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Analysis of new Dimensions of Insurance Sector in Post Liberalization

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Abstract

Since its inception in 2001, insurance industry has come a long way in India. It has undergone perceptible structural changes. More than 40 private players are interesting for space in the insurance market of India, once dominated by LIC and GIC. This has not only generated options for the common people, but has also provided them a valuable tool of investment. Since last four years the growth of the industry has been averaging around 15%. In the first year it was 100% but now it has gradually came down to 15%. On an average it is around 10% to 15% per annum. The life insurance industry has led the growth in the insurance sector. There the growth is mainly due to unit linked products which are very closely related to mutual funds product. They are looked upon as investment returns. So, they involve a very small element of risk coverage. Perhaps that is the reason they have picked up fast. In this paper, an attempt is made to analyze the new dimensions of insurance industry in post liberalization and deregulation like raising of foreign direct limit, micro insurance in rural market, bank assurance, reinsurance and (ATR) i.e. Alternate Risk Transfer.

Key words: *insurance industry, opportunities, personalized business*

Introduction

Since its inception in 2001, insurance industry has come a long way in India. It has undergone perceptible structural changes. More than 40 private players are giving importance for space in the insurance market of India, once dominated by LIC and GIC. This has not only generated options for the common people, but has also provided them a viable tool of investment.

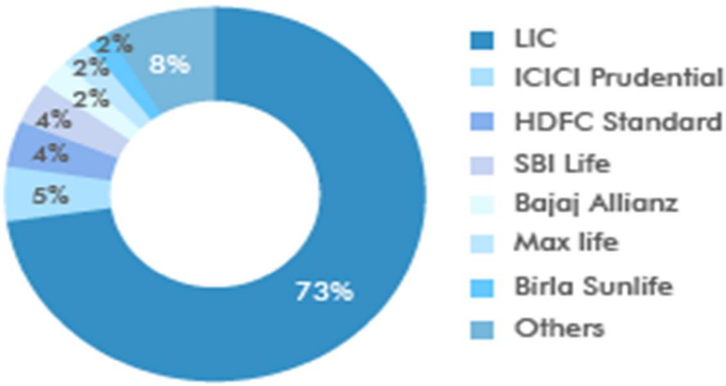
Insurance Regulatory and Development Authority (IRDA)

Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000. The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market. IRDA is the major body providing better opportunities for private players in India.

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 regulations under Section 114A of the Insurance Act, 1938 and has from 2000 onwards framed various regulations ranging from registration of companies for carrying on insurance business to protection of policyholders' interests.

Today there are 28 general insurance companies including the ECGC and Agriculture Insurance Corporation of India and 24 life insurance companies operating in the country.

Market Share of Various Companies in terms of premium collected



Emerging Trends in Insurance Industry in terms of product innovations

Several private players have ventured into the insurance industry especially for the last four years and the growth of the industry has been averaging around 15%.. In the first year it was 100% but now it has gradually tapered down to 15%. On an average it is around 10% to 15% per annum. The life insurance industry has led the growth in the insurance sector. There the growth is mainly due to unit linked products which are very akin to mutual funds product. They are looked upon as investment returns. So, they involve a very small element of risk coverage. Perhaps that is the reason they have picked up fast.

In General insurance growth has come in the form of personalized business like health insurance and the motor insurance. More innovations have come in segments like overseas travel insurance policies. The procedures have been simplified. Similarly in health several products have come up and many modifications have been introduced. Some companies have packaged some of the policies and they are giving extended coverage.

Insurance Market after globalization

After 1970 besides LIC and GIC many MNCs have entered in to the same sector like Bajaj Allianz, ICICI Prudential, HDFC, sBI Life, Max Life, Birla sunlife and others. Insurance is acting now on two dimensions i.e the element of investment and the element of protection. The economic value addition has taken the concern of same business.

Marketing after globalization has become more customer oriented, better service oriented and of course more competitive.

