

Liberalization of India's Life Insurance Sector: An Evaluation

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I Introduction

This paper tracks the story of Indian insurance sector reforms and provides a performance analysis of the private sector firms. The liberalization of the insurance sector is one of the most debated issues because of the ramifications on the economy due to the complex product design, long-term asset liability structure of insurance sector. The process of re-opening of the sector had begun in 1993 when a committee under the chairmanship of R.N. Malhotra was set up to suggest measures to reform insurance industry. The Malhotra committee submitted its report in 1994 and the Insurance Regulatory and Development Authority of India (IRDA) was established by the IRDA Act in 1999. Finally, in 2000, the IRDA issued licenses to the private sector companies. Thus, the issue of insurance sector liberalization has been also contested in India since 1993. The main contentions were based on the ideological ground, as the Life Insurance Corporation Act, 1956, bestowed the public insurer, LIC of India, with the role of the benevolent entity or widow's trustee!

At the micro level, the insurance sector has the fundamental role of providing for the protection against unforeseen events. Its importance cannot be overestimated. The insurance sector is the key domestic investor in various sectors of the economy providing funds for nation building projects and infrastructure. It is one of the largest domestic financiers to the government. Being one of the largest domestic investors; it practically acts as an anchor for the stability of the capital markets. The insurance sector also has a leading role in social security and financial inclusion drive in the economy. Irrespective of this dynamic role of the insurance sector, unfortunately, it remains the most ignored, misread segment of the financial sector with its distinct operations and hard to understand mechanics. On this backdrop, the present study tries to probe into the aftermath of the insurance sector liberalization to verify whether there has been an improvement in efficiency, competitiveness and financial health of all the stakeholders in the insurance industry.

The extant literature on economic reforms in India rarely delves into the effects of insurance sector liberalization. Many studies on financial sector reform in India give a cursory treatment to the insurance sector reforms as merely one amongst the miscellaneous financial sector reforms (Sinha 2002, Ahluwalia 2002, Mohan 2005, Gordon and Gupta 2005). Some empirical studies try to examine the nexus between insurance sector development and economic development (Vadlamannati 2008, Ang and McKibbin 2007). These studies consider the GDP growth as the measure of economic development and cannot arrive at a deterministic conclusion. The effort to

capture the elusive relation between economic development and insurance sector within the constraints of quantitative techniques has its inherent limitations.

Some of the seminal studies are published within a few years after the insurance sector liberalization (Sinha 2002, Ranade and Ahuja 1999). Given the gestation period of life insurance industry, it was too early to comment on the performance of the private life insurance companies within a few years of liberalization. The later studies pertaining to the liberalization of insurance sector focus primarily on a comparison of the public sector and private sector insurance firms and are based on a limited time series and cross section data covering the small number of private sector firms (Ansari and Fola 2014, Rajendran and Natarajan 2010, Chaudhary 2016).

Objectives and Significance of the Study: The breakeven of the life insurance sector requires at least seven years and for general insurance, it is approximately five years. Hence, at present enough time has passed since the liberalization of India's insurance sector, to evaluate the performance of the private sector firms.

The primary objective of the present study is to evaluate the performance of the life insurance sector in India in the post-liberalization period by focusing on the financial performance of the private sector life insurance firms.

Before liberalization, Life insurance sector was characterized by the monopoly of Life Insurance Corporation of India. In general insurance sector also, the General Insurance Corporation and associates were almost like a cartelized monopoly market. The Indian insurance sector in India has shown a stunted growth as compared to the global standards. The objective behind liberalization has been to revive the industry through increased the business with more number of players in the market. The present study tries to examine whether this perceived promise of liberalization has been fulfilled after the decade and half of insurance sector liberalization in India.

The remaining part of the study is as follows, Section II, discusses the post-liberalization trends in the growth of life in India. Section III analyses the post liberalization performance of the sector. Section IV provides the analysis of the performance of the private sector firms in the life insurance sector based on five criteria of financial soundness and Section V concludes the study.

II The Advent of Insurance Sector Liberalization and Growth of Insurance Industry in India

Following the recommendations of the Malhotra Committee report, in 1994, the Insurance Regulatory and Development Authority (IRDA) was incorporated as a statutory body in April 2000 to promote competition, to enhance customer satisfaction through increased consumer choice and lower premiums and most importantly to ensure the financial security of the insurance market. The IRDA opened up the market in August 2000. Foreign companies were allowed ownership of up to 26 per cent. The Authority has the power to frame regulations under Section 114A of the Insurance Act, 1938. The liberalization of life insurance sector was closely followed by restructuring of the subsidiaries of the General Insurance Corporation of India as independent companies in December 2000. The GIC was converted into a national reinsurer. Parliament passed a bill de-linking the four subsidiaries from GIC in July

