

Second Generation of Reform in Indian Insurance Industry: Prospects and Challenges

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Historical Background

- ➔ First life insurance company (Oriental Life Insurance Company) in India was established in the year 1818.
- ➔ First general insurance company (The Triton Insurance Company Ltd.) in India was established in the year 1850.
- ➔ As many sections of society are effected by the insurance services made available, it was monitored at the federal level since inception.
- ➔ Insurance Act, 1938 was a time tested legislation, which has addressed many important issues concerning the insurance business in India.

Historical Background – contd..

- ➔ 245 life insurers were nationalized in the year 1956 to setup "Life Insurance Corporation of India".
- ➔ 107 general (non-life) insurers were nationalized in the year 1972 to setup "General Insurance Corporation of India" and its 4 subsidiaries.
- ➔ Nationalization of insurance was opted on account of malpractices then prevailing and inability of some of the insurers to duly manage the policyholders' funds and also to spread the message of life and general insurance to every nook and corner of the country and to serve the needs of the economy in the best interests of the people.

Historical Background – contd..

- ➔ As a part of comprehensive reform process initiated in the year 1991, central government has setup a committee on reforms in insurance sector headed by Mr. R. N. Malhotra.
- ➔ The committee recommendations include setting up independent regulatory machinery and gradual opening of insurance sector for private/foreign participation.
- ➔ With the enactment of “Insurance Regulatory and Development Authority Act, 1999” private participation in the Indian insurance market was allowed though foreign equity in any insurance company being restricted to 26%.

Growth of Insurance Companies

	2001-02	2003-04	2007-08
Life Companies	12	14	18
Public	1	1	1
Private	11	13	17
Non-Life Companies	11	15	19
Public	5	7	7
Private	6	8	12

Growth of Life Insurance Premiums

Rs. Crores

Premium Figures	2001-02	2003-04	2006-07
Total	50094 *(43.54%)	66654 (19.56%)	156041 (47.38%)
Proportion of 1st Year premium	21.28%	20.78%	29.07%
Proportion of Single Premium	18.35%	8.90%	19.39%
* Growth rate during the year			

Insurance penetration (Premium as a % of GDP)

Year	Total Business	Life	Non-life
2000	2.32	1.77	0.55
2003	3.28	2.60	0.67
2006	4.80	4.10	0.60

Insurance density

(Premium per capita in US dollar)

Year	Total business	Life	Non-life
2000	9.9	7.6	2.3
2003	16.4	12.9	3.5
2006	38.4	33.2	5.2

Status of Life Insurance Industry

Rs. Crores

Description	2004-05	2005-06	2006-07
Total policyholders' Investments	4,41,062	5,43,425 (23%)	6,08,773 (12%)
Available Solvency Margin	23,502	29,776	40,494
Solvency Ratio	125%	134%	154%

Status of Non-Life Insurance Industry

Rs. Crores

Description	2004-05	2005-06	2006-07
Gross Premium	17,481	20,360 (16%)	24,905 (22%)
Total Investments	42,805	59,431 (39%)	60,880 (2%)
Available Solvency Margin	7,676	9,458	12,674
Solvency Ratio	206%	205%	252%

Performance Indicators Non-Life Industry

➔ Loss Ratio = $\frac{\text{Net Incurred Claims}}{\text{Net Earned Premium}}$

➔ Expense Ratio = $\frac{\text{Expenses of Management}}{\text{Net Earned Premium}}$

➔ Operating Ratio =

$\frac{\text{Net Incurred Claims} + \text{Expenses of Management}}{\text{Net Earned Premium} + \text{Investment Income}}$

Status of Non-Life Insurance Industry – contd..

