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Impact of F.D.I. On Insurance sector in India - A case study of Life insurance services

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ABSTRACT

The study concluded that increase in foreign direct investment (F.D.I.) is optimistic move for the future of Indian Life Insurance Sector, since this sector need huge amount of capital investment which can be done effectively only through increase in FDI and it enhance overall performance of insurance sector. Innovative insurance product and services, better use of technology, increase in employment and competition etc. are by-product of increase in F.D.I in insurance Sector. Government of India through Insurance Regulatory and Development Authority of India (I.R.D.A.I.) and Reserve Bank of India (R.B.I.) need to keep regular check on the outflow of India currency. India is growing economy and many consider it an attractive country for investment in mainly to its fast growing and changing insurance market. Indian insurance industry is still less penetrated and has huge growth potential. Foreign direct investment (F.D.I.) plays significant role in the economic development of the country. This study is based on secondary data collected from I.R.D.A and research papers from various journals.

***Keywords*:** India; Foreign Investment; FDI; Life Insurance; Insurance Industry

1. INTRODUCTION

In the post liberalization period life insurance sector has started gaining new shapes with newer innovations. Big brands like Reliance, Birla, ICICI, Tata, HDFC, Aviva, ING

Vysya etc. have tied up with foreign insurance partners. Before privatization life insurance was only provided by the LIC of India. They have monopoly in life insurance sector. Even though the growth has been remarkable over years, yet the insurance penetration is pretty low. The life insurance average index shows that the number of policies sold is very low viz., 13.2 per 100 persons in India compared to the Asian counterparts' countries like Malaysia and Japan where it is 37.0 and 201.4 respectively. Even the life insurance premium as a percentage of Gross Domestic Product is very low too and which is expected in increase in coming years indicating a vast potential for all the life insurance players.

2. MEANING OF INSURANCE

There are countless risks in every field of life, it is something commonly accepted phenomenon. The chances of occurrences of the events causing losses are quite uncertain because these may or may not take place. Therefore, with this view in mind, people facing common risks come together and make their small contributions in the common fund. While it may not be possible to tell in advance, which person will suffer the losses, it is possible to work out how many persons on an average out of the group, may suffer losses. When risks occur, the loss is made good out of the common fund. In this way each and every one shares the risks. In fact, they share the loss by payment of premium, which is calculated on the likelihood of loss.

