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Impact of FDI on Insurance Sector

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ABSTRACT

FDI (Foreign Direct Investment) in Insurance sector inculcates the saving habits, which in turn generates long term ingestible funds for infrastructure. India is no doubt a growth economy and many consider it as an attractive country to invest in, particularly in its rapidly growing and changing insurance market. After a decade of strong growth, Indian insurance industry is facing severe headwinds owing to slow growth, rising costs, stalled reforms, worsening distribution structure. FDI is a better alternate to reduce such problems. So government of India has taken liberalized steps by lowering trade barriers and removing certain restrictions. Government has raised FDI in insurance sector from 26% to 49%. This increment in FDI has two sided effects on our Indian economy. In this paper we have attempted to discuss the positive and negative impacts of FDI on insurance sector. Positive impact is in the form of more capital inflow, entry of new players, advanced technology, innovative ideas, employment opportunities and growth of insurance industry. Flow of FDI in insurance sector is a welcome measure but we should also consider the negative impact of FDI in the form of repatriation of profits resulting negligence of social responsibility, also harmful to development of indigenous players. An unwarranted increase in the size of foreign holding in the insurance sector will inevitably expose the country to risks not commensurate with those that an emerging market economy such as ours is equipped to grapple with.

Key Words: *FDI, Insurance sector, Inflows, Employment, Growth, Infrastructure etc.*

INTRODUCTION

FDI (Foreign Direct Investment) refers to capital inflows from abroad that invest in the production capacity of the economy and are usually preferred over other forms of external finance because they are non-debt creating, non-volatile and their returns depend on the performance of the projects financed by the investors. In today's competitive global business environment investments are required for growth and development. FDI as an investment tool is an integral part of open and effective international economic system which acts as a catalyst in the development of a country. FDI inflow helps the developing countries to develop a transparent, broad and effective policy environment for investment issues as well as builds human and institutional capacities to execute the same. The significance of FDI is that such investments are risk free to the country and bring with it the advantages of advanced technology, management practices and assured markets. In due course there is a technology transfer as the local workforce gains knowledge of the manufacturing processes and management practices. The value added in these industries is contribution to GDP and foreign exchange earnings. Therefore FDI contributes to foreign exchange earnings, employment creation and increase in income, especially of skilled and semi-skilled workers in these industries. There is a strong relationship between foreign investment and economic growth. Larger inflows of foreign investments are needed for the country to achieve a sustainable high trajectory of economic growth.

The basic philosophy of insurance is a cooperative device by which the loss likely to be caused by an uncertain event is spread over a number of persons who are exposed to it and who proposed to insure themselves against such an event. 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.

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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.

OBJECTIVES OF STUDY

- To identify the present status of Foreign Direct Investment in Insurance Sector.
- To study the future prospects of Foreign Direct Investment for Insurance Sector.
- To know the significance of Foreign Direct Investment for Indian Insurance Industry.

INSURANCE IN INDIA

Insurance in India refers to the market for insurance in India which covers both the public and private sector organizations. It is listed in the Constitution of India in the Seventh Schedule as a Union List subject, means it can only be legislated by the Central government.

The insurance sector has gone through a number of phases by allowing private companies to solicit insurance and also allowing foreign direct investment. India allowed private companies in insurance sector in 2000, setting a limit on FDI to 26%, which was increased to 49% in 2014. However, the largest life-insurance company in India, Life Insurance Corporation of India (LIC) is still owned by the government and carries a sovereign guarantee for all insurance policies issued by it.

MAJOR PLAYERS IN INSURANCE INDUSTRY

Earlier the Insurance industry in India consisted of two state owned insurers, namely, Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC), including its four subsidiary companies. With effect from December 2000, these subsidiaries have been delinked from parent company and converted into independent insurance companies:

- Oriental Insurance Company Limited
- New India Assurance Company Limited
- National Insurance Company Limited
- United India Insurance Company Limited

The Insurance Regulatory and Development Authority (IRDA) issued the initial batch of licenses in 2001, categorized as life insurers and non-life insurers. Following are the major players:

NON-LIFE INSURERS

1. Bajaj Allianz General Insurance Company Limited

2. ICICI Lombard General Insurance Company limited

3. IFFCO-TOKIO General Insurance Company Limited

4. National Insurance Company Limited

5. New India Assurance Company Limited

6. Oriental Insurance Company Limited

7. Tata AIG General Insurance Company Limited

LIFE INSURERS

1. Bajaj Allianz Life Insurance Company Limited

2. Life Insurance Corporation of India Limited

3. Birla Sun Life Insurance Company Limited

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4. HDFC Standard Life Insurance Company Limited

5. ICICI Prudential Life Insurance Company Limited

FDI IN INDIAN INSURANCE INDUSTRY

Insurance in India started without any regulation in nineteenth century. After the independence, Life Insurance Company was nationalized in 1956, and then general insurance business was nationalized in 1972. The LIC had monopoly till the late 90's when the insurance sector was reopened to the private sector.

