CHAPTER-3

INSURANCE AND PENSION: ERA OF PRIVATIZATION AND GLOBALIZATION; A CRITICAL APPRAISAL

1. Introductory Outline

Under the New Economic Regime of liberalization, privatization and globalization, insurance companies face a dynamic global business environment. Radical changes are taking place owing to the internalization of activities, the appearance of new risks, new types of covers to match with new risk situation, and unconventional and innovative ideas on customer's service are required. Low growth rates in developed markets, changing customer needs and the uncertain economic conditions in the developing world are exerting pressure on insurer's resources while testing their ability to service. The existing insurers are facing difficulties from non-traditional competitors that are entering in the retail market with new approaches and through new channels. The basic premise of globalizations is opening up of new service market to provide the developing countries with new opportunities for the expansion of trade and economic growth.

The rapidly changing economic scene, the political attitude, social values and structures, cultural patterns, developments in information technology have transformed life styles in urban and rural areas. The Commutative impact introduces an element of uncertainty in the possible developments in all sectors. At the same time insurance industry also does not remain untouched. Development in other part of the world, which is witnessing sweeping changes in terms of convergence of financial and insurance markets through banc-assurance, replacement of reinsurance contract by financial instruments, sale of insurance through unconventional distribution channels and consolidation through mergers and acquisitions will also have their impact on the Indian insurance industry. Till the year 2000, the insurance industry was
a government monopoly and is new experiencing cut-through competition because a number of players have entered into the Indian market in the form of Joint venture with Indian private partners. Consequently Indian insurance industry has closely integrated with world economy thereby making imperative for insurance to operate outside national boundaries.¹

At present 312 million middle class consumers in India have enough financial resources to purchase insurance products like pension, health care, dividend benefit, life property and auto insurance. Only 2.5 per cent of this insurance population, however, has insurance coverage in any form. The potential premium income is estimated at around US $80 billion. This will place India as the sixth largest market in the world.²

It is rightly pointed, that the pension system in India is still in its infancy. There are generally three forms of plans; provident funds gratuities, and pension funds. Most of the pension schemes are confined to government employees. But the vast majority of the workers are in the informal sector. As a result, most workers do not have any retirement benefit to fall back on after retirement. Total assets of the entire pension plan in India amount to less than USD 40 billion.³

Therefore, there is a huge scope for the development of pension funds in India. The finance minister of India has repeatedly asserted for the privatization of pension system in India. On this assertion NPS was introduce in the year of 2004, than PFRDA Bill was present in 2005 in the parliament but it is still in pending. Now the Indian pension system is in pre-mature stage of privatization.

If, the Indian insurance and pension system, has been analysis, it is observed that definitely the benefit will be to people from the privatization, but it is general tendency, not any thing provides only benefit, there will always be a possibility of some harm. Under such situation responsibility comes on the government that, there must be about 80% benefit which can cover 20% harm.
Same situation are founded under insurance and pension sector in this era. No doubt insurance industry progress after privatization and pension sector will be at the way of progress but there is need of some future directions for much benefit than the harm.

2. Insurance: Era of Privatization and Globalization

The insurance industry affects money, capital market and the real sector in an economy, making insurance facility necessary to ensure the completeness of a market. It is an industry with strategic importance for any country as it contributes to the financial sector as well as confers social benefit for the society. At the micro level an insurance policy protects the buyer against financial loss arising from a specified set of risks at some cost. It thus reduces anxiety and promotes financial stability by providing much needed social security net, especially in times of crumbling family ties and nuclear households in developing countries. Despite the obvious advantages of insurance, India was one of the least insured countries in the last few decades of the 20th century. In 1999 per capita insurance premium in developed countries was very high, whereas in India is very low (per capita insurance premium is only $8 and premium as a parentage of GDP stood at 2% in India).

