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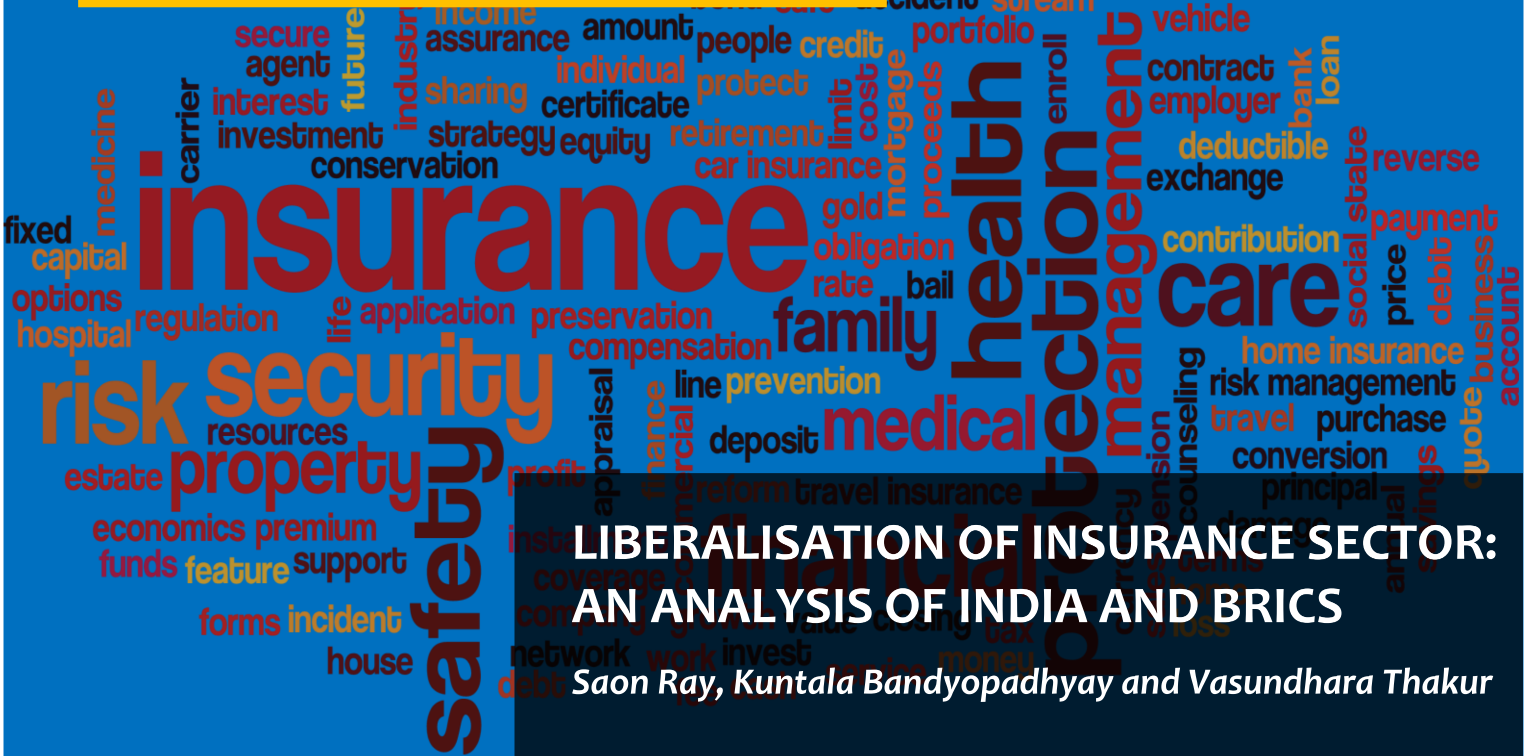

LIBERALISATION OF INSURANCE SECTOR: AN ANALYSIS OF INDIA AND BRICS

Saon Ray, Kuntala Bandyopadhyay and Vasundhara Thakur

Key Highlights

- Global diversification of financial institutions including insurance sector has been proven beneficial to many economies by providing them with increasing capital flow, higher competition, introduction of newer technologies and distribution channels.
- During the last few decades, there has been an ongoing global trend of liberalization of domestic financial sector, including insurance.
- India is on its journey of opening up its insurance sector to increase foreign participation. The paper aims to critically evaluate the liberalization process of India's insurance sector and the impact it has made onto the sector, both life and non-life segments.
- The paper also analyses the liberalization approach taken up by the BRICS countries for their own insurance sectors and the results experienced and presents the impact of insurance sector on an economy's performance in the World Bank's Ease of Doing Business index rankings.