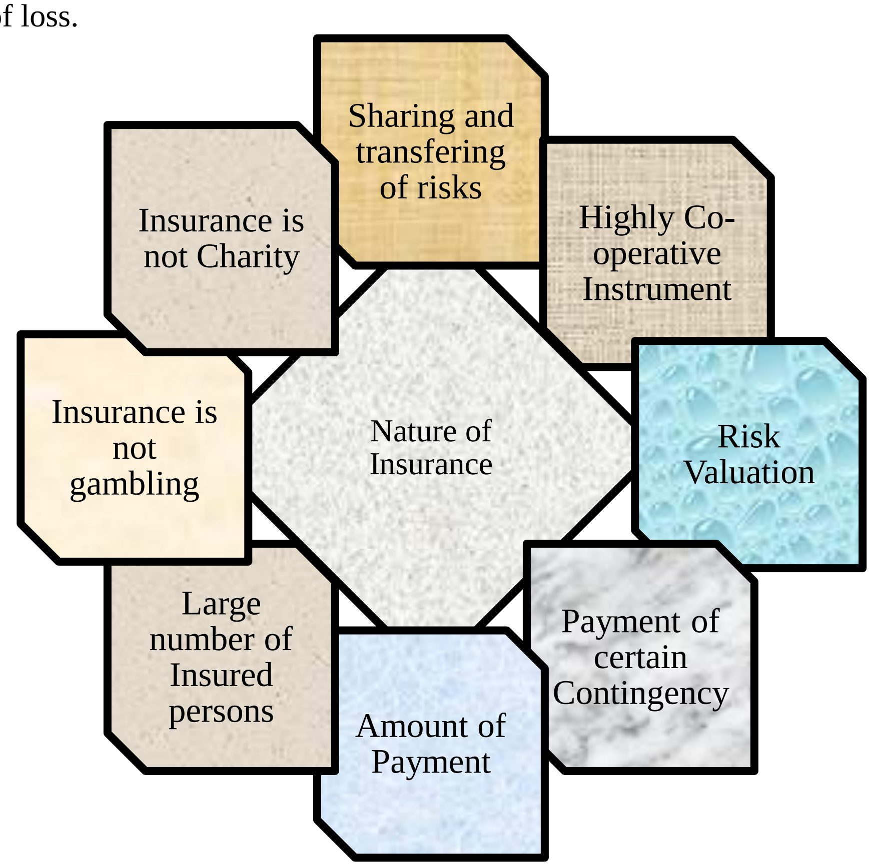

Fig. 1. Nature of Insurance

3. NATURE OF INSURANCE

1. Sharing and transfer of risk

Insurance is a financial instrument adopted to share the financial losses that might occur to an individual or his family on the happening of a specified event. The event may be death in case of life insurance, theft in case of *theft* and burglary *insurance and motor accident in case of motor insurance etc*. The losses occurring from these events if insured, are shared by all the insured in the form of premium. Hence, risk is carried out from one individual to group.

2. Highly co-operative instrument

One of the key features of any insurance plan is that highly co-operative instrument under which a group of persons who agree to share the financial loss agreed together. To compensate all the losses from his own capital is not possible any insurer. Insurer is able to pay the amount of loss by insuring a large number of persons. Since insurance plans are co-operative instruments, there is no compulsion here on any person to purchase the insurance policy.

3. Risk valuation

Evaluation of the risk is done before insuring to charge the amount of share of an insured, called as premium. Evaluation of risks can be done through several methods. Higher insurance premium may be charged, if there is expectation of higher risk. In this way the probability of loss is calculated at the time of insurance.

4. Payment at certain contingency

The amount of insurance is paid for the certain contingency. Payment is made whenever contingency occurred. The insurance contract can be life and non-life insurance contract. The life insurance contract is considered to be a contract, of certainty, as the contingency and the death or the expiry of insurance policies term, will definitely happen and the payment is certain. There are some types of life insurance policies in which payment is not certain due to uncertainty of a specific contingency within a specific period. For example in term insurance policies, the payment is made only when death of the insured person happened within the particular term or duration, may be one or two years. Likewise in pure endowment payment is made only at the survival of the insured at the maturity of the insured period. In other types of insurance contracts, the contingency can be the fire or the marine risks etc., which may or may not happen. Therefore, if the contingency happens, payment is made; otherwise no amount is given to the policy-holder.

5. Amount of payment

In case of non-life insurance the purpose is to make good the financial loss suffered. So amount of payment depends upon the value of loss suffered due to the specific insured risk only if insurance is there up to that amount. Whereas in life insurance, the purpose is not to make good the financial loss suffered. The insurer promises to pay a fixed sum on the happening of certain contingency. If the contingency takes place, the payment falls due if the policy is valid and in force at the time of the contingency.

6. Large number of insured persons

Small numbers of persons can also be insurance but it will be limited to smaller area or region. Smaller the size of group, higher the cost of insurance to each person, so in order to make insurance cheaper large of number of persons should be covered. Larger the number of person, lower the cost of the insurance and lesser the amount of insurance premium. Large number of persons should be insured, to spread the loss immediately, easily and economically.

7. Insurance is not a gambling

Under gambling the person bids on something and exposes himself to risk of losing whereas in the insurance person try to cover up his/her risk. Insurance helps indirectly to increase the productivity of the community by reducing worry and increasing initiative. The uncertainty of covering up of risk is changed into certainty by insuring property and life because the insurer promises to pay a definite sum at damage or death. From the economic point of view, the life insurance contract is basically non-speculative; in fact, no other business operates with greater certainties. From the insured point of view, too, insurance is also the opposite of gambling. Nothing is more uncertain than life and life insurance offers the only sure method of changing that uncertainty into certainty. By getting insurance, one protects himself against the risk of loss and if one does not get insurance coverage, then definitely it is to some extend gambling with valuable things.