After terrorist attack on World Trade Centre in the year 2000, the momentum of growth of world economy suffered some temporary setback. According to 3rd Annual Globalization Report of World Watch Institute, the growth rate fell shapely from 4% to 1.3% . But the world had become stabilized after that and the economic growth was setback with entry of so many MNCs and Insurances.

Triggered by sound fundamentals in global economy and internalization of world markets, several countries turned towards free market regimes in banking and insurance putting an end to several decade old state owned controlled markets. The insurance market in China and India is brighter. The leading reinsurance company like Swiss Re and Munich Re has projected 20-25% growth in health and life insurance market by 2015, particularly in countries like India and China.

New Dimensions of Insurance Industry after Liberalization

Need For Raising FDI Limit

Reforms in Insurance sector were started in India way back in 1993 as a part of overall financial reforms. The main idea was to make insurance industry vibrant and dynamic so that it can support the growth process leading to overall economic growth of the country in post liberalization era. At present the foreign direct investment in insurance sector is permitted up to 26 per cent of equity.

Higher amount of Foreign Direct Investment (FDI) in insurance sector would increase penetration of insurance in India as existing companies will try to expand their reach and new companies making entry into the market will work for their space in the market. Higher amount of FDI is likely to enrich the business by bringing world class business practices and process. Simultaneously it would help expand distribution capabilities. It is proposed therefore to raise FDI limit from existing 26% to 49%. This will help the insurance industry in the following ways. Higher FDI in insurance sector can give much needed capital for growth of insurance sector which in turn will help in the long term economic development.

1. Ambitious infrastructure projects of Government can get stable long term source of funds.
2. Higher amount of FDI in insurance would increase penetration of insurance in India which is low compared to global average.
3. An increase in FDI in insurance will benefit the economy as people will invest in long term fund which will increased the growth of economy.
4. Insurance in India is mainly confined to urban sector Vast potentials are lying untapped in rural India. For accessing into these areas new approach is necessary in the matter of product design, pricing and product delivery mechanism. As far as rural health is concerned there are many new entrants waiting for making entry into the market, considering huge potential. Private players may tap these potentials. Thus raising of FDI limit in insurance sector will strengthen the market and thus lead to the economic growth of the country.

Micro Insurance in Rural Market of India

World's poor are entrapped in a vicious cycle of poverty. The vicious cycle of low income - low savings low investments. To break this vicious cycle the Government of India (GOI) and Non Government Organizations (NGOS) have started the micro insurance schemes in India. The Indian rural market with its enormous size, demand base, variety, and divergent customs offers great opportunities to marketers.

With the rural population having increased to about 75% of the total population the demand for products and services has increased in rural areas but the supply and penetration is almost nonexistent. The insurance sector has not made much headway in the rural sector.

The insurance market in India was liberalized in the year 2000 but has not expanded much in real terms beyond the urban domains. It is a common belief amongst the insurance companies that it is expensive to do business in rural areas. There are many challenges in providing micro insurance to rural population since low income people are susceptible to risks. Commercial insurers have largely stayed away from the low income market mainly because of high cost and small premiums. In rural areas infrastructure is lacking and literacy levels are low.

The rural market is also characterized by inadequate and inappropriate services, inadequate information and communication gaps. These are the precise reasons for low demand for insurance in spite of strong need. Micro insurance may provide an innovative way to fight poverty and is different from insurance in general as it is a low value product. Micro insurance requires an intermediary between the customer and the insurance company. The intermediary could be a non Government Organization (NGOS) or micro finance institution (MFIS). In the micro insurance the target market is specified low income communities. Policies are classically sold to a cluster which pools together its risk and prepaid contributions. Premiums paid are normally small and paid frequently suiting the paying capacity of these communities.

Thus the rural poor who are low income people are protected against health risk (death, disability, illness, injury, hospitalization) and property risk (damage, loss of crop/ livestock, cattle, theft,) which take place due to natural calamities such as drought, flooding, tremor, devastating disease, death and widowhood.