EXECUTIVE SUMMARY

In the last few decades, there has been a global trend of liberalization of the domestic insurance sector. While the United Kingdom and the United States were pioneers in the deregulation process of the financial sector in the 1980s, other countries have followed suit.

This paper aims to present the relationship between liberalisation of the insurance sector and growth, focusing on India's experience. It critically evaluates the liberalization process of India's insurance sector and its impact on the life and non-life segments and the reinsurance sector. The paper also analyses the liberalization approach in the BRICS countries for comparison. It elucidates the role played by an economy's insurance sector to improve the business environment of that country, which is reflected in the World Bank's Ease of Doing Business (EODB) index rankings.

INSURANCE AND LIBERALIZATION: THEORY AND EMPIRICAL EVIDENCE

The nexus of insurance and economic growth and financial development has been well established by a number of studies. There are two prime channels through which the insurance sector influences the macroeconomic development: it acts as a financial intermediary and provides ex-ante protection against risks and ex-post financial recovery. Other positive effects of insurance on economic development include generation of employment and service delivery; impetus to innovation and entrepreneurship; capitalization on high risk, high return investment opportunities; smoothening of trade and commerce; and may act as a substitute for government social security programs. Conjointly with the banking sector and the stock market, insurance activities add to economic growth. Empirically it has been shown that the insurance sector's impact on economic development is relatively greater in the developing countries as opposed to the developed countries.

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Considerably less economic research has been concerned with how economic reforms or liberalisation impact the insurance sector. Insurance markets are influenced by global trends as well as well as local constraints (Lee and Lin, 2016; Cummins and Vernard, 2008). The important global trends are the increasing sophistication of insurance products, globalisation of risk diversification through reinsurance, and emergence of mega-financial intermediaries. Differences in financial markets, taxation, regulatory systems, insurer investment strategies, and insurance distribution systems are also key local factors.

There are various benefits of liberalizing a country's insurance sector. These include allocative efficiency, higher technology transfers rates, and greater wages. In financial sectors like insurance, increased foreign direct investment (FDI) can potentially strengthen institutional development in the host country through improved regulation and supervision (Goldberg, 2004). The presence of foreign competitors may motivate domestic firms to cut costs thus making them profitable (Leverty, Lin, and Zhou, 2009). Competition from foreign insurers may also curtail monopolistic tendencies of domestic-owned insurers. Foreign firms may introduce new services, technology and skills that domestic companies can copy, contributing to more efficient practices. These companies may export high skilled managers to work in their foreign branches and/or establish professional training programmes, increasing the quality of human capital in the industry. Finally, the entry of foreign firms may also lead to improvements in regulation and supervision and the development of a legal framework. Overall, greater foreign penetration may increase the efficiency and productivity of the domestic market (Leverty, Lin, and Zhou, 2009).

LIBERALISATION OF INDIA'S INSURANCE SECTOR

The Government of India announced a number of initiatives over the last couple of years to globally integrate and boost the insurance sector. As indicated by studies, evidence of benefits of liberalisation of India's insurance sector can be seen in the sector's performance such as penetration and density, product innovation, introduction of alternate channels, distribution, and customer services.

LIBERALIZATION OF BRICS INSURANCE MARKETS

Studying the impact of liberalization of insurance sector on BRICS provides not only a case study of significant global economic powers but also help us understand the liberalization of India's insurance sector better since India shares similar stage of economic development and social political framework with these countries. The impact of liberalisation of the insurance sector in the BRICS is presented in Figure 1.

In life insurance business, India is ranked 10th among the 88 countries, for which data is published by Swiss Re. India's share in global life insurance market was 2.8 per cent during 2017. The share of Indian non-life insurance premiums in global non-life insurance premiums was at 1.1 per cent and India ranked 15th in global non-life insurance markets according to IRDAI Annual Report 2017-18. Figure 2 shows the key insurance sector trends in the BRICS countries in the last few years. Unfortunately, in comparison with the other BRICS nations, it is clear that India is a laggard in terms of insurance penetration and density.

HINDRANCES TO FOREIGN INVESTMENT IN INDIAN INSURANCE AND RE-INSURANCE SECTOR

Even after initiating considerable reforms, there still remain key challenges and barriers for the foreign insurers to operate in India profitably. These barriers take the form of ownership restrictions, limits on diversification, and price restrictions. The Insurance Act 2015 allows a foreign insurance company to set up a business in India only by establishing a licensed local insurer through a joint

Figure 1: Liberalisation impact on BRICS's insurance sectors: A snapshot

Brazil

- Progressive opening up of the Brazilian insurance sector has helped in growth and expansion of its insurance sector.
- The insurance sector evolved from a participation rate of 0.8% of the GDP in 1994 to 2.55% in 2008, and the penetration rate rose to 3.2% in 2008 from 0.7% in 1995.
- Brazil emerged as the country with one of the highest growth rates in insurance premiums worldwide: 12.1% between 2013 and 2014, and 10.2% between 2014 and 2015.