Description	2004-05	2005-06	2006-07
Loss Ratio	82.41%	88.39%	81.27%
Expense Ratio	38.85%	39.96%	34.66%
Operating Ratio	88.50%	90.70%	84.02%

International Comparison of Business Mix Non-Life Insurance Industry

Country	Motor	Fire	Liability	Others
CANADA	48%	30%	14%	8%
UK	32%	42%	10%	16%
AUSTRALIA	37%	27%	19%	17%
INDIA	48%	14%	1%	37%*

* Includes Health Insurance of nearly 15%

Special features of Insurance

- ➔ Insurance vs Rest Financial Sector.
- ➔ Breakeven point – Capital Requirement.
- ➔ Separate Shareholders' Account & Policyholders' Account.
- ➔ Presence of Participating and Non-Participating products.

Financial Soundness Indicators for Life Insurance Industry

- ➔ $(\text{Capital} + \text{Reserves} + \text{Surplus}) / \text{Policy Reserves}$: Indicates the capital adequacy.
- ➔ $\text{Equities} / \text{Investments}$: Indicates market risk.
- ➔ $\text{Operating Expenses} / \text{Gross Premium}$: Indicates operational efficiency and hence operational risk.
- ➔ $\text{Investment Income} / \text{Investments}$: Indicates earnings and efficiency of investment management and hence investment risk.
- ➔ $\text{Outstanding Claims} / \text{Cash and Bank Balance}$: Indicates liquidity and hence liquidity risk.

Financial Soundness Indicators for Life Insurance Industry

Indicator	2004-05	2005-06	2006-07
(Capital + Reserves+ Surplus) / Policy Reserves	1.15%	1.32%	1.67%
Equities / Total Non Linked Investments	14.40%	19.79%	17.67%
Equities / Total Linked Investments	28.85%	55.37%	53.14%
Operating Expenses to Gross Premium	10.22%	9.08%	8.72%
Total Investment Income / Total Investments	9.05%	8.05%	7.55%
Outstanding Claims / Cash and Bank Balance	5.04%	4.01%	4.86%

Financial Soundness Indicators Non-Life Insurance Industry

- ➔ $(\text{Capital} + \text{Reserves} + \text{Surplus}) / \text{Assets}$: Indicates the adequacy of assets and hence asset risk.
- ➔ $\text{IBNR} / \text{Technical Reserves}$: Indicates Sufficiency.
- ➔ $\text{Operating Expenses} / \text{Gross Premium}$: Indicates operational efficiency and hence operational risk.
- ➔ $\text{Investment Income} / \text{Net Premium}$: Indicates earnings and efficiency of investment management and hence investment risk.
- ➔ $\text{Current Assets} / \text{Current Liabilities}$: Indicates sufficiency of liquidity and hence liquidity risk.

Financial Soundness Indicators for Non-Life Insurance Industry

Indicator	2004-05	2005-06	2006-07
(Capital + Reserves+ Surplus) / Total Assets	19%	16%	19%
IBNR / Total Technical Reserves	7.69%	9.38%	8.33%
Operating Expenses to Gross Premium	24.83%	24.93%	21.32%
Investment Income / Net Premium	7.69%	9.38%	8.33%
Current Assets / Current Liabilities	55.03%	59.82%	61.35%

Year 2000 – So far

- ➔ Policyholders Protection Regulation.
- ➔ Grievances Redressal Mechanism and Introduction of Ombudsmen.
- ➔ Requirement of minimum percentage of business from rural and social sectors to enhance the availability of insurance cover to nook and corner of the country.
- ➔ Introduction of Micro-insurance products to cater the needs of rural populace.

Year 2000 – So far contd..

- ➔ Introduction of new distribution channels viz., brokers, corporate agents, micro insurance agents.
- ➔ Introduction of mandatory training for the insurance intermediaries.
- ➔ Comprehensive set of regulations for the range of Intermediaries.
- ➔ Encouraging health insurance and introduction of Third Party Administrators (TPA).

Year 2000 – So far contd..