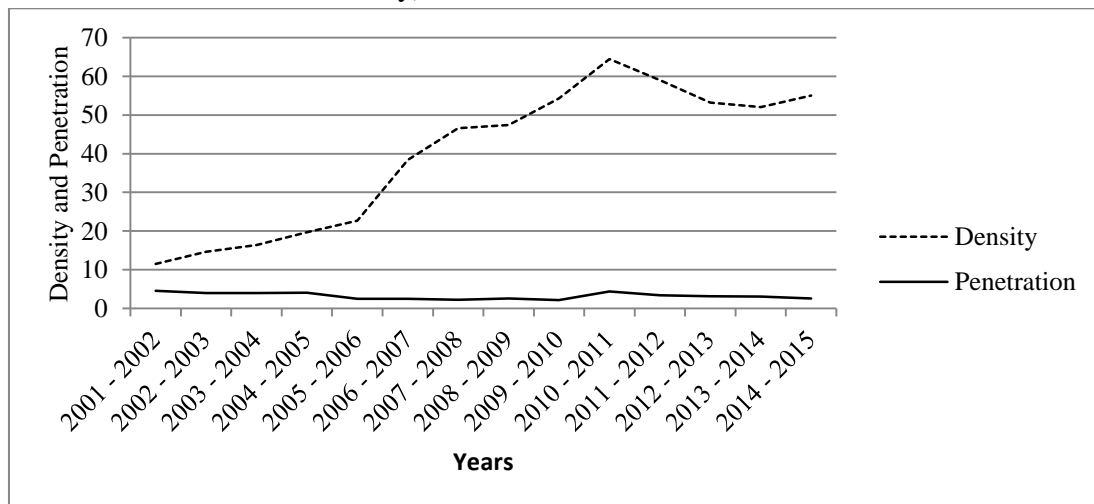
2002. Today there are 28 general insurance companies including the ECGC and Agriculture Insurance Corporation of India and 24 life insurance companies operating in the country.

Life insurance sector was liberalized after a lot of heated deliberations among the policy makers, political parties, and various pressure groups. Has the expansion of the sector, the entry of foreign firms and the privatization and liberalization benefitted the life insurance industry? Is this benefit matching up to the expectations at the time of implementing this path-breaking policy reform? Is India ready for this kind of competitive life insurance market? The present study strives to find answers to these key questions.

Trends in Life Insurance Sector in the Post-liberalization Period

The globally accepted indicators of measuring the growth of life insurance sector are the life insurance penetration and density. The life insurance penetration is defined as the ratio of gross premiums to the GDP. This shows the growth of life insurance as compared to the economic growth. Another common measure of the development of life insurance sector is the density of life insurance is the ratio of life insurance premium to the total population of the country. India’s insurance sector showed very low levels of both these indicators, as compared to the global levels. The liberalization of life insurance sector was expected to result in a higher level of growth of the sector in terms of both insurance penetration and density.

Chart 1: Trends in Growth of Life Insurance Sector after Liberalization (Life Insurance Penetration& Density)



Source: Derived from the Database on Insurance Sector, IRDAI.

As shown by the above chart, in the post –liberalization period, the density of life insurance has increased from 4.6 to 22.4 during 2001to 2006. In the later period, it has exponentially increased to 64.4 in 2011 and it has been stagnant in the band of 50 to 55 in the latest five-year span from 2011 to 2015.

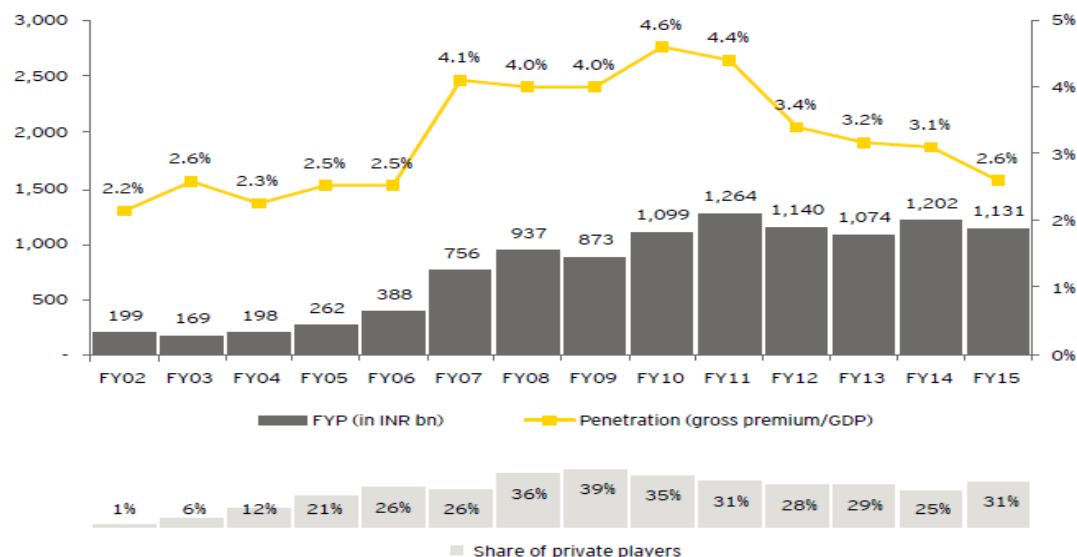
The life insurance penetration has been changing in a narrow band. It spurred immediately after the liberalization from 2002 to 2006 around 4.6 to 4.1 then it dropped to 2.53 again bounced back to 4.4 in 2010 and hovered between 3.5 to 2.5.

