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# Role of Foreign Direct Investment in Insurance Sector with Perspective in India

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***Abstract:*** *India is a developing economy and there is need of Foreign Direct Investment. In this paper, we have estimated the amount of capital flows into the sector through Foreign Direct Investment. The Insurance sector in India has undergone transformational change over the last decade. In the Union Budget 2014-15 the UPA Government amended the stake from 26% to 49%. The insurance sector is hampering investments and growth within the industry, it will affect the ability of companies to offer a better and wider range of products at Competitive prices. The paper objectives are to investigate and review announced insurance policy and regulation with a viewpoint of foreign investors to gain an understanding of the current position on FDI as well as an overview of the Indian policy and regulatory environment. The LPG policy creates an environment for the generation of Long term contractual funds for infrastructural investments.*

***Keywords:*** *Insurance sector, Foreign direct investment, Indian policy*

## Introduction:

The insurance sector is of considerable importance to every developing economy; it inculcates the savings habit, which in turn generates long-term investible funds for infrastructure building There is hardly a facet of the Indian psyche that the concept of 'foreign' has not permeated. This term, connoting modernization, international brands and acquisitions by MNCs in popular imagination, has acquired renewed significance after the reforms initiated by the Indian Government in 1991 (Mishra & Bhatnagar, 2009). As per guidelines issues by the Government of India the insurance sector also opened for foreign investors. After increasing the FDI cap, the Indian Cabinet Committee on Economic Affairs (CCEA) is strongly expected to raise the FDI ceiling in the Insurance sectors in India. Raised FDI threshold to 49% in the Insurance sector from the existing limit of 26%, has been approved in the Union Cabinet 2014-15.

Insurance is one of the significant economic sectors of the country, which at present has extensive scope for expansion and development, to be at par with the insurance sectors in developed countries of the world. Progressing fast with an average yearly growth rate of over 30%, the current worth of Indian insurance industry is about $41 billion. Based on these statistical facts, the insurance industry of India has been ranked as the fifth largest and booming insurance market in the whole world. At present, merely two million Indians are covered under any insurance schemes like Mediclaim, which is just 0.2% of the total Indian population of one billion. In developed countries like USA, this percentage is about 75%. Hence, there is vast scope for development and refinement in the insurance sector of India in future times.

But, at present, only about 50 life insurance and general insurance companies are active in the insurance sector of India. For such purposes, the Insurance Regulatory and Development Authority (IRDA) of India requires a capital infusion amounting to over US $12 billion in the next five years, by domestic and foreign insurance companies.

To understand what FDI in insurance means, one must know what FDI actually means, what happens when a country's sector accepts investments from another country.

Foreign direct investment (FDI) is a direct investment into production or business in a country by an individual or company of another country, either by buying a company in the target country or by expanding operations of an existing business in that country.

Notwithstanding the global nature of FDI, it is (UNCTAD), FDI inflows during the year 2011 undoubtedly the urgent need of developing countries increased across all major economic groupings viz. developed, developing and especially the present–day India which is economically transitional economies; in the year 2012, challenged. It has 4.7% GDP growth (2013-14), 3% there was a steep fall in the developed world, a urban unemployment (2013, NSSO method), around small decline in the developing countries but a huge rise 10% inflation (2013) and 1.7% current account deficit in the structurally weak economies. However, in the year 2013, FDI (2013).To attract FDI, India had earlier tried different routes e.g. investment sought through tax incentives in backward areas ,public private partnerships and through establishing Special Economic Zones. It had even allowed 100% FDI in many sectors during the year 2000. However, the FDI inflow in India exhibits a chequered history. Since 2000, there was an increase in the FDI inflows which reached $ 9 billion in the year 2006. it further increased to a record high of $ 46.9 billion in the recently faced; the developed world even fears its fiscal year 2011-12; it however dropped to $ 36.9 billion the year 2012-13.

## Objectives of the study:

1. The present paper aims to study the pattern of FDI in Insurance Sector and the Government regulation in the said sector.
2. The paper studies current trend in Insurance sector, the challenges and the prospects
3. To know issues in FDI in Insurance sector.