- ➔ Constituting Insurance Advisory Committee and revival of life and general insurance councils to promote transparency and fairness in the conduct of insurance business and emphasize the need for self regulation.
- ➔ Promoting professional training facilities by way of setting up Institute of Insurance and Risk Management and Indian Institute of Insurance Surveyors and Loss assessors.
- ➔ Moderating investment regulations.

Year 2000 – So far contd..

- ➔ Introduction of new types of products viz., unit linked, reviewable annuity, innovative critical illness covers etc.
- ➔ Dismantling of tariffs in non-life insurance business and strong growth in retail non-life insurance business.
- ➔ Introduction of more prudent solvency regime.

Year 2000 – So far contd..

Guidelines to address issues specifically related to “Unit linked insurance products (ULIP)” with effect from July, 2006.

- ➔ To ensure fair insurance coverage.
- ➔ To preserve the long term nature of the life insurance products.
- ➔ To facilitate informed decision.

Agenda for the future

Position of observance – Insurance Core Principles

Group	No. of Principles	Observed	Largely Observed	Partly Observed
I Conditions for Effective Insurance Supervision	1		1	
II The Supervisory System	4	0	4	
III The Supervised Entity	5	1	2	2
IV On-going Supervision	7		3	4
V Prudential Requirements	6	2	1	3
VI Markets and Consumers	4	2	1	1
VII AML, Combating and Financing of Terrorism	1		1	
Total	28	5	13	10

Future Prospects

- ➔ One of the fastest growing and largest economy provides a range of opportunities to improve the scope of insurance business.
- ➔ Rising demand from burgeoning middle class which is currently around 300 million.
- ➔ Favorable demographic profile of the population with low average age of the working population.

Insurance penetration – International comparison

(Premium as a % of GDP)

Market	2004	2005	2006
World	7.99	7.52	7.50
Asia	7.37	6.83	6.60
India	3.17	3.14	4.80

Issues we have today

- In rural areas though low insurance penetration provides an opportunity but low literacy and income levels requires customized solutions.
- In rural areas we have high proportion of work force in unorganized sector.
- Distribution costs increase considerably in the rural areas thereby causing product costs to increase. New cost effective distribution channels need to be identified.

Issues we have today - contd..

- Improving the acceptability of product range to cater the needs of middle class population viz., retail health insurance, mortgage cover, liability insurance, reverse mortgage etc.
- Service standards need to be further improved to meet the growing expectation for the same.
- There should be a trade off between the distribution costs and the product complexity by identifying cost effective way of distributing the insurance products.

Issues we have today - contd..

- ➔ Introduction of defined contributory schemes by central and most of the state governments and corporate entities indicates large annuity market in the near future. Product range to cater the needs of this section needs special focus.
- ➔ Non availability of long term care products and institutionalization of such care services requires attention with the increasing senior citizen population and changing socio-cultural attitudes of the people.
- ➔ Facilitating portability of health insurance products from one insurer to the other.

Issues we have today - contd..

- ➔ Increasing overlap in the operations of various financial institutions to be closely monitored along with other financial sector regulators.
- ➔ Improving information dissemination system by various entities involved there by improving transparency and market conduct.
- ➔ Increasing necessity of more risk focused and market consistent approach to align the reporting standards with that of IFRS and IASB.
- ➔ Facilitating third party rating of insurance companies.

Issues we have today - contd..

- ➔ Mismatch of assets of liabilities and assets of insurers due to non-availability of long term assets, particularly in case of annuity and other long term products.
- ➔ Asset-Liability management risk is more pronounced due to inability to hedge the risks because of the non-availability of mature derivative market.
- ➔ Low persistency levels observed need special focus in order to improve the operational efficiency of the insurance sector.

Issues we have today - contd..

- ➔ Alignment of regulation & Supervision across sectors - Relationship with other supervisors.
- ➔ To be aware of technological development & associated risks.
- ➔ Supervision of economically significant entities ("too-big-to-fail").
- ➔ Shift towards solvency oriented approach
 - Risk-based supervision
 - Pre-emptive instead of reactive regulation.