In 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. 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 Insurance Regulatory and Development Authority (IRDA) operating in the country. These comprise of 23 life insurance, 17 general insurance and 4 health insurance companies. These are all joint ventures between Indian promoters who hold upto 74 % and foreign insurance companies who hold upto 26% as mandated by law.

Government created a specific board named as Foreign Investment Promotion Board (FIPB) to deal with promotion of FDI in India and to be the sole agency to handle matters related to FDI.

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, NRI's (Non Resident Indians) and other forms of foreign investors.

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The increase in the foreign investment limit in insurance joint venture from an earlier 26% was brought about through ordinance promulgation. According to the notified rules, FDI of upto 26% of total paid up equity of an insurance company shall be allowed through the automatic route or without the need for prior government approval. FDI proposal which take total foreign investment above 26% will have to be cleared by the Foreign Investment Promotion Board.

PRESENT STATUS OF FDI

Since the end of 2000, while Life insurance has been privatized, Indian Government has opened the entry door for foreign players and private companies in Life insurance sector. The present scenario has revealed 22 Private Life Insurance Companies working in Indian markets. Private life insurance companies have been keeping behind Indian largest public company (LIC) by way of innovative products, smart marketing, and aggressive distribution that attracts customers towards the private life insurance companies, sign up Indian customers faster than anyone expected. Indians, who had always seen life insurance as a tax saving device, are now suddenly turning to the private sector and snapping up the new innovative products offer to customers and investment plans. In the year 2002-03 public company (LIC) collected 5,46,228.49 crores in comparison with five selected private sector companies total collection of 733.52 Crores. In the year 2004-05, while total significant collection of public company was 75,127.29 Crores and comparatively with selected private companies there was total collection of premium around 4402.29 cr. In the year 2007-08 while total collection of public companies was 149789.99 cr. And in selected private companies there was total collection of premium of 27979.99 cr. During the last session 2009-10 public company had collected total premium around 1, 85,985 cr. And in comparison selected private companies, there was total collection of premium 16,495.86 cr. The huge premium collection increase in every financial year was gearing insurance business in India on fast pace. Present figures of the insurance companies and its market share indicates the penetration of life insurance companies in Indian markets, such penetration indicate the fruitful growth and its positive result of utilization of foreign investment in life insurance sector. The new players have improved the service quality of the life insurance. As a result LIC continued in declining in its career from the year 2000 onward, market share have been distributed among the private players. In the financial year 2009-10, LIC held 65% market share among doing business of life insurance companies in India, for upcoming nature these private players are gaining strength to give more competition to LIC in earlier future. Market share of LIC decreased from 95 % (2002-03) to 81 %(2004-05). In the financial year 2007-08 LIC held 74.39% and following private players held the rest of the market share. The central government has proposed to enhance foreign direct investment (FDI) in insurance to 49% in its second wave of reforms announced recently. Earlier foreign investment in private insurance companies was restricted to 26% of their capital, which is now proposed to be increased to 49% by passing an amendment to the Insurance Act in the ensuing session of Parliament. Announcing this decision, former Finance Minister P. Chidambaram said "the benefits of this amendment to the insurance act will go to the private sector insurance companies, which require huge amounts of capital and that capital will be facilitated with the increase in foreign investment to 49%." He also clarified that this will not apply to public sector insurers like Life Insurance Corporation of India (LIC) and the five general insurance companies. At present there are 44 private insurance companies authorized by the Insurance Regulatory and Development Authority (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 insurance business requires additional capital as it grows and this has to come

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from the promoters. If the Indian promoters are unable to contribute their share of the capital, they will not be able to grow. Foreign companies with deep pockets will be able to fill this gap, if they are allowed to invest up to 49% of the capital. It was estimated that the private insurers need about Rs 60,000 crores of additional capital during the next five years. Therefore, the raising of FDI cap to 49% would come handy for the foreign partner to increase their stake in the company, without the local partner having to put matching capital in to the company. The foreign partner will be more than happy to increase its stake, as it will help it to get a bigger share of the pie, and will also give it a larger role in running the company according to its ways, by virtue of a higher shareholding in the company. This will, therefore, be a boon to the foreign insurers to come to India in a big way.