## Methodology of the study:

The present study is purely depending upon secondary data which is procured from books, journals, magazines, newspapers and WebPages.

## Overview of Insurance Sector in India

### History of Insurance

A contract of insurance may be defined as a contract whereby, one person, called the ‘insurer’, undertakes, in return for the agreed consideration, called the ‘premium’ to pay to another person, called ‘assured’, a sum of money or its equivalent on the happening of a specified event. The aim of all insurance is to make provisions against dangers which beset human life and dealings. Those who seek it endeavor to avert disasters from themselves by shifting possible losses on the shoulders of others who are willing for pecuniary consideration, to take risk thereof, and in the case of life assurance, theyendeavor to assure to those dependent on them a certain provision in case of their death, or to provide a fund out of which their creditors can be satisfied.

### The British Period

1818 saw the advent of life insurance business in India with the establishment of the oriental life insurance company in Calcutta. In 1938, with a view to protecting the interest of the insurance public, the earlier legislation was consolidated and amended by the insurance act, 1938 with comprehensive provisions for effective control over the activities of insurers.

### The Nationalized Period

The insurance amendment act of 1950 abolished principal agencies. However, there were a large number of insurance companies and the level of competition was high. There were also allegations of unfair trade practices. The government of India, therefore, decided to nationalize insurance business. In nationalized era an ordinance passed on 19th January, 1956 nationalizing the life insurance sector and Life Insurance Corporation came into existence in the same year. LIC absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies-245 Indian and foreign insurers in all. The LIC had monopoly till the late 90s when the insurance sector was The Business & Management Review, Volume 5 Number 4 January 2015 International Conference on Issues in Emerging Economies (ICIEE), 29-30th January 2015 33 reopened to the private sector. Due to new liberalization, privatization and globalization, the insurance sector was reopened to the private sector.

### The Liberalized Period

The insurance regulatory and Development Authority was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA opened up the market in august 2000 with the invitation for application for registrations. The bill allows foreign equity stake in domestic private insurance companies to maximum of 26% of the total paid-up capital and seeks to provide statutory status to the insurance regulator. Foreign companies were allowed ownership of up to 26%. In December, 2000, the subsidiaries of the general insurance corporation of India were restructured as independent companies and at the same time GIC was converted into a national reinsurer. Parliament passed a bill de-linking the four subsidiaries from GIC in July, 2002.

Today there are a number of private sector insurance companies. The table below shows the breakup of insurance companies:- Number of insurance companies in India.

| Types of Business | No. of Public Sector Companies | No. of Private Sector | Total companies |
|---|---|---|---|
| Life Insurance | 01 | 23 | 24 |
| General Insurance | 06 | 22 | 28 |
| Re-insurance | 01 | 0 | 01 |
| Total | 08 | 45 | 53 |

**Source:** Insurance Regulatory & Development Authority Official Website www.irda.org

**Government Policy regarding Insurance Sector in India**

While presentation the Union Budget for 2013-14, the Finance Minister announce as follows: " In order to remove the ambiguity that prevails on what is Foreign Direct Investment and what is Foreign Institutional Investment, I propose to follow the international practice and lay down a broad principle that where an investor has a stake of 10% or less in a company, it will be treated as FDI. A committee will be constituted a to examine the application of the principle and to work out the details expeditiously" Pursuant to the announcement, a committee was constituted by Government of India under the chairmanship of Dr. Arvind Mayaram, Secretary DEA, Ministry of finance and recommended that-

1. Foreign investment of 10% or more through eligible instruments made in an Indian listed company would be treated as FDI. All existing foreign investments below threshold limit made under the FDI route shall however, continue to be treated as FDI.

2. An investor may be allowed to invest below the 10% threshold and this can be treated as FDI subject to condition that the FDI stake is raised to 10% or beyond within one year from the date of the first purchase. The obligation to do so will fall on the company. If the stake is not raised to 10% or above, then the investment shall be treated as portfolio investment.

3. In case an existing FDI falls to a level below 10%, it can continue to be treated as FDI without an obligation to restore it to 10% or more, as the original investment was an FDI.