8. Insurance is not charity

Insurance is not possible without charging premium whereas charity is given without any consideration. It is kind of business, in insurance against payment of premium it guarantees the payment of loss occur, It provides security and safety to an individual as well to society. It is a business profession since at the time of disasters it provides adequate sources only by charging a nominal premium for the service. [10]

4. INSURANCE SECTOR IN INDIA

In India, insurance business started 150 years ago. With the establishment of the Oriental Life insurance company in Calcutta, the business of life insurance in India was started in 1818. It was started by Mr. Bipin Behari Dasgupta and Europeans living in India were their primary customers. The first native insurance provider in India was formed in 1870 with the name Bombay Mutual Life Assurance Society. In 1938, Insurance Act was passed and department of insurance under the authority of superintendent of Insurance was established for the administration of the Insurance Act. In 1939 – 1955 uncovers absence of trust which was the foundation of life insurance business and nationalization got vital. LIC of India was formed in 1956 by an Act of parliament and is fully owned by Government of India. As on till date there are total 24 Life Insurance Companies in India. Life Insurance Corporation of India, ICICI Prudential Life Insurance Company, Bajaj Allianz Life Insurance Company, and HDFC Life Insurance Company etc., are the few names of Public sector and Private sector companies.

In life insurance policy there are two important parties to the contract, the policy holder and the insurer. The life insurance policies are legal contract between the policy holder and the insurer, terms and conditions are to be describing on it. It is a contract between the policy holder and the insurer to pay nominee a sum of money on the occurrence of the insured person’s death or for various rider options or in the case of maturity of the policy, policy holder will receives whatever amount he has deposited as premium plus bonus on it. In return policy holder agrees to pay fix amount of premium on regular basis or in lump sum (one time premium payment) to the insurer.

Following charts shows the various types of insurance:

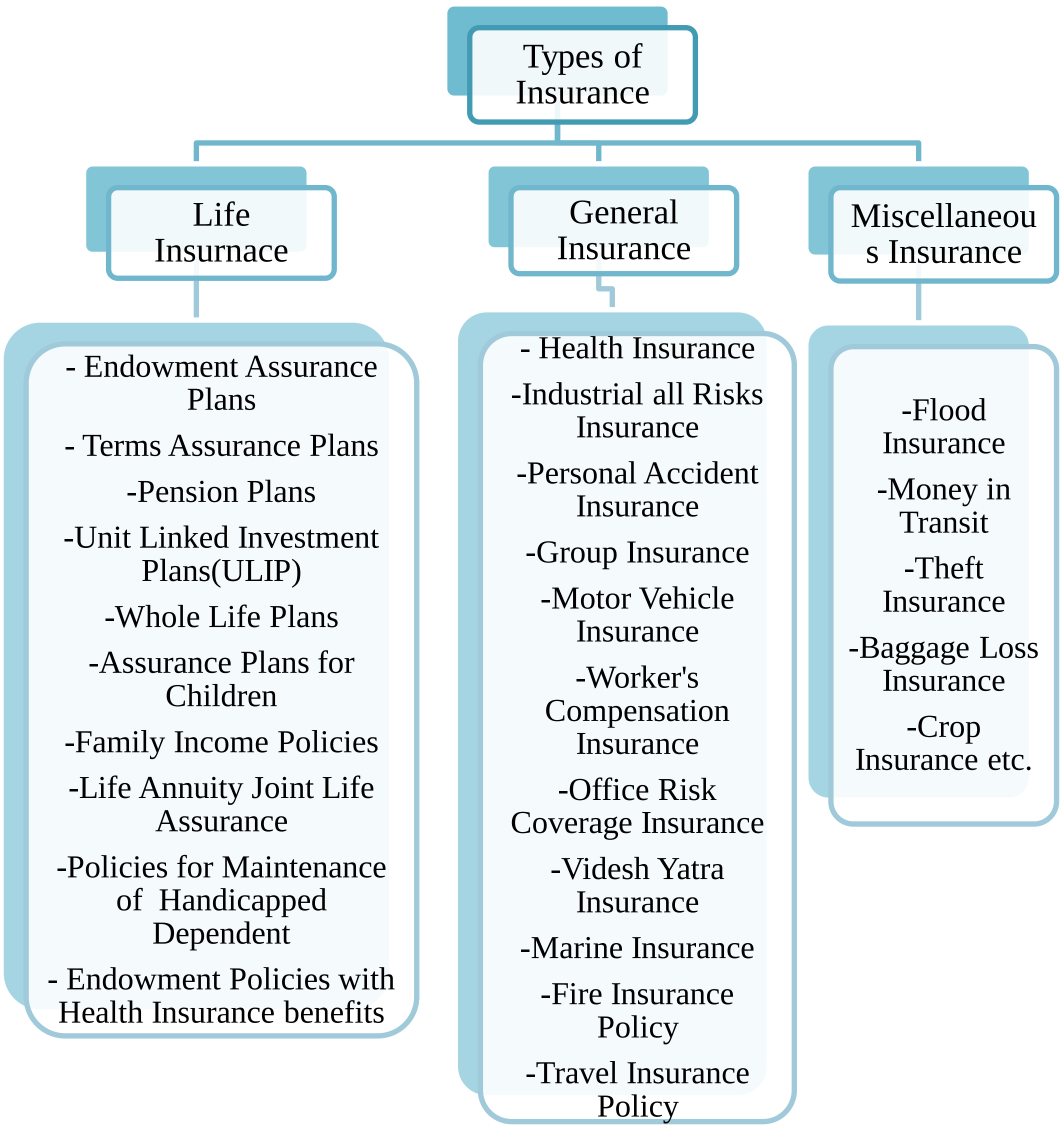

Fig. 2. Types of Insurance

Life insurance is mainly taken for two objectives, first is for risk coverage and second is for the investment objective.

i) *Risk coverage* : Lump sum payment is provided if specific event occurred.
ii) *Investment* : Money is invested with a motive of getting greater return. [14]

It is different from other insurance in the sense that the subject matter of insurance is life of human being. In today's scenario life insurance enjoys biggest scope because life insurance is required by each and every person. In the modern world, Insurance occupies importance due to the amount of risk and increasing complexity in the economic system which can be insured. Various types of insurance evolved with the changing time and demand of system.

In India there are mainly two types of Insurance: Life Insurance and General or Non-Life Insurance. Insurance not covered under life insurance and general insurance falls under the Miscellaneous insurance. [12]

5. MEANING OF F.D.I

A foreign direct investment (F.D.I) is an investment made by a company in one country, into a company in another country. It refers to an investment made to acquire lasting or long-term interest in company or entity based operating outside of the economy of the investor. The investment is direct because the investor, which could be a foreign person, company or group of entities, is seeking to control, manage, or have significant influence over the foreign enterprise. FDI is a major source of external finance which means that countries with limited amounts of capital can receive finance beyond national borders from wealthier countries. [4] (Source: available from http://www.usforeignpolicy.about.com/od/introtoforeignpolicy/a/ what-is-FDI.htm)
Foreign Direct Investment can further be divided into :

- Greenfield Foreign Direct Investment
- Brownfield Foreign Investment.

6. GUIDELINES FOR F.D.I IN INDIAN INSURANCE MARKET :

The Insurance Laws (Amendment) Act 2015 introduced some much awaited reforms, including, increasing the foreign investment cap in the insurance sector to 49 percent, permitting overseas reinsurers to open branch offices to carry out reinsurance business in India, etc. The Insurance Laws (Amendment) Act, 2015 also provides for “Indian Owned and controlled” requirement for an Indian Insurance Company. The Insurance Laws (Amendment) Act, 2015 defines Indian insurance company under Section 2(7A) as under:

“Indian insurance company” means any insurer, being a company which is limited by shares, and, (a) Which is formed and registered under the companies Act, 2013 as a public company or is converted into such a company within one year of the commencement of Insurance Laws (Amendment) Act, 2015; (b) In which the aggregate holdings of equity shares by foreign investors, including portfolio investors, do not exceed forty nine per cent of the paid up equity capital of such Indian insurance company, which is Indian owned and controlled, in such manner as may be prescribed. Explanation – For the purpose of this sub clause, the expression “control” shall include the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreement or voting agreements; (c) Whose sole purpose is to carry on life insurance business or general insurance business or reinsurance business or health insurance business. In exercise of the powers conferred by clause (aaa) of subsection (2) of section 114 of the Insurance Act, 1938 read with clause (b) of subsection (7A) of section 2 of the Insurance Act, 1938 and section 24 of the Insurance Regulatory and Development

Authority Act, 1999 (41 of 1999), the Central Government has notified the Indian Insurance Companies (Foreign Investment) Rules, 2015. These Rules mainly govern Indian control of Indian Insurance Company, Indian ownership and issues relating to foreign investment. The definition of "Indian ownership" has since been amended by Indian Insurance Companies (Foreign Investment) Amendment Rules, 2015.

As per the above definition, control can be exercised by the virtue of

(a) Shareholding; (or)
(b) Management rights; (or)
(c) Shareholders agreements; (or)
(d) Voting agreements; or
(e) Any other manner as per applicable laws.