The Insurance Amendment Bill to raise FDI cap in the insurance industry from 26 per cent to 49 per cent had been pending in the Rajya Sabha since 2008. India is full of potential but hit by regulatory hurdles, a sharp dip in GDP growth and uncertain market conditions. Even though norms allow FDI up to 26 per cent, several foreign players had quit India. The hike in FDI cap was subject to parliamentary nod, not an easy task given that the ruling coalition was in a minority. Foreign investment in private insurance companies was restricted to 26% of their capital, which was proposed to be increased to 49% by passing an amendment to the Insurance Act.

Taking a reformative step, new Finance Minister, Mr. Arun Jaitely had proposed increasing the FDI cap in the insurance sector to 49%. To this effect, in July 2014, the Cabinet Committee on Economic Affairs (CCEA) approved 49% FDI in insurance industry, the green-flagging reforms in the sector. The Finance Ministry said that the foreign equity investment capital of 49% will be applicable to all Indian insurance companies and they shall not allow the aggregate holdings by way of total foreign investors , including portfolio investors to exceed 49% of their paid up equity capital.

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This reform will be big boost in the industry. According to industry observers, a lot of international companies have been waiting to enter India and a further opening up of the sector will give them an entry point.

FUTURE PROSPECTS OF FDI

By 2020, India's insurable population is expected to touch 75 crores. As a result, the importance of life insurance in financial planning is only set to increase. With the new government's stress on reforms, steps taken by IRDA to make insurance more consumer friendly and India's favorable demographic conditions, the future of India's Insurance Industry looks good.

IMPACT OF FDI ON INSURANCE SECTOR

Positive Impact

1. More capital Inflow: FDI has the potential to meet India's long term capital requirements to fund the building of infrastructures which is critical for the development of the country. Infrastructure has been the major factor which has restricted the progress of the Indian economy. Insurance sector has the capability of raising long term capital from the masses as it is the only avenue where people put in money for as long as 30 years and even more. An increase in FDI in insurance would indirectly be a boon for the Indian economy, the investments not withstanding but by making more people invest in long term funds to fuel the growth of the Indian economy.

2. More Employment Opportunities: The growth scenario in the insurance sector is creating numerous employment opportunities in the economy. There is an upsurge in the demand for marketing experts, finance specialists, human resource professionals, statisticians etc. Experts in the new specialty areas like underwritings, claims, managements, actuarial management etc. are also being occupied in the industry.

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3. Wider Scope for Growth: FDI in insurance would increase the penetration of insurance in India, where the penetration of insurance is abysmally low with insurance premium at about 3% of GDP against about 8% global average. This would be better through marketing effort by MNCs, better product innovation, consumer education etc.

4. Linkage Effect: Insurance related service-domains like training, workshops, risk assessment and rating and risk management have positively changed making it possible for the industry to explore the new areas. Beside this, the increase in the insurance players will significantly boost up related fields like advertising, brand building etc. which in turn would promote the ancillary industries.

5. Provide customers with competitive products, more options and better service levels: Opening the FDI in the insurance sector would be good for the consumers, in a lot of ways. Increasing FDI limit would impact a lot of industries in a positive way. Consumers will be able to get better, innovative and competitive products and enhanced service quality. Alternatives will be available to them to make a better choice.

6. Optimum Utilization of Resources: India has pool of resources which are not utilized properly due to lack of capital, lack of technology etc. FDI helps to make optimum utilization of resources. Foreign players provide the necessary capital, technology and expertise for better utilization of the same.

7. Availability of New Technology: FDI in insurance sector also fetches the new areas of attracting customers by providing various innovative schemes. The new players have started an extensive variety of products that calls for need based selling technologies.

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8. Moving towards Global Practices: India's insurance market lags behind other economies in the baseline measure of insurance penetration. At present only 3.1%, India is well behind the 12.5% for the UK, 10.5% for Japan, 10.3% for Korea and 9.2% for the US. Currently, FDI represents only Rs. 827 crore of the Rs.3179 crore capitalizations of private life insurance companies.