4. In a particular company, an investor can hold the investments either under the FDI route or under the FII route, but not both. Insurance being integral part of the financial sector plays a significant role in India's economy. Apart from protecting against mortality, property and casualty risks and providing a safety net for individuals and enterprises in urban and rural areas, the insurance sector encourages saving and provides long-term funds for infrastructure development and other long gestation projects of the nation. The development of the insurance sector in India is necessary to support its continued economic transformation.

This millennium has seen insurance come a full circle in a journey extending to nearly 200 years. The process or re-opening of the sector had begun in the early1990s and the last decade and more has seen it been opened up substantially. In 1993, the government set up a committee under the chairmanship of R.N.Malhotra, former governor of RBI, to propose recommendations for reforms in the insurance sector. The objectives were to complement the reforms initiated in the financial sector. The committee submitted its report in 1994wherein, among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies are allowed to enter by floating Indian companies, preferably a joint venture with Indian partners.

The IRDA opened up the market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26%. The Authority has the power to frame regulation under section 114-A of the Insurance Act, 1938 and has from 2000 onwards framed various regulations protection of policyholders interests. Today there are 28 general insurance companies (Non-life) including the Export Credit Guarantee Corporation (ECGC) and Agriculture Insurance Corporation of India, 24 life insurance companies that have set up operations in the life segment post opening up of the sector 20 are in joint venture with foreign partners. Of the twenty two private insurers who have commenced operations in the non-life segments, 18 are in collaboration with foreign partners.

According to the Annual Report of the IRDA, 9 out of the 12 private companies in life insurance suffered losses in 2002-03. The aggregate loss of the private life insurers amounted to Rs. 38633 lakhs in contrast to the 2 Rs.9620 crores surplus (after tax) earned by the LIC. In general insurance, 4 out of the 8 private insurers suffered losses in 2002-03, with the Reliance, a company with no foreign equity, emerging as the most profitable player. In fact the 6 private players with foreign equity made an aggregate loss of Rs. 294 lakhs. On the other hand the public sector insurers in general insurance made aggregate after tax profits of Rs. 62570 lakhs. Not only are the public sector insurance companies more profitable than the private ones, the private insurer which is most profitable (Reliance) is one which has no foreign equity. If profitability is taken to be an important indicator of efficiency, it is clear that the case for further hike in the FDI cap in the insurance sector cannot be made on efficiency grounds

### The State of India's Insurance Industry

The Indian insurance industry seems to be in a state of flux.After a decade of strong growth, the Indian insurance industry is currently facing severe headwinds owing to reasons like:

- ✓ Slowing Growth
- ✓ Rising Costs
- ✓ Reforms being stalled
- ✓ Worsening distribution structure

### IRDAAnnual Report 2010-11:

To understand this better, let us have a look into IRDA's (Insurance Regulatory and Development Authority) report on Indian Insurance Industry landscape for the 10 year period between 2010 and 2010

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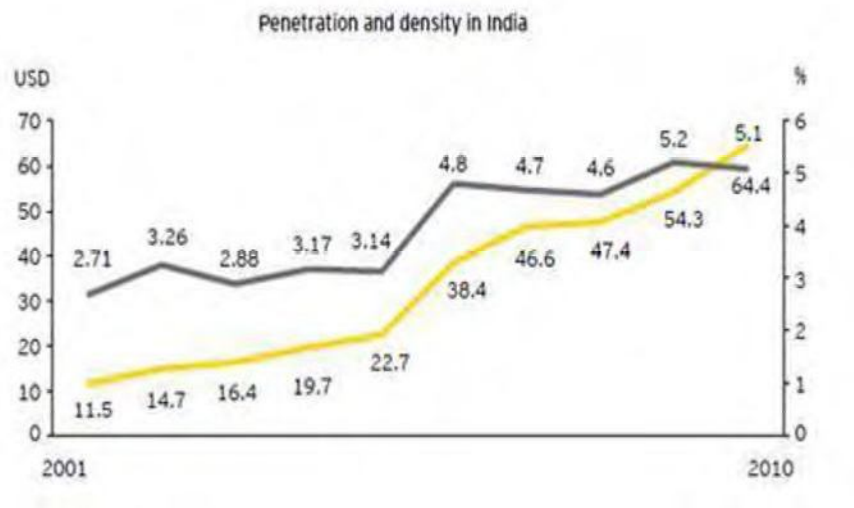


Despite strong improvement in penetration and density in the last 10 years, India largely remains an underpenetrated market. The market today is primarily dependent on push, tax incentives and mandatory buying for sales.