In order to bring more clarity on the issue of compliance with the manner of "Indian owned and controlled", the Authority, in exercise of powers conferred under Section 14 (1) of the IRDA Act 1999, lays down the following guidelines on compliance of "Indian owned and controlled".

1. **Applicability:**
   These guidelines are applicable to Indian Insurance Companies which
   a) May come into existence after notification of the Act;
   b) May propose to hike their foreign investment from the existing level; and
   c) Do not intend to increase their current foreign stake from the existing level.

2. **Total foreign investment:**
   Both direct and indirect holding in an Indian insurance company shall not exceed 49 percent. Total foreign investment shall be computed in accordance with Rule 2 (P) read with Regulation 11 of the IRDAI (Registration of Indian Insurance Companies) Regulations, 2000.

3. **Control:**
   Control can be exercised by any one or more of the following criteria:
   (a) Virtue of shareholding; (or)
   (b) Management rights; (or)
   (c) Shareholders agreements; (or)
   (d) Voting agreements; (or)
   (e) Any other manner as per the applicable laws.

4. **Indian Control:**
   The Indian insurance company shall ensure the following:
   i. Majority of the directors excluding independent directors should be nominated by the Indian promoter (s) / Indian investor (s);
   ii. Appointment of key management person including Chief Executive Officer / Managing Director /Principal officer should be through the Board of Directors or by the Indian promoter (s) and / or Indian investor (s); However, Key Management Person (s) excluding CEO may be nominated by the foreign investor provided that the appointment of such Key Management person is approved by the Board of Directors,

wherein majority of the directors excluding independent directors are the nominees of Indian promoter (s) / Indian investor (s).

iii. The control over significant policies of the insurance company should be exercised by the Board, provided that the constitution of the Board is compliant with para (i) above.

iv. Where the Chairman of the Board is having a casting vote, such Chairman should be nominated by the Indian promoter (s) and / or Indian investor (s);

v. Quorum: Quorum shall mean and include presence of majority of the Indian directors irrespective of whether a foreign investor's nominee is present or not. The right of a Foreign Investor's nominee to constitute valid quorum for meetings is only a protective right and to that extent would not amount to control within the meaning of Explanation to Clause (7A) (b) as long as the presence of nominees of Indian Promoter (s) / Investor (s) are also mandatorily taken into account for the purposes of quorum. (Provided that provisions of Companies Act, 2013 shall come into force in case of an adjournment.)

5. **Manner of ensuring compliance of "Indian Owned and Controlled"**

i. An undertaking to this effect shall be filed by all Indian Insurance Companies duly signed by the Chief Executive Officer and Chief Compliance Officer confirming the compliance of "Indian owned and controlled".

ii. Every undertaking shall be accompanied by :

a) A certified copy of resolution passed by the Board of Directors confirming the compliance of "Indian owned and controlled";

b) Where applicable, certified copy of the agreement / Joint venture agreement where amendments have been carried out to these agreements / joint ventures agreement to give effect the provisions of "Indian owned and controlled".

6. **Insurance Intermediaries:**

These guidelines are also applicable to Insurance Intermediaries as defined in the IRDA Act, 1999 such as Brokers, Third Party Administrators, Surveyors and Loss Assessors etc. However, in case of an insurance intermediary having more than 50 percent of its revenue from the noninsurance activities, these guidelines shall not be applicable to such insurance intermediaries.

7. **Time Limit for Compliance :**

i. Compliance by Existing Indian insurance companies: Existing Indian insurance companies stated at para 1 (b) and (c) above are required to comply with "Indian Owned and controlled" guidelines within a period of three months from the date of issue of these guidelines. However, the Authority may, on an application made to it by an existing insurer, for valid reasons, grant a further period of three months to comply, provided that the total time taken by an existing insurer to comply with "Indian owned and controlled" stipulations does not extend beyond six months. [6]

(Source: Available from https://www.irda.gov.in/admincms/cms/whatsNew_Layout .aspx?page= PageNo2644&flag=1)

7. GUIDELINES OF R.B.I FOR FOREIGN DIRECT INVESTMENT :

An Indian company may receive Foreign Direct Investment under the two routes as given under:

i. Automatic Route

FDI is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities/sectors as specified in the consolidated FDI Policy, issued by the Government of India from time to time.

ii. Government Route

FDI in activities not covered under the automatic route requires prior approval of the Government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance. Application can be made in Form FC-IL, which can be downloaded from http://www.dipp.gov.in. Plain paper applications carrying all relevant details are also accepted. No fee is payable.