It was evident that something needed to be done to tap the potential for further growth. With privatization of traditional public sector business like banking, power, telecom and airlines gaining momentum in 1991, the government also realized that the opening up of the insurance sector could lead to enhancement of insurance penetration within the country by leveraging on the rising per capital incomes are rising literacy rates. The life insurance sector was thus opened for private entry in the year 2000 with the passing of the IRDA Act. Opening of the sector to private firms was aimed at fostering competition and innovation through a greater variety of products. It was also looked at as an avenue for generating greater awareness on the need for buying insurance as a service. About 10 year has been passing since liberalization of
insurance sector, so it is right time to analyze the emerging scenario with the consequential expectation from the insurance industry.\textsuperscript{4}

1. **Insurance: Governmental Goal behind the Privatization**

The chief reasons that the government increasingly chooses to privatization of insurance sector are clear. The government chooses the privatization in order to improve the performance of the firms through the discipline of private ownership, as well as to raise the revenue without raising taxes. The specific objectives articulated for privatization programs are often very ambitious, and most tend to mirror the goals voiced by the government during the early decades. These goals are as follows.\textsuperscript{5}

1. **Privatization should Encourage Competition and Improve Insurance Penetration**

Insurance is a fast changing field and its full potential can be better exploited in a free market where dynamism and innovation is enrooted. This is possible when there is a judicious mix of regulation and healthy interplay of market forces. The under-developed insurance market in India offers enormous opportunities for growth if conditions are made favorable for them. For this to happen there must be the large enough number of players so that none of them could individually or in combination with other, dominate the market.

Even with the entry of limited number of players, the pressure from the market to improve performance and service is felt. Encouraging and building up meaningful competition is expected to encourage insurers to seek out new market potential more energetically. It will also widen the financial base in the economy and will provide an additional stimulus to capital formation and a more efficient use of capital. Due to this reason, the government of India, on the recommendations of Malhotra Committee, open the low entry barrier for private player and stipulate to the minimum number of live to be cover by the private player in the rural and the social sector. The result is that the all
companies operating with equity substantially higher than the requirement. Now the insurers have consistently achieving higher figures than the given target.  

2. **Privatization should innovate through Products which suit Customer Better**

Indian is under insured but there are more than enough rooms for everyone, if new players reach the previously neglected sectors and areas, introduce a new product range and offer more cost effective and efficient customer services. There is no reason to prevent them from doing so, because the government privatized the insurance sector.

The result is that the new players following on improving products range, on this line some new products such as Term Insurance Plan, Whole Life Plan, Endowment plan, Single Premium Plan, Annuities and pension are introduce by the private player. The terms and conditions of these policies are customer oriented, meaning thereby as per the needs of the customers which providing benefit in terms of their return.  

3. **Privatization should improve the Service Standard of Insurance**

The government can not perform all the functions with equal efficiency. The regulatory role, promotional role, entrepreneurial role and planning role have not been fully discharged by the government. Due to this reason the government opens the door for private players under the government mandate of a minimum capital requirement of 100 crores, of which a maximum of 49% stake can be held by a foreign partner as equity. The government appointed IRDA a whole sole Regulatory body to the whole insurance business.

The result is that there is improvement in the business standard of insurance. The most of the private players are appointing “Actuary” Enquiry Officer after taking approval from the IRDA. The ‘Actuary’ decide the
eligibility criteria for any business traction and no insurer can transact any business unless the approval of the Actuary. If any fraud has been committing in business, the Actuary will be responsible for them. The Actuary will be responsible for stability and solvency of the insurance company. The insurer are appointing agent for the expansion of their business. The appointment criteria for the agent are decided by IRDA. The criteria is that the agent must be a person who complete 100 hours training class from any Insurance Training Institute and possess certificate of this training. After that he clear the exams conducted by Insurance Institute of India.

The insurer have right to advertise their business but such advertisement must be under the prescribed limits of Advertisement Code. The insurer also have right of formulating Insurance Regulations for addressing policy holder and their prospects. The twelve such types of Ombudsman Institution has been set-up by the government countrywide to address consumer grievances within 3 month.  

