Chapter IV
Reform Process of Insurance Sector in India

The insurance industry in India has witnessed many radial transformations during the last about one hundred ninety years of its inception. The insurance business remained in the hands of private insurers with minimal government intervention up to 1956. Both the life insurance as well as the general insurance companies were nationalized by the government in the years 1956 and 1972 respectively, giving them a chance to have monopoly in the field. But, unlike life insurance, a different structure was created for the general insurance industry. One holding company was formed with four subsidiaries, and again, the private sector was allowed to enter the insurance business in the year 2000.

4.1 Insurance Industry in India: A Historical Perspective

The history of insurance in India can be traced with the establishment of a British company called the Oriental Life Insurance Company in 1818, followed by the Bombay Assurance Company in 1823, and the Madras Equitable Life Insurance Society in 1829. All these companies operated in India but did not insure the lives of Indians. They were insuring only the lives of Europeans living in India. The first general insurance company known as Triton Insurance Company Ltd., was established in 1850. It was owned and operated by the British. The first indigenous general insurance company was the Indian Mercantile Insurance Company Limited set up in Bombay in 1907 (Sinha, 2005; Sharma and Agarwal, 2005). The wholly Indian-owned insurance company, namely, The New India Assurance Company Limited was incorporated on July 23, 1919 which commenced its operations in October the same year (Narayanan, 2006).

There was no exclusive legislation to govern the activities of insurance companies during the 19th century. To control the operations of life insurance in India, the Indian Life Insurance Companies Act, 1912 was enacted. However, the first comprehensive legislation was introduced with the passing...
of Indian Insurance Act, 1938. The Act made provision for required equity capital to carry out insurance business, ceiling on shareholding pattern, strict control on investments, agency commission etc. Subsequently, a separate wing was established in the Ministry of Finance to administer the provisions under the Act (Sharma and Agarwal, 2005). Though a number of statutory laws and insurance Acts were passed from time to time to regulate and control the business, yet as many as 66 out of 215 life business companies perished between 1935 and 1955. This was largely due to growing business mismanagement and malpractices, manipulation of life funds to indulge in speculative trading, large scale liquidation of insurance companies, interlocking of funds, and control and influence of large business houses which led to public disenchantment and resentment (Rajan and Dhunna, 2002). This led to the nationalization of life insurance by amalgamating all private companies under one corporation, i.e., L.I.C. The number of companies in the general insurance sector increased steadily, and by 1972 their number had gone to 107. However, out of these 107 companies, more than 50% were in financially bad shape. Taking into account the bad health of private operators and vast fund mobilization potential in this sector, Government of India nationalized the General Insurance sector w.e.f. 1st January, 1973. It formed four subsidiaries, namely, (1) The New India Assurance Company Ltd., (2) The Oriental Insurance Company Ltd., (3) The National Insurance Company Ltd., and (4) The United India Insurance Company Ltd., with a holding company General Insurance Corporation of India.

In spite of the commendable growth and performance of the LIC and GIC on both economic and social fronts, a vast potential still exists as majority of insurable population is still untapped. Macro indicators such as population coverage, per capita premium, contribution to employment and GDP are still very low as compared to developed countries, although they compare reasonably well with other developing countries. The consumers have less choice of products in the absence of tailor-made products to suit different categories of people in terms of their levels of income, nature of profession and
needs. Therefore, the criticism that is voiced against the state monolith is on grounds of ‘efficiency’. It is believed that competition would lead to reduction of costs (premium rates) and shall offer a wider choice of products to the consumers. In consonance with these concerns, the reform process of Indian insurance sector was initiated by the Government of India.

4.2. Reform Process of Insurance Sector in India

The Government of India constituted the Malhotra Committee to examine and recommend the measures for the introduction of the reforms process in the insurance sector. R.N. Malhotra, retired Governor of the Reserve Bank of India, was named its Chairperson. The committee examined the structure of the insurance industry and recommended changes to make it more efficient and competitive, keeping in view the structural changes in other parts of the financial system of the economy (Sharma and Agarwal, 2005). The Government accepted the report of the Committee, which was submitted to the Government in January 1994.