The life insurance density and penetration in India remained stagnant for most of the period, even after liberalization and continues to be much lower than the global average.

Business Expansion: Has the liberalization helped in reviving the Life Insurance Business?

The following chart2 presents the growth of life insurance business in India in terms of first premium and penetration (Gross premium/GDP). The chart also presents the growth of market share of the private sector life insurers.

Chart 2: Trends in Growth of Life Insurance Sector after Liberalization (First-year premium and Life Insurance Penetration)



Source: CII, 2015, IRDA, Swiss Re, World Insurance Reports.

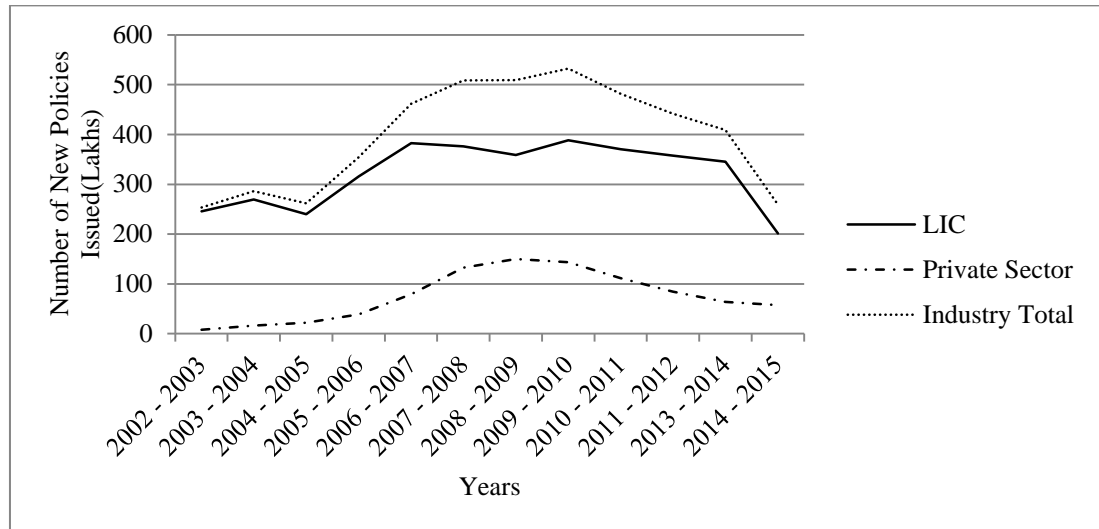
Table 1: Year on Year Growth of First Year Premium

Year	Industry Total (Rupees Crore)	YoY Growth Rate of First Year (%)
2001 - 2002	19857	2.05
2002 - 2003	16942	0.85
2003 - 2004	19788	1.17
2004 - 2005	26218	1.32
2005 - 2006	38786	1.48
2006 - 2007	75649	1.95
2007 - 2008	93713	1.24
2008 - 2009	87331	0.93
2009 - 2010	109894	1.26
2010 - 2011	126398	1.15
2011 - 2012	113966	0.90
2012 - 2013	107361	0.94
2013 - 2014	120320	1.12
2014 - 2015	113328	0.94

Source: IRDA Database.

The following chart 3 shows the trends in size of the business of the life insurance sector. The chart shows the number of policies sold by the public sector LIC of India and those sold by all the private sector firms taken together, from 2001 to 2015.

Chart 3: Business Volume Expansion: Number of New Policies Issued

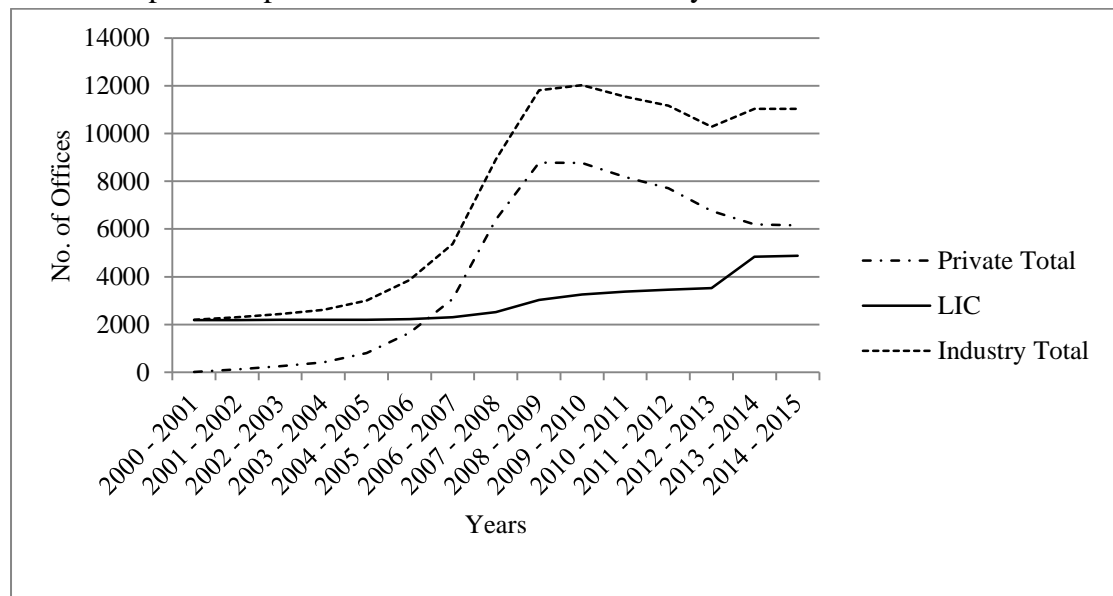


Source: Derived from IRDA Database.