4. Privatization should Increase Efficiency in Allocation of Resources by the Dynamic Management Portfolio

In India a multiplicity of authorities, each one with its different rules and norms, complicated decision in relation to investment, instead this there is an insistence on strict prudential supervision, of investment by insurance companies by the government. The longest duration funds are those which pertain to whole life insurance and pension plans. Endowment plans also entrust peoples savings with the life insurers for a period of time and so do variable assurances. Naturally, it is obvious that the fund managers should have the freedom within certain parameter to select both the asset allocation policy and the choice of investment.

So first of all there is one opinion which favors setting up of such an umbrella organization in India too, so that all decisions relating to financial matters will emanate from one sources and will have some uniformity.
After all, in a competitive environment, each company will try to out
form others, and will therefore, try to give better returns to its customers, for
this it may be consider investing in assets other than mandated instruments, for
which, within certain parameters, freedom should be available to investment
management.\textsuperscript{10}

So the IRDA has been established as a parent regulating authority for
insurance companies and remove the governmental monopolistic barriers from
the insurance players. The insurance players today are expected to invest the
funds judiciously with the combined objectives of liquidity, maximization of
yield and safety by confirming to the Authority’s guideline on investment. An
investment policy has to be submitted to the Authority by the insurers before
the start of an accounting year for efficient resources allocation.

At last the insurance shifts from monopolistic attitude to privatization
improve to the operating profitability, investment yield, and marketing and
actuarial efficiency ratios of the insurers over the past year.

5. Privatization should bring about Change in Consumer Outlook

The various aspects of the economic policy affect the growth of
insurance market such as taxation policy of government deeply affect to the
insurance sector, which is particularly relevant for life insurance, is also a long-
term contract and inculcates among the policy-holders the habit of saving.
Taxation of returns on investment influence, investment decisions and high
rates of taxation will discourage the desire to save. In India, there were
complaints that the rates of return on life policies are not what they could be.
Therefore, tax incentives played a vital role in determining the attractiveness of
such policies. Best consumer favor risk product i.e. term insurance over purely
savings oriented policies.\textsuperscript{11}

Due to this reason the government privatized to the insurance companies
and tax charge only on the life policies rather than non-life policies. The result
is the role of insurance is undergoing a phenomenal change today as is evident from the product bouquet and the product advertisements. The emphasis lies on insuring oneself and ones close family member for more self reliance more. To meet the varying needs of various individuals the insurance players have a vast foray of products in their bouquet. Besides this, almost all companies offer the flexibility to the customers to choose the most suitable product for themselves by combining features of a number of products together. Thus the product can be customized to suit the customer as per their needs.

To change the consumer outlook the insurance companies today have widened their distribution channels by approaching prospective customers through agents, brokers and banc-assurance. With information technology revolutionizing the financial sector, another channel has been made available for selling which is the internet.

These types of activities of private players changing the outlook of consumer.12

2. Insurance: Pitfall of Privatization; Unseen by the Government

The entire thing in the world has some appeared and some hidden features, but people attract toward appeared features and neglected to the hidden features which pose the danger in future. Same thing was happen with the Indian government in respect of the privatization of insurance. Indian government gives importance only to the appeared feature and neglect to hidden danger. Some hidden dangers of privatization of insurance are as follows-

1. The privatization over playing the market in the insurance sector, meaning thereby that the new player doing well from a small base and achieving a staggering growth13. The example is that the first year total growth rate of private player was of 153 percent and 101 percent in term of first year and number of policies respectively. But the market share of
LIC in respect of first year premium has fallen to 87.04% from 99.39% in 2002-03. The result of 13% contribution of private player within the third year of the opening up of the sector towards privatization is a significant variable as well as indication for the government that in coming few year, their will be private monopoly and governmental own public sector entities goes in much loss

2. The privatization providing enough business to the private player instead of this that the nationalized player will continue to hold strong position in market share. The public sector insurance companies also increasing their product market by introducing the various new products such as Jeevan Mitra Triple Cover Plan, Bal Vidya Plan, Jeevan Mitra Plans but the policy-holder taking back their policies from the public sector companies and going towards private sector corporation because the facilities provided by private companies are much better than the public company under such situation private companies overtake to public companies.