4.3 Recommendations of the Malhotra Committee

The Malhotra Committee had made certain recommendations to the Government to change the face of the industry and to give it a more meaningful direction. Regarding the liberalization of the insurance industry, the Committee made the following important recommendations:

(a) Private sector should be allowed to enter the insurance business:

The Committee had deliberated on the subject and the following issues weighed in favour of opening the industry to competition:

- Competition would lead to better customer service.
- It would improve the quality and price of insurance products.
- The entry of new players would lead to better penetration of the market.
- When other wings of the financial sector like banking, mutual funds, merchant banking, and non-banking financial sectors were exposed to competition, there was no reason to keep insurance insulated.
- Public view was converging towards competition in the insurance sector.
• As public sector insurance institutions had created a good pool of professional talent and marketing network, there was no fear of them being incapable of facing competition.

(b) No composite Insurance Companies:

The Committee recommended that no single company should be allowed to transact both life and general insurance business. The Committee had so recommended as life and general insurance are two different lines of business, and prudence demands that there should not be any mixing up of funds.

(c) Number of new entrants to be controlled:

The Committee felt that this step was necessary to control the cropping up of small private sector companies and their wilting away during a financial crisis.

(d) Minimum paid-up capital:

With a view to ensure that only companies with a good track record in their line of business apply for licenses to act as insurance companies, the Committee recommended a paid- up capital of Rs.100 crore for the new entrants. At the same time, the Committee felt that this requirement could be lowered in cases where the promoters are state level co-operative institutions.

(e) Obligation to do business in rural areas and for weaker sections of the community:

This stipulation was introduced to ensure a level-playing ground for all insurance companies. New entrants may tend to concentrate on more lucrative business to the neglect of the common people and the rural areas. To avoid this, the Committee had recommended that both life and non-life companies should procure a prescribed percentage of business from these segments.

(f) Selective entry to foreign companies:

The Committee felt that permitting foreign insurance companies would be in the interest of the Indian economy, particularly in the context of globalization. It recommended that entry to foreign companies should be on a
selective basis. Foreign companies entering India should be required to float an Indian company, preferably as a joint venture.

(g) **Technology upgradation:**

The insurance has become an information-driven industry all over the world. This, in effect, means heavy dependence on IT and development of computer support systems. The industry has to develop software to improve effective customer service and claim management.

(h) **Pension Sector:**

To popularize the contribution to individual pension funds by self-employed professionals, traders and workers in the unorganized sectors, the Committee recommended income tax concessions up to a prescribed limit for contribution to individual pension schemes floated and managed by insurance companies. The Committee cited the nature of tax concessions available on individual contributions to the pension funds and concessions available to pension funds in the UK; it suggested that substantial concessions should also be available for contributions to pension funds in India, and this should cover schemes managed by all the insurance companies as well.

(i) **Privatization of LIC and GIC:**

The Committee felt that as a State-owned entity, LIC suffered many operational constraints, and its flexibility and ability to respond to changing situations was limited. Many of the constraints are due to the reason that, in the eyes of law, LIC falls within the definition of 'State'. To overcome this situation, LIC should be taken out of the definition of 'State'. To achieve this, the share of the Government in the equity of LIC should be reduced to 50% or to 49% as the Government had decided in the case of certain PSUs. To enable LIC to run as a board managed company with a dominant shareholding by the Government, the shareholding pattern has to change, and LIC has to be registered as a company under the Indian Companies Act.