The data shows that after the initial short period of growth, up to 2007, the later period, from 2007-2008, and 2011-2012 up to 2015-2016 shows a huge decline in the overall life insurance business. In the pre-liberalization period, the cumulative average growth rate (CAGR) of the number of life insurance policies has in fact declined.

Chart 4 shows the geographical expansion of the life insurance business in terms of a number of offices.

Chart 4: Spatial Expansion of Life Insurance Industry



Source: Derived from IRDA Database

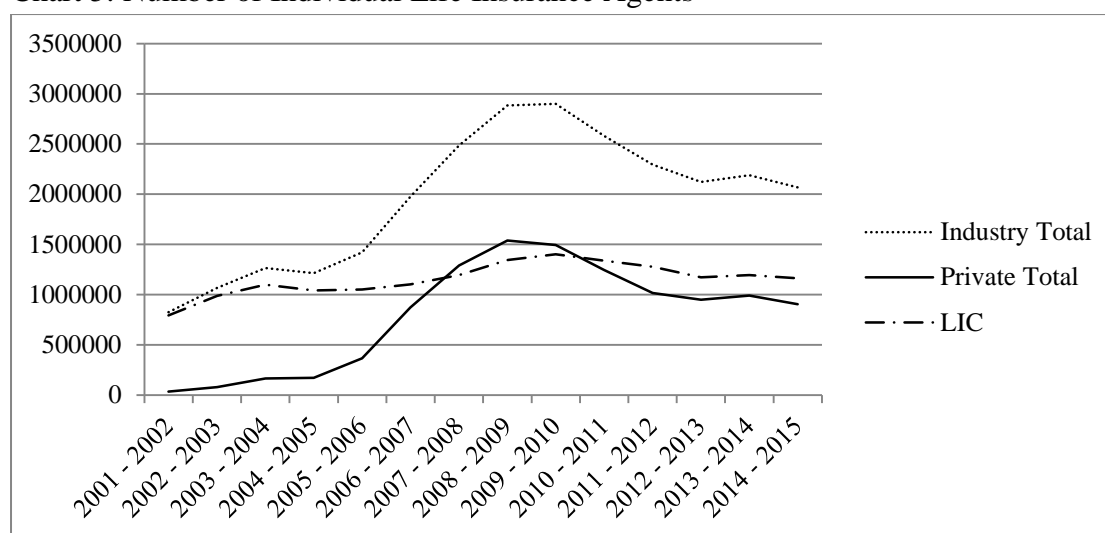
The trends clearly show that the growth in the number of offices by the private sector has declined after 2009-10, while the number of offices of LIC of India has increased steadily.

The rise in the number of offices of the public sector insurer may be a proactive response to the increasing competition in the sector.

Number of Individual Agents: Marketing Machinery and Income Generation

The number of agents shows the marketing effort as well as the income and employment generation by the insurance. The chart 5 shows that the number of individual agents appointed by the private firms has increased exponentially from 1,70,942 in 2005 to 14,02,807 in 2010 and then decreased to 9,04,303 in 2015. The number of individual agents appointed by LIC of India is moving in the stable range of 10,41,737 in 2005 and 11,63,604 in 2015.

Chart 5: Number of Individual Life Insurance Agents



Source: Derived from IRDA Data

Trends in the Product Composition of Life Insurance Sector

After the liberalization of the life insurance sector, in 2000-2001, there was a race among the private players to grab the market share in the newly competitive market. This is shown by the conspicuous rise in life insurance penetration from 2001 to 2007. During 2007 to 2010, the sector showed positive growth irrespective of the global financial crisis.

The high growth high-interest macroeconomic environment in India supported the business drive of the private life insurance firms. The life insurance sector’s first-year premium grew at an average rate of 23 per cent over the decade of 2002 to 2015 (IRDA, Handbook on Insurance Sector Statistics, 2013-2014; CII Report, 2015).

The growth of life insurance industry during 2002 to 2010 was primarily thriving on the unit-linked products ULIPs which inflated the scale of life insurance business. This produced a distorted picture as the growth of ‘quality’ insurance products was not rising.

At this point, the IRDA intervened to monitor the private sector players and to bring out the balanced growth of various insurance products for the better sustainability and efficacy of the sector and the paramount objective of customer protection.