Russia

- Experts in the insurance field have opined that the entry of foreign insurance companies will augment participation in insurance market and will also possibly improve service quality.
- An increase in the role of foreign insurers may cause substantial cost reductions for the insurance services (Zemnitskiy, 2001).

India

- Significant capital flows to the insurance sector due to the earlier FDI limit hike.
- Opening up of the sector has also been beneficial in terms of penetration and density, product innovation, introduction of alternate channels, distribution, customer services, and a better array of services at competitive prices has been provided by foreign players' entry (Srivastava and Tripathi, 2012; Rao, 2005; Dubey, 2005; Bajpai, 2006; Pamecha and Chhajer, 2013).
- Life insurance business has also experienced some gains.

China

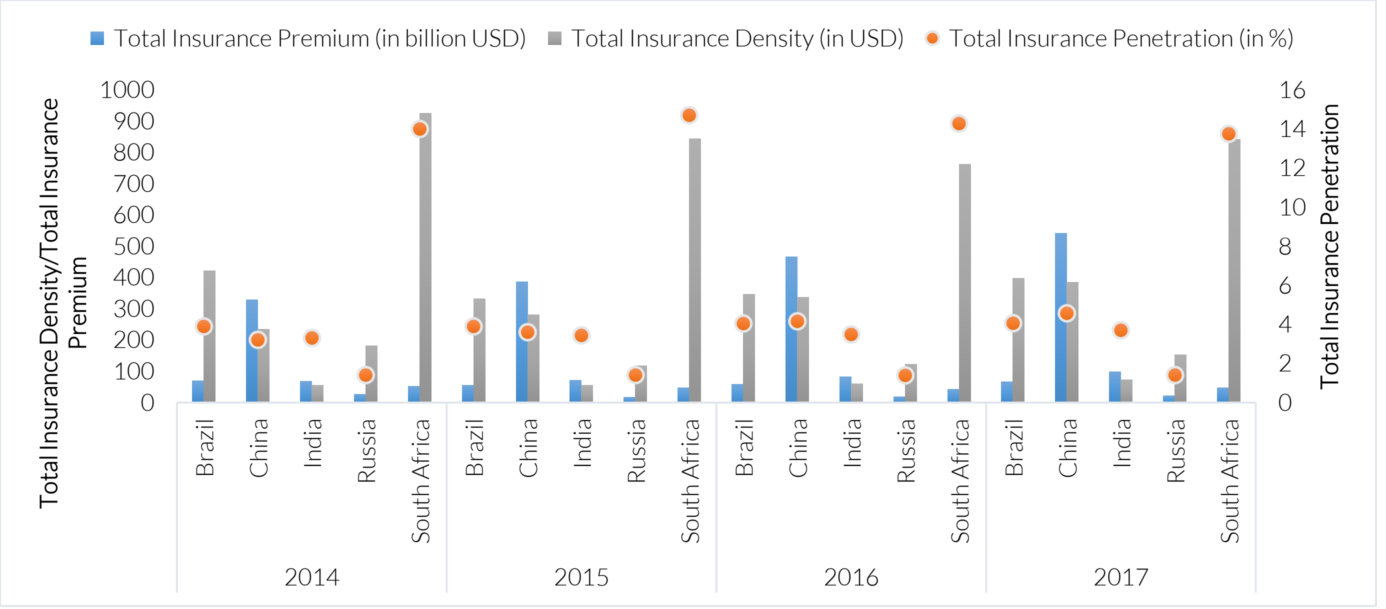
- Opening up of the Chinese economy has brought strong growth for the insurance sector with the premium income experiencing an uptick.
- Average efficiency of domestic insurers improved after the WTO accession and foreign insurers are more likely to be represented in the "best-practice" frontier, positively influencing performance in the Chinese market (Leverty, Lin, and Zhou, 2009), and financial capital influx after liberalisation had significant positive impacts on firm operating efficiency (Lu, Wang, and Kweh, 2014).