Thus micro insurance is the use of insurance as an economic instrument at the 'micro' (i.e. smaller than national) level of society. It refers to providing cover for insurable risks of micro entrepreneurs, small and landless farmers, women and low income people through recognized, semiformal and informal institutions. India has a special Microinsurance Act that regulates the suppliers through its special agency for insurance regulation- the IRDA. Under this Act the insurance companies are obliged to conduct a certain percentage of their business in rural areas or with marginalised groups. Micro Finance has provided the institutional areas on which structure of micro insurance could be built in rural areas.

Schemes of Micro Insurance

1. The Personal Accident Insurance Scheme (PAIS) which is being provided along with the Kisan Credit Card (KCC) and Rashtriya Krishi Bima Yojana (RKBY) for insuring crops are the only risk mitigation mechanism available to rural households.
2. Many State Governments are offering Health Insurance facilities to the rural poor which have also generated considerable acceptance and awareness about insurance products in the rural areas.
3. In October 2004 the RBI permitted Regional Rural Banks (RRBs) to take on insurance business as a "Corporate agent". RRBs have several branches is

rural areas & they can play an important role.

4. In IRDA regulations have certain most innovative features in legally recognizing NGOS, MFIs (Micro Finance Institutions) and SHGs as "micro insurance agents". This has the potential of significantly increasing rural insurance dispersion.
5. A lot of commercial banks have united foreign insurance policies. Thus banking outlets and Co-operative societies could provide the needed outreach to provide micro insurance facilities without any further adding to business costs.
6. The GOI has also launched its new Social Security initiative - Aam Admi Bima Yojana (Common Person's Insurance Programme) for poor families that do not own agricultural land. It extends death and disability coverage to an estimated 15 million rural and landless households. Under this programmes the State and the Union governments are expected to bear the premium of Rs. 200 for every policy holder who is insured to the extent of Rs. 50,000 in case of natural death and 75,000 in case of an accident. A number of micro insurance schemes are state led. Many others are partnership between private insurance companies and microfinance institutions. In such a partnership the microfinance institutions assume the role of an agent and distributes the product of the insurance company to its clients. This helps the insurance company to reach difficult markets cheaply. The insurance company benefits from the trust relationship the local microfinance institution has established with the target population.

Reinsurance

The term 'reinsurance' stands for the practice whereby a reinsurer, in return of premium paid to it, indemnifies another insurer for a portion or all of the liability taken up by the latter due to a policy of insurance that it has issued. This latter party is called the 'reinsured'. Reinsurance is a type of risk management involving transfer of risk from insurer to reinsurer.

Merits of Reinsurance

1. Reinsurance safeguards capital and reinforces stability. In a highly volatile market it may sometimes be hard to correctly price new products because of inadequate information. Incorrect pricing could lead to unanticipated claims that the insurance company cannot meet. If there were not reinsurance the insurance company would have to settle these claims out of its own capital therefore reinsurance helps to protect the solvency of the insurance company.
2. Reinsurance enables the insurer to take up large claims and expand capacity. In India regulations restricts the insurer from risking more than 10 percent of its surplus on any one risk. Reinsurance provides the insurance with ability to cover large individual risks and guarantees timely settlement of the claim.
3. Reinsurance helps insurance company to upgrade itself and insurance company can benefit immensely by tying up with a successful reinsurer. The reinsurer can provide important underwriting training and skill development and

share expertise gained from other countries. Since the success ofÂ reinsurer is linked to the profits of the insurance company it is in the best interest of the reinsurer to measure that the company is sound. The reinsurer can also contribute to designing the product, pricing and marketing new products. It can also offer back office support such as faster claims processing and automation of operations.

4. The insurance buyers are now much more aware of the way the market works. Increasingly they are demanding high quality insurance products and are conscious of the fact that reinsurance is an important criterion to be considered while selecting an insurance policy.