Second Generation of Reforms

- ➔ Improve insurance awareness and reach by way of promoting new cost effective distribution channels.
- ➔ Identifying more and more Non-Government Organizations, Self Help Groups, and Micro-Finance Institutions to be included as Micro-insurance agents to cater the needs of rural people.
- ➔ Monitor various causes leading to the grievances of policyholders' and take all possible steps to contain them.

Second Generation of Reforms – contd...

- ➔ Promoting insurers to offer range of policy servicing options through innovative and cost effective tools.
- ➔ Classification and separate qualifications need to be considered for intermediaries to distribute special types of products like health insurance, annuities, long term care etc.
- ➔ Facilitating the industry wide data repositories in respect of various risks to enable insurers to appropriately price the respective products.

Second Generation of Reforms – contd...

- ➔ Promoting Tele marketing and Internet based marketing of insurance products need to be encouraged.
- ➔ Encourage fair pricing of insurance products by having an appropriate incentive structure.
- ➔ Risk-focused, forward-looking approach: prompt & effective response to high-priority issues.
- ➔ Encouraging industry/professional bodies to formulate norms for arriving at the Embedded Value (EV) of the insurance companies.

Second Generation of Reforms – contd...

Ensuring insurers adhere to Treating Customers Fairly (TCF) norms to ensure –

- ➔ Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.
- ➔ Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.
- ➔ Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.

Second Generation of Reforms – contd...

TCF would also ensure –

- Where consumers receive advice, the advice is suitable and takes account of their circumstances.
- Consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard and as they have been led to expect.
- Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

Second Generation of Reforms – contd...

- ➔ Encourage research in the area of developments in mortality and morbidity of Indian population, due to medical advancements, to facilitate more appropriate pricing of insurance products.
- ➔ Facilitate the development of machinery to handle the payment of annuities as with the introduction of Defined Contribution pension schemes by many governments would cause the transactions in this area to increase both in number and amounts involved.

Second Generation of Reforms – contd...

- ➔ Encourage insurance industry to offer basic or simplified products also, particularly health insurance products, which would allow portability between various insurance companies.
- ➔ Encourage industry entities like life insurance council and general insurance council to take active part in improving market conduct and service standards and placing greater emphasis on incentives for the insurers efforts in this direction.

Second Generation of Reforms – contd...

- ➔ Optimal combination of rules-based and principles – based approaches of regulating the industry.
- ➔ Promoting Corporate governance in the industry which recognizes and protects rights of all interested parties.
- ➔ Developing separate set of regulations for reinsurance companies and to encourage health and reinsurance market in India.

Second Generation of Reforms – contd...

- ➔ Facilitate securitization of insurance products enabling the availability of additional capital to insurance companies.
- ➔ Priority of financial reforms over financial liberalization.
- ➔ Ensuring sufficient flexibility in the regulatory framework to sequence market opening.

Second Generation of Reforms – contd...

To put in place Prompt Corrective Action Framework:

- An effective tool to maintain stability in the financial sector and an essential part of effective supervision and enforcement system.
- Relates to consequences of poor underwriting, premium inadequacy, inefficient administration, improper risk management and weak corporate governance system.
- Developed in banking system – yet to be applied in insurance.
- Establishment of standards such as based on certain critical ratios, for example, solvency ratio to assess the situation against which corrective action should be taken.
- Action may be divided into structural and discretionary and may include penalties, submission of business improvement plan, written directions, agreements, cease and desist order etc.

Challenges for Insurance Supervision

- ➔ Rapid consolidation (Mergers & Acquisition).
- ➔ Formation of more strategic alliances.
- ➔ Emergence of changing business models & new service providers.
- ➔ Development of new & innovative products & alternative distribution channels.

These have implications on

- ➔ Solvency requirements.
- ➔ Stronger incentives for insurers to restrain competition.
- ➔ Potentially higher incidences of unhealthy market practices.

THANK YOU