South Africa

- Presence of foreign firms in domestic markets improves industry competitiveness and the the monopolistic tendencies of domestic insurers can be explained by the tight exchange controls and regulatory restrictions on foreign participation in the insurance markets (Alhassan and Biepke, 2017).
- Higher price competition, improved product offering and service quality, and product development have been attributed to the presence of foreign firms in the South African insurance market (Butterworth and Malherbe, 1999).

Source: Adapted from Ray et al., (2020c) and further compiled by authors' from various sources

Figure 2: Insurance Sector Key Trends – BRICS



Note: *Data for India pertains to the financial year.* **Source:** *OECD.Stat; Swiss Re; IRDAI (2019a)*

venture with one or more local partners. It also created a requirement that an "Indian Insurance Company" (one incorporated under the India Companies Act) be "Indian owned and controlled." (IMF, 2018a). Insurers only have permission to undertake activities that are incidental to or supplement the provision of insurance, which stymies their diversification agenda. Also, under Indian law a foreign firm can have a stake in only one domestic insurer in the same space. This provision reduces a foreign insurer's market share and also hinders its ability to raise capital and diversify operations. In India, there is also a ceiling on the maximum price any outgoing foreign shareholder can achieve for its shares in the joint venture thus limiting a profit on sale.

The Insurance Laws Amendment Act 2015 allowed foreign reinsurers to open branch offices in India. The act permitted foreign reinsurers to legally conduct insurance business in India without an Indian partner. However, foreign reinsurance companies must wait for the insurance regulator to provide guidance on minimum capital requirements, profit repatriation, and related issues.

Due to all these regulatory burdens, many foreign companies entering the Indian insurance market have faced significant difficulties in turning a profit in joint ventures in both the life insurance and non-life sectors. Moderate-to-heavy losses and slow premium growth have led several foreign joint ventures to exit the Indian life insurance market.

EASE OF DOING BUSINESS AND INSURANCE INDUSTRY

Reforms in financial sector, including insurance sector, can greatly improve the ease of doing business ranking. Via its role in the macroeconomic development of an economy, a strong and healthy insurance sector can facilitate growth of enterprises by improving the overall business climate. Countries have successfully improved their EODB ranking by simplifying their tax paying process with help of improved insurance sector policies.

Economy Profile-Brazil, Doing Business 2020 report points out that registering the employees in social integration program which is intended to identify workers with the social security system so that they may request unemployment insurance and, if needed, benefit from the unemployment guarantee fund, takes only one day and costs nothing. But there are other insurance sector areas where Brazil needs improvement. In the dealing with construction permits category, no party is required by law to obtain an insurance policy to cover possible structural flaws or problems in the building once it is in use.

In China, registering employees with the Social Welfare Insurance Center takes only one day and no cost, which considerably simplifies this mandatory procedure for starting business-owners. China also scores the highest possible score in the Liability and insurance regimes index, a component of the construction permit indicator, as per China's economy profile, World Bank Doing Business 2020.

Introduction of decennial liability and insurance has made better building quality control and has positively impacted the parameter of 'Dealing with Construction Permits' as per Economy Profile-India, Doing Business 2019 report. As per the mentioned report, process of obtaining a construction permit in India has been made faster and less expensive by streamlining the associated process.

Paying taxes has been made easier by introducing an electronic system for paying employee state insurance contributions. India's rank in the parameter of "Enforcing Contracts" is still low due to high associated cost. Recovery times and recovery rates of creditors in terms of resolving insolvency are poor. India can vastly improve its ease of doing business performance by giving greater attention to insurance segments such as title insurance and unemployment insurance.

South Africa needs to improve its insurance game. According to the Doing Business 2020 Report, South Africa does not have any liability and insurance regime required for building permits. The Russian Liability and insurance regimes index scores poorly, because no party is required by law to obtain insurance, and hence does not contribute to its EODB rank. On the positive side, Russia does have a quite advanced unemployment benefit system and social security as per the Doing Business 2020 Report.

CONCLUSION

Although not as much explored as the interconnection between the insurance sector performance and economic growth of an economy, the relationship between the liberalization of insurance sector and performance of insurance sector is a crucial one. Given the global trend of international integration of insurance market and India's ongoing measures to opening up its insurance sector to increasing foreign participation, we have critically examined the impact of liberalization on the insurance sector. There is evidence that increasing foreign participation can benefit India's insurance sector by increasing capital inflow, higher competition, introduction of newer technologies and distribution channels. By analyzing the liberalisation experiences of BRICS insurance sectors' we find evidence of positive linkages between higher foreign participation and insurance sector performance. Last but not the least, insurance sector features significantly in the improvement of an economy's business environment which gets reflected in the EODB rankings of the World Bank.

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Note: For references please refer to the working paper

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