.

I would now refer briefly to the issue of privatization. In the literature, 'privatization' has a whole range of connotations. At one end, all measures which enhance the role of the private sector can be regarded as a process of privatization. At the other end of the spectrum, outright sale of public sector enterprises involving transfer of ownership and management to private parties are regarded the ultimate in privatization. In between, there can be various stages of privatization. For instance, government's decision to disinvest upto 49 per cent of the total equity of selected public sector enterprises, including public sector banks, is a recipe for privatization, notwithstanding the officially stated position that 'privatization' is not on government's agenda. Against this background, let us consider the degree and rationale of privatization that the committee has suggested for the insurance companies. The recommendation that government equity in these companies be reduced to 50 per cent of the total would retain the dominant say of the government in the company boards. But as explained earlier, the companies would become board managed and move out of the definition of 'state' thereby overcoming several constraints that affect their flexibility as commercial service organizations. For instance, the general insurance companies have internal audit, external audit by company auditors, and audit by the Auditor General. There is a widespread feeling among officers of these companies that their ability to take prompt commercial decisions on insurance claims is often inhibited by apprehensions of ex-post questioning in the course of the latter audit. A former chairman of GIC, Shri R.K. Daruwala said in a lecture he delivered in this series in 1988 that "the audit by the C and A.G. has destroyed the initiative and sapped the morale of the officers which is very dangerous for this service oriented industry". There are several other well known constraints and I do not wish to elaborate them here. The other salutary effect of the committee's proposal would be the enhancement of managerial autonomy of company executives and the ability of the company boards and executives to respond quickly and substantively to new challenges that they are likely to confront in a competitive situation. When the private sector is being liberalized, the public sector should not be kept in shackles. The point is that the content of the proposal rather than the label of privatization and the political overtones of the label's semantics, should govern the debate on this issue.

While I am on this subject, let me also raise the broader question as to whether the government should deny itself the option of privatization of public sector enterprises (PSEs) involving changes in control and management where this may be necessary. I am not one of those who believe in wholesale privatization of PSEs and favour a selective approach based on sensible criteria. Surely, there are many PSEs that need not be in the public sector. There are others where the government need hold no more than a small part of the equity. Yet others are non-viable and need to be sold off or wound up. The Committee on Disinvestment of Shares in Public Sector Enterprises which was chaired by Dr. C. Rangarajan, presently

Governor of the Reserve Bank of India had made some important recommendations in this behalf which need early consideration.

Business Potential

The Indian insurance market has a large potential considering the country's huge and burgeoning population, a growing and increasingly affluent middle class, gross domestic savings of around 23 per cent of GDP, its GDP growth rate which averaged 5.6 per cent over the 1980s and is expected to rise to 6-7 per cent in the second half of 1990s, industrial output that could grow by 8 to 10 per cent per annum, and rising trade volumes. This should provide increasing business opportunities to life and non-life insurers. In a competitive environment, both the public and private sectors would vie for a share in a growing market. Further, as mentioned earlier, despite large increase in life and general insurance coverage, many lines of business remain underexploited. For instance—

(a) Even though the LIC currently writes about one crore new life policies in a year, a high percentage of insurable lives remains without insurance cover.

(b) The spread of medical insurance and the quality of available covers are inadequate and call for innovative approaches and marketing initiatives.

(c) There is considerable scope for developing and marketing pension and annuity schemes, especially for self employed professionals, traders and people employed in the large informal sector. These schemes could get a big boost if the government were to accept the committee's recommendations for liberal tax incentives to promote such long-term savings.

(d) Except for term covers for groups of employees in certain segments of the organized sector, term insurance is an under-developed area. The same is true of unitlinked insurance schemes.

(e) The vast scope for personal lines of insurance remains largely untapped.

(f) There is a general perception that most industrial risks are inadequately covered and that much more needs to be done in the areas of loss control and risk reduction.

It is to be expected that when competition develops such untapped areas and the new opportunities thrown up by economic development would be dynamically addressed.