Table 2: Product Composition of Life Insurance (2001-2015) Share of each Fund in total assets under management

Year	Life Fund	Pension & Group Fund	ULIP Fund
2001	100.00	-	-
2002	100.00	-	-
2003	88.14	11.76	0.10
2004	87.15	12.37	0.48
2005	85.48	12.77	1.75
2006	81.53	13.16	5.31
2007	77.06	11.84	11.10
2008	70.71	11.92	17.37
2009	68.71	12.44	18.85
2010	60.79	11.69	27.52
2011	58.81	13.28	27.91
2012	61.64	14.96	23.40
2013	64.19	16.18	19.63
2014	65.81	17.25	16.94
2015	66.53	17.33	16.14

Source: Handbook of Indian Insurance Statistics, IRDA, 2014-2015.

The data in Table 2 on the product composition of the life insurance sector reflects that the initial spurt in the growth of market share of the private life insurance companies was mainly because of the Unit Linked Life Insurance (ULIPs).

III The Private Sector Life Insurance Firms: Still Struggling to Find a Foothold?

The post liberalization period can be divided into three distinct phases for the life insurance sector.

The first phase: The first phase is from 2001 to 2005 when the private sector firms started entering the market and tried gaining the ground gradually. This is the phase of gradual growth. By end 2006 there were 13 private sector firms in the market.

The second phase: The second phase is the high growth phase characterized by the spurt in the number of private firms. The number of life insurance firms has increased to 25 and remained stagnant after 2011. During the high growth phase in 2005 to 2011, the share of private players rose to 39 per cent of the first year premium in FY09, while that of the public sector behemoth Life Insurance Corporation of India (LIC) dropped to 61 per cent. This phase is underlined by the selling of Unit Linked Insurance Plans (ULIPs) by the private firms. ULIPs share in product composition increased from 11.10 per cent of the total sale in 2007 to approximately 28 per cent in 2011 (IRDA, Handbook on Indian Insurance Sector 2014-2015).

The Third Phase: The third phase is the phase of private sector stagnancy.

This started from 2011 with the regulatory restrictions on ULIPs by IRDA. The unit-linked products (ULIPs) lost their attraction with the customers as well as the insurers in 2011. This was a wake-up call to the private firms to control their high-cost operations and to provide quality insurance products. The private players' market share shrunk to 25 per cent in 2014. Recently the private sector is dominated by the banking sector firms selling bancassurance. SBI Life, ICICI Prudential, Bajaj Allianz, HDFC Life Insurance are the prominent life insurers in the private sector with their wide network, bancassurance products, and advanced technology. According to the CII report (2015), top four private players are all bancassurance-led and now command 54 per cent of the private market share and 17 per cent of the total market share.

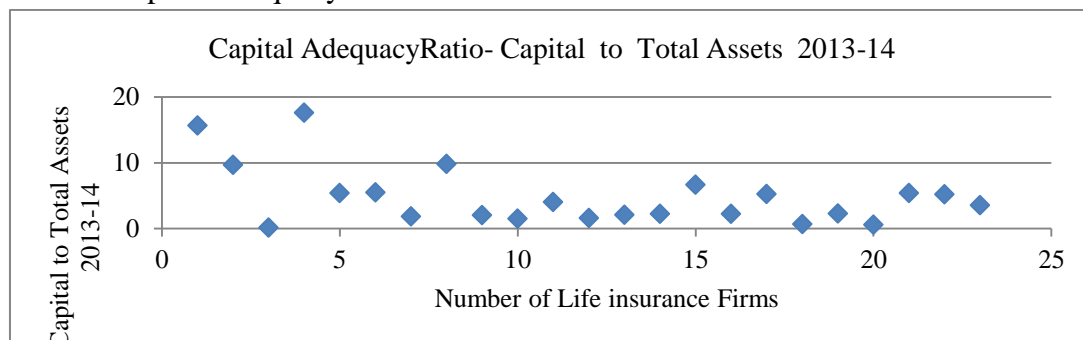
IV Performance Analysis of Private Sector Life Insurance Firms

The CAMELS framework of financial soundness is a well-accepted framework for banks and financial institutions. In the case of the life insurance companies, the interpretation, and significance of various financial indicators are different from the banks and other financial institutions. Hence, a specific framework to measure financial soundness is developed based on the quantitative soundness indicators. This framework is called as CAMELS framework (Capital adequacy, Asset quality, Reinsurance, Adequacy of claims and actuarial, Management soundness, Earnings and profitability, Liquidity and Sensitivity to market risk), which incorporates the specific indicators for life insurance risk and solvency to the CAMELS framework. The following analysis shows the distribution of the firms in life insurance sector in India based on five selected indicators of life insurance sector financial soundness. These indicators are based on the globally accepted financial soundness framework for life insurance sector. (Das, Davie and Podpiera 2003). These indicators are used in this study as per the levels prescribed in the IRDA norms wherever applicable.

Capital Adequacy Ratio

Capital adequacy ratio is the ratio of total capital to total assets. For the banking sector, the Basel norms provide an internationally accepted norm for the capital adequacy ratio. For the life insurance sector, no such standard is assigned. Nevertheless, it shows the financial soundness of a firm in terms of the asset base of the firm.