**The Indian Government Plan to Revive The Industry**

The proposal to raise FDI cap has been pending since 2008 when the UPA Government came up with Insurance Laws (Amendment) Bill to hike foreign holding in insurance joint ventures to 49 per cent from the existing 26 per cent.

**At a glance:**

| | No. of Companies | Profitable Companies |
|---|---|---|
| **Life Insurers** | 24 | 17 |
| Public Companies | 1 | 1 |
| Private Companies | 23 | 16 |
| **Non-Life Insurers** | 21 | 13 |
| Public Companies | 4 | 4 |
| Private Companies | 17 | 9 |

**FDI received in 2012-13**

**Life Insurers 6045.9 crs**

**Non-life Insurers 1586.6 crs**

Source :IRDA Annual Report 2014

**Benefits of increased FDI in insurance sector:**

1.Insurance products: Private as well as government insurers will benefit from the proposed hike of FDI; these companies will offer better and wide range of insurance products to customers at larger competitive prices.

2.Smaller Companies: FDI will help smaller insurance companies to break-even faster and help monetize (convert into currency) the holdings of the promoters of the older life insurance companies.

3.Capital inflow: Immediate capital inflows of $2 billion and long term inflows of about $10 billion can be expected.

4.Technology: Insurers will not just get capital but also technology and product expertise of the foreign partner who is the domain expert.

6.New Players: We can expect about 100 life and non-life insurance companies to serve a market of our size. Increasing FDI could see 25-30 new insurers entering the market.

7.Penetration: With the population of more than 100 crores, India requires Insurance more than any other nation. However, the insurance penetration in the country is only around 3 percent of our gross domestic product. Increased FDI limit will strengthen the existing companies and will also allow the new players to come in, thereby enabling more people to buy life cover

8.Employment: With more money coming in, the insurance companies will be able to create more jobs to meet their targets of venturing into under insured markets through improved infrastructure, better operations and more manpower.

9.Increased Capital Inflow – Most of the private sector insurance companies have been making considerable losses. The increased FDI limit has brought some much needed relief to these firms as the inflow of more than 10,000 crore is expected in the near term.This could go up to 40,000 crore in the medium to long term, depending on how things pan out.

11.Favorable to the Pension Sector –If the pension bill is passed in the parliament then the foreign direct investment in the pension funds will also be raised to 49 percent. This is because the Pension Fund Regulatory Development Bill links the FDI limit in the pension sector to the insurance sector.

12.Consumer Friendly – The end beneficiary of this amendment will be common men. With more players in this sector, there is bound to be stringent competition leading to competitive quotes, improved services and better claim settlement ratio

**Conclusion**:

There are always pros and cons of each decision, FDI will increase competition and basis economics would suggest that when the supply increases as compared to demand the prices will come down, thus benefiting the end customers. The insurance sector in India is still under developed as compared to developed countries, and despite private players now allowed to enter this sector, we only have a small number of providers. FDI would increase the number of insurance companies and may also make possible better plans at lower prices. But careful consideration is required to ensure that the investment stays for long term and does not get withdrawn, leaving the companies and their domestic customers in a miserable position, and not all profits are moved outside the country but some reinvested or spent in our country. Regulations need to be revisited to ensure that Insurance Companies are subject to relevant and strict

**Future perfect**:

Increasing the FDI ceiling will make the Indian Insurance sector more vibrant and dynamic in the intermediate and long term. Increased competition coupled with wider variety of products will result into a healthy Industry. Insurance companies and other players have to gear-up and plan now to reap the future benefits

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