As far as GIC is concerned, it was recommended that GIC should cease to be a holding company of four of its subsidiaries, and should act as an Indian Reinsurer under the Indian Insurance Act. It was further recommended that the
share capital of GIC should be raised to Rs.200 crore from its present level of Rs.107.50 crore. Out of this, 50% of the equity should be held by the Government and the rest by the Public at large, including employees of GIC. As far as the four subsidiary companies are concerned, it was suggested that they should function as independent companies run by a board. It was further proposed that the equity capital of each of these companies should be raised to Rs.100 crore with a 50% holding by the Government and the rest by the public and the employees of the respective companies.

(j) Establishment of an Insurance Regulator:

While considering the implications of opening up the industry to competition, the Committee also examined the role of the Controller of Insurance, and the need for a regulatory body for the insurance sector. The Controller of Insurance was vested with wide powers under the Indian Insurance Act, 1938. With the progressive nationalization of the life and general insurance sectors, the powers of the Controller of Insurance were reduced as many of the functions were transferred to the nationalised companies themselves or, wherever necessary, the Government itself started exercising the powers directly. The Committee felt that this dispensation was flawed even in the context of a State monopoly and would have to change in a competitive environment. The Committee suggested restoring the office of the Controller of Insurance to its full statutory powers and segregating it from the Ministry of Finance. The Committee had also suggested setting up an Insurance Regulatory Authority as a multi-member body and as a highly professional and compact organisation with adequate IT support, similar to the Securities and Exchange Board of India (SEBI). With this in view, the Committee proposed the establishment of a powerful and autonomous regulatory body on the lines of SEBI. The Committee also further stated that the regulatory authority should have full functional autonomy and operational flexibility to discharge its functions in a free and fair manner (Narayanan, 2006).
4.4. **Mukherjee Committee Report**

Immediately after the publication of the Malhotra Committee Report, a new committee (called the Mukherjee Committee) was set up to make concrete plans for the requirements of the newly formed insurance companies. Recommendations of the Mukherjee Committee were never made public. But, from the information that filtered out it became clear that the committee recommended the inclusion of certain ratios in insurance company balance-sheets to ensure transparency in accounting. But the Finance Minister objected. He argued (probably on the advice of some of the potential entrants) that it could affect the prospects of a developing insurance company (Banga, 2007).

4.5 **Insurance Regulatory Authority (IRA)**

Based on the recommendations of the Committee, the Government constituted an interim authority, called the Insurance Regulatory Authority, to look into the implementation aspects of the report. The Authority comprised a Government nominee and a member each from the life and general insurance industries. The primary task of the Authority was to frame regulations on its functioning and act as the insurance regulator. Subsequently, based on the recommendations of a standing committee, the Authority was vested with the responsibility of developing the insurance business in India and also train and develop professionals and intermediaries for the purpose. In August 1997, when the Insurance Regulatory Authority Bill was piloted in the Lok Sabha, it could not be passed. The Bill was strongly criticized and denounced and had to be withdrawn.

4.6 **Insurance Regulatory and Development Authority (IRDA)**

The IRA Bill, renamed as Insurance Regulatory and Development Authority Bill, 1998 was passed by the Lok Sabha on December 2, 1999 and subsequently by the Rajya Sabha on December 7, 1999, and notified on December 29, 1999. The enactment of the Insurance Regulatory and Development Authority Act, 1999 ended the State monopoly of the sector. The IRDA, as an autonomous body, was constituted on April 19, 1999 vide Government of India notification no. 277. The Act vested the IRDA with the
responsibility of regulating and developing the business of insurance and reinsurance in India.

The principal responsibility of the IRDA includes:

- Framing various regulations governing the activities of the insurance companies and corporations—both Indian and Indian companies with foreign business partners.
- Discharging the responsibility of the Controller of Insurance in opening offices, licensing intermediaries, etc.
- Monitoring the activities of the Tariff Advisory Committee (TAC), divesting the GIC of its authority to transact non-life business and designating it as the Indian Reinsurer.