Conclusion

Let me conclude. Insurance sells protection against uncertainties of life, business and trade. An efficient and responsive insurance industry is essential for enhancing the sense of security in the community at large and facilitating economic activity. Life insurance is also an important medium of long term savings. Insurers must aim to cover all sections of the population and different business activities and provide insurance covers to meet the varying needs of individuals, groups and industries at reasonable cost. As the country moves up the technology scale and the economy becomes increasingly sophisticated, the insurance industry must have the imagination, innovativeness, expertise, technology as well as the whiplash of competition to respond constructively, promptly and fairly to the changing and complex demands of its clientele. To that end, it is essential to liberalize the Indian insurance industry. The sooner this is done the better.

ANNEXURE

Summary of major findings of MARG survey

1. The awareness levels of the various policies of both GIC and LIC are quite limited even among people who hold policies of these corporations. Among non-policy holders, as expected the awareness levels are even lower.
2. In the area of general insurance, spontaneous awareness of the four subsidiaries ranges between 23% and 67% across various categories of general insurance policy holders. In fact, a fair proportion consider LIC and Peerless as companies offering general insurance. Among non-holders of general insurance, spontaneous awareness levels of the GIC subsidiaries are abysmal — below 15%. In fact, more non-holders think LIC offers general insurance than any GIC subsidiary.
3. Non-policyholders of both life and general insurance policies mainly do not hold these policies because of their inability to pay the premium. For general insurance, many non-policy holders do not perceive the need to acquire a policy.
4. A majority of the individuals who have made claims on LIC or the GIC subsidiaries feel that the claims have been settled speedily and satisfactorily. In these areas, LIC's customers appear to be better placed than GIC customers (though one has to take account of the fact that many of LIC's claims are on maturity and paid as a matter of course).

	LIC Individual	GIC Auto	GIC Individual (Non-Auto)
% lodging claim in 5 years	5	11	40
% of claimants saying last claim settled			
satisfactorily	75	60	67
speedily	67	52	59
Average no. of days to settle last claim	87	97	121
Average value of last claim (Rs. '000)	44	20	56

5. When asked to rate the overall service provided by LIC and the GIC subsidiaries on a five-point scale (ranging from Excellent to Very Poor), in almost all cases, 10% or fewer rate LIC or the GIC subsidiaries 'poor' or 'very poor'. On the whole, LIC's overall ratings are somewhat better than those of the GIC's subsidiaries.

   However, on specific aspects there appears to be some degree of dissatisfaction with documentation and service levels.

6. A clear majority of LIC Agents (90%) and GIC Agents (78%) were satisfied with their career with the insurance companies. As expected, they desired a better remuneration package. GIC Agents were relatively less satisfied with training seminars run by the companies. LIC Agents on the other hand, rated LIC's training seminars much better. There is also some dissatisfaction among LIC Agents in their dealings with Development Officers.

   75% and more of GIC and LIC Agents felt that customers are very/quite satisfied with the service provided by the insurance companies.

7. GIC surveyors felt that a fair proportion of customers were dissatisfied with the amount paid on the claim. They did not have a very positive opinion of the employees of the GIC subsidiaries on grounds of technical skills and honesty and believed that the general insurance industry was far behind its western counterparts.

8. In general, both life and general insurance policy holders welcomed the entry of the private sector into the insurance industry. They perceived two broad areas of benefits that would accompany the entry of private sector companies.

   — greater efficiency

   — better financial benefits (higher bonus, lower premium, etc.)

   However, for the past 20 years and more, the Indian policyholder has lived in an environment where all insurance has been provided by nationalised companies. Thus, he is used to the cast iron financial stability of these companies. Consequently, the major concern of a number of persons, in relation to even reputed private companies, is that, their money may not be safe and the possibility of defalcation/dishonest management.

   These views are also shared by Agents and Surveyors who, in addition, were concerned about job security.

   Some target groups were asked to visualise their ideal scenario in the future. They were given three options.

   — only public sector

   — only private sector

   — public + private sector

In most cases, the clearly preferred choice was a mixed scenario with both public and private sector companies competing in the market. In all categories, except LIC Agents, the only private sector scenario was the second choice. Among LIC Agents, however, there was a strong plea for maintaining a public sector monopoly.

	Only Public	**Only Private**	**Both**	**No option**
LIC Policyholders Corporate	9	29	60	2
GIC Policyholders Corporate	15	23	61	1
LIC Agents	42	12	42	4
GIC Agents	17	30	51	3
GIC Surveyors	14	20	64	2

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