9. Healthy Competition: The need for quicker delivery of insurance products has provoked the competing insurance players to follow more sophisticated, automated systems. This has taken Insurance sector to new height.

10. Infrastructure facilities: The main aim of life insurance is to mobilize the savings of public for the development of the economy by way of long term investments in social and infrastructure sectors. The opening up of insurance market to FDI would enable huge flow of funds into infrastructure.

11. New Risk management Practices: Increased FDI cap in insurance sector will also benefit the country by way of providing new jobs, new risk management practices and product innovation.

Negative Impact

1. Effect on the Domestic Private Sector: In most cases, these policies were imposed as the condition for receiving aid and loans from the international community. Most evidence from the history of successful private sector development points to the need to use some form of infant industry protection and incentives to the domestic private sector, currently denied to most developing countries under the WTO and by IFI conditionality. Such measures were successfully used in India to develop its vibrant private sector.

2. Efficiency of the companies with FDI: The opening up of this sector for private participation in 1999, allowed the private companies to have foreign equity up to 26 per cent. Following this up 12 private sector companies have entered the life insurance business. Apart from the HDFC, which has foreign equity of 18.6%, all the other private companies have foreign equity of 26 per cent. In general insurance 8 private companies have entered, 6 of which have foreign equity of 26 per cent. Among the private players in general insurance, Reliance and Cholamandalam does not have any foreign equity.

3. Credibility of foreign companies: The argument that foreign companies shall bring in more expertise and professionalism into the existing system is debatable after the recent incidents of the global financial crisis where firms like AIG, Lehman Brothers and Goldman Sachs collapsed. Earlier too, The Prudential Financial Services (ICICI's partner in India) faced an enquiry by the securities and insurance regulators in the U.S. based upon allegations of having falsified documents and forged signatures and asking their clients to sign blank forms. This was after it made a payment of $2.6 billion to settle a class-action lawsuit attacking wrong insurance sales practices in 1997 and a $ 65 million dollar fine from state insurance regulators in 1996. AMP closed its life operations for new business in June 2003. Royal Sun Alliance also shut down their profitable businesses in 2002.

4. Repatriation of profits: However, the FDI inflows benefits the host country, but the outflows in the form of profits remittances (the profits on investment that are repatriated to the country of origin) also affects the country negatively. Major share of profits goes out of the domestic country.

5. Greater channelization of savings to insurance: One of the most important duties played by the insurance sector is to mobilize national savings and channelize them into investments in different sectors of the economy. However, no significant change seems to have occurred as far as mobilizing savings by the insurance sector is concerned even after the liberalization of the insurance sector in 1999. Therefore the private or foreign participation has not been able to achieve the goal.

6. Flow of funds to infrastructure: The primary aim of life insurance is about mobilizing the savings for the development of the economy in long term investment in social and infrastructure sectors. IRDA figures further imply that the share of the public sector life and non-life insurance companies in investment in infrastructure is greater than their market share. Despite the FDI cap being set at 26%, the investment from the insurance sector to the infrastructure sector was predominantly from the public sector companies. Hence the point of raising the FDI cap in the insurance sector for mobilizing resources does not hold good

CONCLUSION

In this paper, we concluded that the demands for raising the present FDI limits of 26 per cent in the insurance sector may be reviewed taking into account the changing demographic patterns as well as the role of insurance companies in supplying the required long term finance in the economy. And since insurance is a high gestation, capital intensive business and the sector needs fresh capital to fund its existing businesses and expansion.

Growth of insurance sector will also help in developing other sectors and providing capital to the government for long-term infrastructure projects. Cross-country analysis also supports the increase in FDI limit as sectoral cap was higher than India even in China for insurance and a few other sectors, while countries like Brazil and Russia have higher sectoral caps than India across most of the sectors.

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A strong domestic consumption, rural health, education, connectivity, high savings, low dependency on exports, burgeoning middle class, positive demographics, talent pool and intellectual capital are some of the key strengths of our economy. However, somewhere down the line, some bottlenecks started emerging as we did not pay enough attention to re-engineering and making our institutions contemporary with the growing needs and changing environment. One of the underlying needs is the building of an institutional and financial infrastructure and the latest move i.e. FDI hike is a right step in the right direction.

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