An Indian company issuing shares /convertible debentures under FDI Scheme to a person resident outside India shall receive the amount of consideration required to be paid for such shares /convertible debentures by:

(i) Inward remittance through normal banking channels.
(ii) Debit to NRE / FCNR account of a person concerned maintained with an AD category I bank.
(iii) Conversion of royalty / lump sum / technical know how fee due for payment or conversion of ECB, shall be treated as consideration for issue of shares.
(iv) Conversion of import payables / pre incorporation expenses / share swap can be treated as consideration for issue of shares with the approval of FIPB.
(v) Debit to non-interest bearing Escrow account in Indian Rupees in India which is opened with the approval from AD Category – I bank and is maintained with the AD Category I bank on behalf of residents and non-residents towards payment of share purchase consideration.

If the shares or convertible debentures are not issued within 180 days from the date of receipt of the inward remittance or date of debit to NRE / FCNR (B) / Escrow account, the amount shall be refunded. Further, Reserve Bank may on an application made to it and for sufficient reasons permit an Indian Company to refund / allot shares for the amount of consideration received towards issue of security if such amount is outstanding beyond the period of 180 days from the date of receipt. [8]
(Source : https://www.rbi.org.in/scripts/FAQView.aspx?Id=26)

8. BENEFITS OF INCREASE IN FOREIGN DIRECT INVESTMENT IN INSURANCE SECTOR OF INDIA

- Increase in wide and innovative insurance products and services in India.
- Better competitive market.
- Better exposure of technology and other services from foreign partner.
- Increase in insurance penetration and density.
- Increase in employment opportunities.

Table 1. Insurance Penetration and Density in India.

Year	Life Insurance		Insurance Industry	
	Density (USD)	Penetration (Percentage)	Density (USD)	Penetration (Percentage)
2001	9.1	2.15	11.5	2.71
2002	11.7	2.59	14.7	3.26
2003	12.9	2.26	16.4	2.88
2004	15.7	2.53	19.7	3.17
2005	18.3	2.53	22.7	3.14
2006	33.2	4.1	38.4	4.8
2007	40.4	4	46.6	4.7
2008	41.2	4	47.4	4.6
2009	47.7	4.6	54.3	5.2
2010	55.7	4.4	64.4	5.1
2011	49	3.4	59	4.1
2012	42.7	3.17	53.2	3.96
2013	41	3.1	52	3.9

Source: Available from http://www.swissre.com/sigma/

The measure of insurance penetration and density reflects the level of development of insurance sector in a country. While insurance penetration is measured as the percentage of insurance premium to GDP, insurance density is calculated as the ratio of premium to population (per capita premium). [1]

From the table it can observe that, there is increase in the insurance penetration and density in our country from 2001 to 2013. Post 2010 there is decline in the percentage which is major due to lack of funds. In order to overcome this, central government has increased the limit of Foreign Direct Investment (F.D.I) from 26 percent to 49 percent. [3]

9. DRAWBACK OF INCREASE IN FOREIGN DIRECT INVESTMENT IN INSURANCE SECTOR OF INDIA

- Possibility of rise in unethical practices due to less control of government of India over Insurance sector.
- Higher mobilization of Indian Saving amount to foreign countries.

- Threat to public sector companies' market share due to increasing number of private life insurance players.
- Products and services offered may not fulfill Indian customer's expectations.

10. CONCLUSION

Increase in foreign direct investment (F.D.I.) is optimistic move for the future of Indian Life Insurance Sector, since this sector need huge amount of capital investment which can be done effectively only through increase in F.D.I. and it enhance overall performance of insurance sector. As of now, Insurance companies are in hesitation about to take positive steps towards F.D.I. There are good chances that increase in F.D.I. will improve the Insurance penetration and density. Along with that innovative insurance product and services, better use of technology, increase in employment and competition etc. are by-product of increase in F.D.I. in insurance Sector. Government of India through Insurance Regulatory and Development Authority of India (I.R.D.A.I) and Reserve Bank of India (R.B.I.) need to keep regular check on the outflow of India currency.

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