**Objectives of the Insurance Regulatory and Development Authority (IRDA):**

- To protect the interest of and secure fair treatment to policyholders.
- To bring about speedy and orderly growth of the insurance industry for the benefit of the common man, and to provide long-term funds for accelerating growth of the economy.
- To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates.
- To ensure speedy settlement of genuine claim, to prevent insurance frauds and other malpractices and put in place effective grievance redressal machinery.
- To promote fairness, transparency and orderly conduct in financial markets dealing with insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players.
- To take action where such standards are inadequate or ineffectively enforced.
- To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirement of prudential regulation (Annual Report of IRDA 2002-03).
Functions of Insurance Regulatory and Development Authority:

The IRDA has been established to perform the following regulatory functions:

- Issue and withdraw licenses.
- Specify qualification codes of conduct and training for intermediaries and agents.
- Specify the form and manner in which books of accounts shall be maintained.
- Regulate investment of insurance funds.
- Specify and percentage of life insurance business to be undertaken by the insurer in both rural and social sectors.
- Approve the appointment of the managing directors (Ali et al., 2007).

The IRDA began functioning on April 19, 2000 with N. Rangachary as its first Chairperson and with 4 full-time directors and 2 part-time directors, in addition to the 25-member Insurance Advisory Council. The members of the council represented various industries and professions. The IRDA appointed its first advisory panel with 23 members on May 25, 2000.

4.7 Insurance Councils

The insurance councils that were in existence under the provision of the Indian Insurance Act 1938, were not effective and practically defunct during the days of State monopoly. After the advent of the IRDA in February 2001, vide the power vested in it under Sections 64C and 64F of the Insurance Act, 1938, the IRDA revived the Life Insurance Council and the General Insurance Council. These two councils, each headed by a member of the IRDA, play significant roles in establishing industry standards. As a need was felt for the constitution of an appellate authority for the various decisions of the IRDA, on the lines of the Securities Appellate Tribunal, the Government notified the setting up of an appellate authority for the insurance industry, and also set up a single bench and a division bench; it is expected that shortly a full-fledged appellate body would be set up as envisaged in the Law Commission Report on the subject.
Regulation of insurance is not an exclusive Indian phenomenon. Insurance is amongst the highly regulated businesses in the world. Interestingly, a view is strongly emerging that, in India, the insurance council representing the industry and the IRDA should become a self-regulatory body and address itself to issues relating to the management of the industry as is being done in some countries abroad. However, some industry experts opine that while regulatory mechanisms are regaining lost ground in many countries, as self-regulation had turned out to be a poor proxy, a switchover from well-established regulatory systems to a liberal, self-regulatory mechanism might not be in the interest of the customers.

4.8 Detariffication of Insurance Sector in India

Detariffication has been the most awaited reform in the general insurance industry ever since the Malhotra Committee recommended gradual removal of tariffs in the non-life insurance sector. The detariffing exercise has two phases. The first phase started on January 1, 2007 when the IRDA allowed companies to charge their own premium for all classes of business that had been under a tariff till then. The exception was Motor Third Party Liability Insurance for commercial vehicles. The second phase was started from 1st January, 2009 as the General Insurance Companies have given more freedom to design their own products. IRDA in its circular issued on November 6, 2008 has given the general insurance companies the freedom to offer certain covers outside the scope of the descriptions in the erstwhile tariffs (GIC Re News, 2008).

The reforms have changed the whole scenario of Indian insurance industry. Its character has changed altogether in the wake of transition from a controlled to a competition-driven market. Several new players have entered into the insurance business. The foreign insurers have entered through the joint venture route. Their entry into the field has generated a tough competition in the market which resulted into better customer service. The quality and price of insurance products has greatly improved. The range of products and services has increased so as to give a wider choice to the customers. Both the existing as
well as new players have got ample opportunities to penetrate into untapped areas, sectors and sub-sectors and unexploited segments of population as presently both insurance density and penetration are at a low level. Thus, the reform process started in India has helped the insurance sector to grow in a quick and orderly manner for the benefit of the common man.
References