Regulation regarding Reinsurance in India

Given the importance of reinsurance there are several guidelines laid down by Insurance Regulatory Development Authority of India (IRDA) to ensure fair play. Some of these are as follows.

1. Every insurer should retain risk proportionate to its financial strength and business volume.
2. Certain percentage of the sum assured on each policy by an insurance company is to be reinsured with the National Reinsurer. National reinsurer has been made compulsory only in the non life sector.
3. The reinsurance programme will begin at the start of each financial year and has to be submitted to the IRDA forty five days before the start of the financial year.
4. Insurers must place their reinsurance business, in excess of limits defined outside India with only those reinsurers who have a rating of at least BBB standard and Poor (S & P) for the preceding five years. This limit has been derived from India's own Sovereign rating, which currently stands at BBB.
5. Private life insurance companies cannot enter into reinsurance with their promoter company or its associates though the LIC can continue to reinsure its policies with GIC.

The objective of these regulations is to expand retention within India, ensure the best protection for the reinsurance costs incurred and simplify administration.

Bancassurance:

One of the more recent examples of financial diversification is 'bancassurance' the term given to the distribution of insurance products through branches or other distribution channels of banks.

In India the concept of bancassurance appears to be gaining ground quite rapidly both through commission based arrangements and joint ventures between banks and insurance companies. There are costs associated with setting up a successful bancassurance network. The proper training of bank personnel to understand the market insurance schemes is vital to the success of these ventures.

There is also a need to invest extensively in IT and other support systems that would provide an integrated backup for banking and insurance services. Regulatory issues need to be addressed comprehensively and sorted out particularly with respect to competition and market structure problems. Given these changes bancassurance and collaboration between banks and insurers has a long way to go in India.

Alternative risk transfer:

Despite the total transformation of Insurance sector after the liberalisation Indian insurance has been still behind in comparison with the world wide insurance development which has brought the convergence of insurance markets with money markets and capital markets. The service sectors like banking and insurance have adopted a new mechanism called Alternative Risk Transfer (ART) to meet the incidence of costly insurance losses which cannot be covered by the traditional insurance & reinsurance. Thus bankers and investors have adopted alternative risk transfer for their success and survival.

The earthquake, hurricane, Tsunami and other natural disasters and their ever increasing exposures have brought some revolution and breakthrough in the traditional or conventional insurance and reinsurance practices. The ART products are Insurance derivatives which involve transfer of property and casualty risk through the issuance of derivative instruments. Another is Insurance securitization which involves the process of transfer of property and casualty risks from one party (the issuer) to another party (the investors). The ART products have not found significant place in Indian insurance industries. At present Indian general insurers do not find any much difficulty for reinsurance for protection against large loss arising out of any single events.

With the increasing operations of MNCs in this sector and full-fledged operation of bancassurance by general insurance companies and introduction of credit insurance by state owned company like New India Assurance Company and prospects of agriculture insurance in India there will be need for more ART products in the near future. Further recent IRDA regulations on solvency margins for insurers and reinsurers rising market expectations for more efficient risk financing programmes development of Indian capital market and replacement of FERA by FEMA are all inducing factors for insurers, re-insurers, investors and bankers to make a proper use of essential ART products to transfer insurance risks from insurance market to capital markets.

Conclusion

India's economy is growing consistently. With the LPG move the Government is recognizing the need to improve infrastructure. Insurance industry has a major role to play in the economic development of the country as it plays a major role in providing long term funds for infrastructure development and at the same time strengthens the risk taking ability. Insurance industry has a great social significance. It is associated with disasters calamity etc. Insurance companies generate funds out of insurance premium collected and help in uplifting the economy. It also has potential of employment opportunities. It appears that Indian Insurance market after globalization has bright future. The economic status of people is changing. So many new Government policies and economic reforms are taking place in insurance sector. The charisma of economic growth is vast and never ending but the insurance as a bird has to fly. No doubt the Insurance market after globalization is a "flying bird"

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