Chart 6: Capital Adequacy Ratio



Source: Based on IRDA, Database.

A lower ratio may be preferred to higher one, as higher ratio indicates high reliance on capital & inefficient use of capital to create assets whereas lower ratio indicates the greater assets base of the company. The data shows that LIC of India, SBI Life, and Bajaj Allianz have the minimum capital to total assets ratio indicating better financial soundness.

Solvency Margin

Solvency margin is the key ratio of financial soundness for the life insurance sector. IRDA defines solvency margin as the ratio of the value of assets to the value of liabilities. IRDA interpretation to the “Solvency Ratio” means the ratio of the amount of Available Solvency Margin to the amount of Required /Solvency Margin.

‘Available Solvency Margin’ means the excess of the value of assets over the value of life insurance liabilities and other liabilities of policyholders’ fund and shareholders’ funds as per Regulations, 2000.

The IRDA defines the solvency ratio in the following way,

Solvency ratio = Total available solvency margin divided by the required solvency margin.

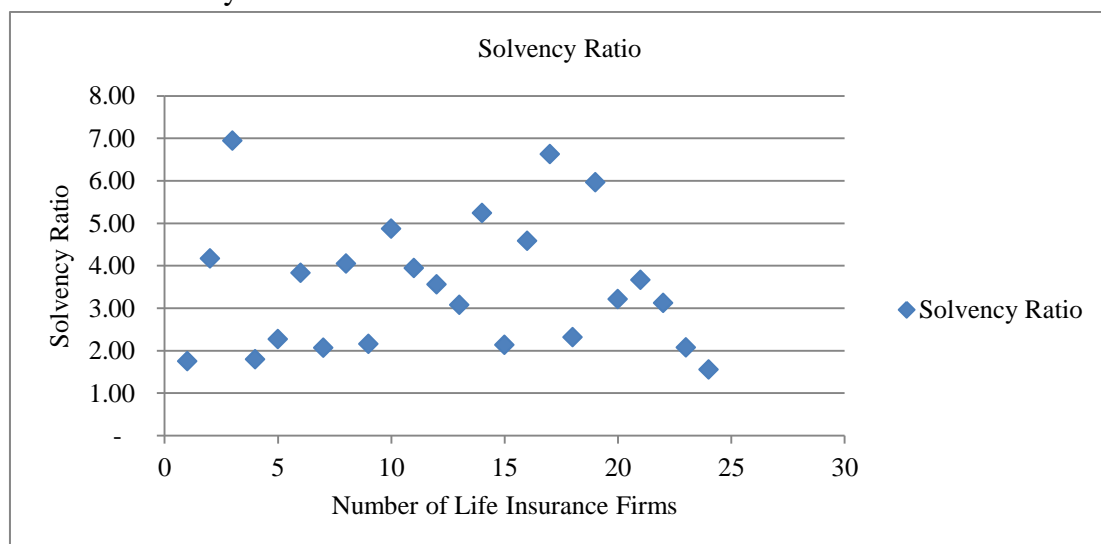
Available solvency margin = Excess of assets over liabilities in policyholder fund + Excess of assets over liabilities in shareholder fund

Required solvency margin = 1.5

As per section 64VA of the Insurance Act, 1938, according to the IRDA, Indian life insurers are required to maintain a minimum ratio of 1.5 as a required solvency margin

For the life insurance sector, the solvency ratio during the post liberalization period ranges between 1.56 for LIC of India to 6.95 for Bajaj Allianz in 2014.

Chart 7: Solvency Ratio

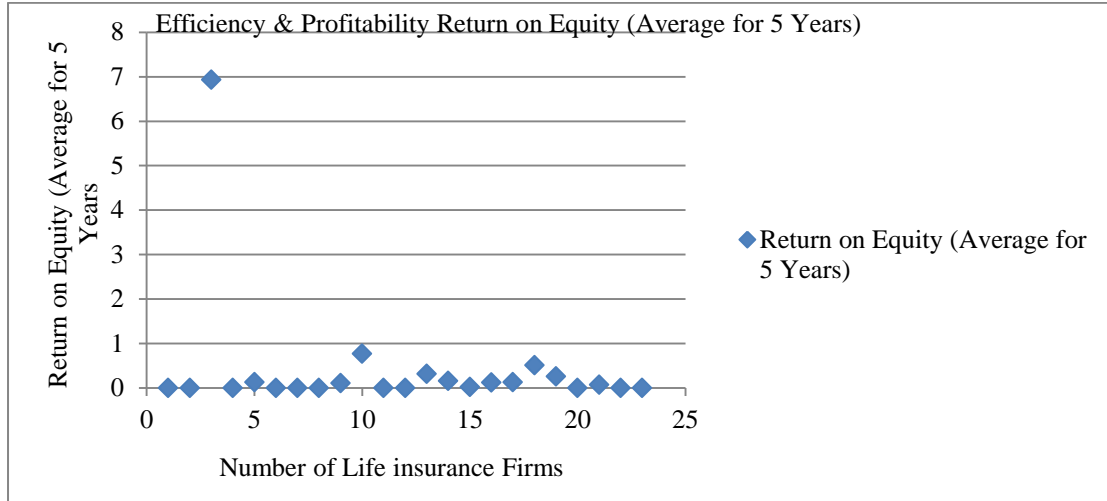


Source: Based on IRDA, Database.

Return on Equity: Return on Equity is the Classic Indicator of Profitability

The ROE (return on equity) is measured as the ratio of Profit after Tax divided by the share capital. The chart 8 shows the five average return on equity for the life insurance firms in India. Among the private sector life insurers, Bajaj Allianz shows the highest average RoE for 2010-2014.

Chart 8: Return on Equity

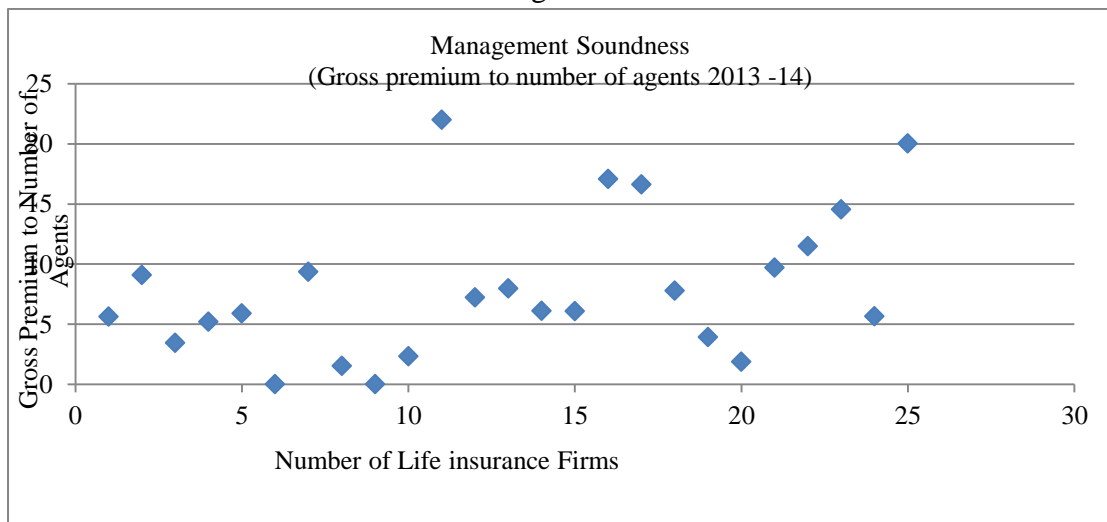


Source: Based on IRDA, Database.

Management Soundness- Gross Premium to Number of agents

The operating efficiency of the firm is indicated by the minimization of the operating cost per unit of business. For the life insurers, marketing personnel is a large portion of costs. The ratio of Gross premiums to a number of agents shows the premium collected per agent. This indicator shows efficient management practice with the possibility of lower premium loading for the customers. The higher the ratio better is the management efficiency. The LIC of India and HDFC Max Life Insurance Ltd. show the highest management soundness by this indicator.

Chart 9: Gross Premium to Number of Agents

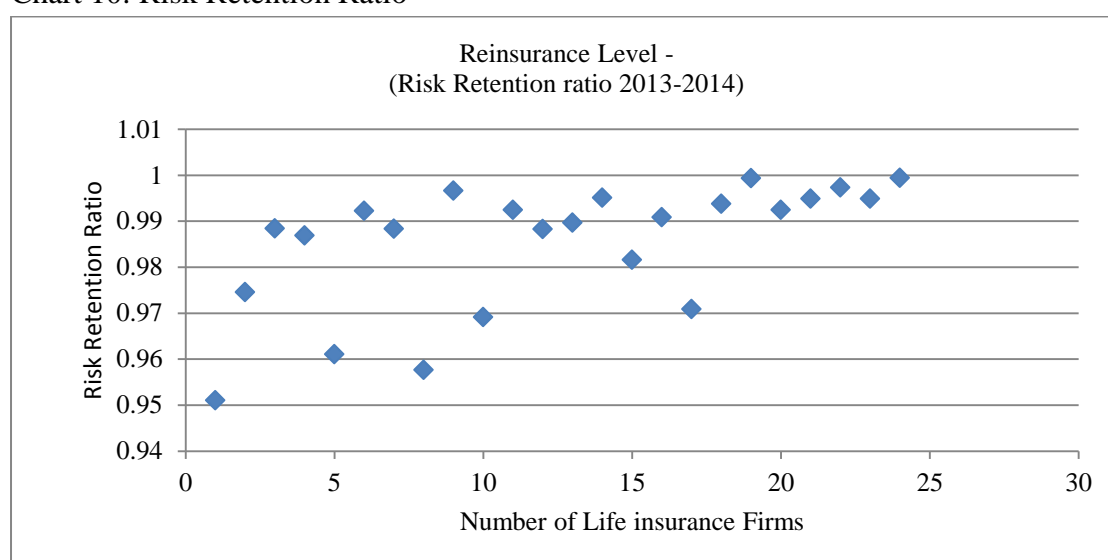


Source: Based on IRDA, Database.

Risk Retention ratio- Reinsurance Indicator

The risk retention ratio is the ratio of Net written premium to Gross written premium. Net written premium is the total written premium minus the premium transferred to the reinsurance companies. It shows the proportion of risk passed onto the reinsurers. If the risk retention ratio is high that means the firm is retaining that portion of risk without transferring it to the reinsurer. IRDA regulation for life insurers is minimum 20 per cent of the risk retention ratio. The ratio of Net Written Premium and Gross Premium which indicates the risk passed onto the reinsurers is negligible. The higher level of reinsurance implies higher transfer costs and premium sharing thereby adversely affecting the profits of the life insurance firms. In India, the risk retention ratio is very high implying that the insurance companies are using reinsurance to cover the risk only for a small amount of policy cover.

Chart 10: Risk Retention Ratio



Source: Based on IRDA, Database.

V Concluding Remarks

The liberalization of insurance sector took almost a decade after the economic reforms in India. The promise of liberalization of insurance sector was the high growth of the sector with increased competition in the market. The evaluation of life insurance sector during the post liberalization period shows that the promise of liberalization is not fulfilled completely. Even after liberalization, the growth of life insurance sector has remained stagnant as compared to the GDP growth and growth of population. The life insurance business shows a decline in CAGR after the initial short-term rise in the number of policies issued. Competition has not resulted in increased business. The primary impediments to the development of life insurance sector are summarized as follows:

Complex and unique nature of life Insurance: The life insurance is a financial product of a unique nature because it consists of a combination of investment return and assurance against the mortality risk which is not covered by any other financial product. Hence, to that extent, it is not comparable with the other financial products. Though conventional life insurance products also have an investment component, the

ULIPs incorporated a greater proportion of investment element in the life insurance by linking it to the stock market returns. The private life insurance companies resorted to increase their business by selling ULIPs by linking it to the stock market returns while life insurers are expected to hold a diversified portfolio of assets. By virtue of its life risk cover and investment return, life insurance serves as a substitute as well as a complement to the other financial products. The ULIPs sought to turn life insurance into a substitute of other return based financial products.

Product Mix and the Inability of the Private Players to Handle Pure Life Insurance Products: The only years which show a decent growth of life insurance business is the period when the private firms thrived on the Unit Linked Products. ULIPs caught the frenzy of Indian investor as it promises market linked returns and liquidity. But it stripped the life insurance off its “insuranceness”. ULIPs have both Insurance and Investment parts. There existed ULIP plans which had no sum assured. This has resulted into the high correlation of life insurance business with the stock market. This kind of correlation with the market volatility is undesirable as life insurance is not a substitute for stock market investment. The private insurers were insisting on the ULIPs as the asset liability management and long-term claim settlement in the case of ULIPs are easier than that of the pure life insurance products.

The Unprecedented Regulatory Tussle: The dynamism of life insurance products and competitive environment called for designing a newer variety of hybrid products which often pose challenges for the regulators. In India, the financial market is regulated by SEBI. In 2010 India witnessed a turf war between the two regulators, SEBI and IRDA over the ULIPs regulation. SEBI banned 14 insurance companies from raising funds from ULIPs, stating that they have not registered their product with SEBI, so they can't issue new ULIPs. While IRDA insisted that the ULIPs were legal as these are insurance products under its purview and could not be banned by SEBI. SEBI stated that since ULIPs are investment products which mimic mutual funds so they should follow its guidelines. SEBI act clearly stated that any product with exposure to the securities market comes under its purview. The conflict took an ugly turn when a day after SEBI barred the companies, IRDA mandated to ignore the SEBI's order and directed them to continue selling the product. Finally, the Ministry of Finance had to intervene. A committee was established under the finance minister to resolve all issues regarding the hybrid products.

The Lop-sided Growth of Private Sector: One important insight emerges from the study of a decade and half of privatization of the life insurance sector. The post liberalization growth of life insurance sector shows that the market is not exactly competitive. The life insurance market shows a lop-sided growth. Distribution of the firms and thus their performance in private sector is not uniform. This has not been noted in the earlier studies. The observations from the post liberalization data show that the sector is divided into top four private life insurance firms led by SBI Life, ICICI Prudential, Bajaj Allianz, HDFC Life Insurance. These companies are thriving on bancassurance. Thus the nature of life insurance business is either drawn by ULIPs or by bancassurance in the post liberalization era.

To summarize, the overview of private sector reflects that the increase in a number of firms and competitive market has not resulted in breaking the low level of life insurance development in India. The financial soundness indicators reveal that the

private firms show reasonable financial soundness, thanks to the vigilant regulation by IRDA. However, on the business expansion side, the private firms are struggling for survival in the competitive market. The life insurance private segment is dominated by a few large firms and shows a very heterogeneous market structure. So far, the business prowess of the private players, if any, largely relied on the 'quasi-insurance' products like ULIPs or bancassurance. The liberalization of life insurance sector has not resulted in any vibrant value addition to the stagnant life insurance industry in India.

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