3. The privatization often overestimate the need for insurance expertise because the exact figures of some new business done by private player are not available, such as the business figure under Unit Linked Plan of ICICI, Birla Sun Life are not known to the customers. Under such situation the necessity of expert agent, broker and smart consultant are feeling by the customers. Such thing increasing the cost of insurance.

4. The privatization increasing the importance of multinational corporations in the insurance as a Joint venture, which is considering as the most popular type of insurance alliance in this present era of most of the insurance company joint hand with player of foreign country such as SBI joint hand with Cardiff, ICIC with Production, TATA with AIG, HDFC with standard life, Bajaj-Allianze & Birla with sunlife.
But this is also true that several partnerships were broken down during the year of 2002. Probably the most dramatic breakdown took place between Hindustan Times (a newspaper group) and the commercial union of the U.K. The management of Hindustan Times realized that they are heavily reliant on a steady daily cash flow.

Similarly, by the end of July 2000, Kodak Mahindra and Chubb declared their divorce. Dabur Group and Allstate also parted company. Allianz and Alpic broke their partnership.¹⁷ So the brokage of present joint venture can be possible.

5. Privatization increasing the exploration of new distribution and marketing channels, such as banc-assurance, corporate agency, and broking among both public and private sector player which increasing the cost of the insurance. Under such situation only strong back brand company such as SBI can stand and other goes back to home:

3. Insurance: Challenge Pose by the Privatization

After privatization, the life insurance industry saw a growth of 10.48 percent in terms of first year premium income and 12.83 percent in terms of new policies sold. The size of the market for 2003-04 was Rs. 187.10 billion worth of the first year premium income with 28.6 million policies. There are extremely satisfactory statistics but certainly not path breaking; they reaffirm the belief that huge potentials still remain unexploited. Under such situation question arises whether privatization is a right decision? The answer is that the privatization is a right decision because it increasing insurance business but there are some lacunas which pose some kind of challenges before us, these challenges are as follows¹⁸

1. Insurance still remain a Tax Saving Tool

The distribution of insurance, till recently, has been through individual agents. They may have sold insurance more as investment and tax saving
products. The feature of insurance cover and its ability to retain the financial status of the family in case of the death of the bread winner may not have been emphasized. This phenomenon is also seen recently where the sales of insurance continue move for saving and tax purposes rather than for pure insurance requirements. The sales of term policies which offer only a risk cover form a small percentage of the total sales of all insurance companies. Agents do not push to these products as the commission amount is lower than in savings products where they got higher commission amount. There is also a typical customer requirement of getting something back on survival that leads the agent to sell a savings plan. This leads to the phenomenon of under insurance as the customer believes that he has bought an investment plan and does not need to review his insurance needs frequently. The reality is that insurance needs change as per change in income, life stages, and life style of each individual and these needs have to be addressed frequently. However, the customer's treats insurance as an investment plan which is not revisited leading to the phenomenon of under-insurance.

2. Inadequate Role of Intermediaries

The practice of selling insurance as an investment has perpetuated over a long period of time and is fed by an agent's obvious need to maximize his income. Under such situation the agents educational position having a long-term relationship with clients which resulting in much more income than maximizing income in the first sale. With this recognition, agents may recommend the right investment and insurance products that suit the individual's specific needs at different stages in their lives. Agents will first have to imbibe this behavior and then convene their clients that what is being recommended is in their best. Building a long term relationship is a lengthily and cumbersome process but with significant long term benefit. Agents will first imbibe this behavior and then convince their clients that is being recommended in their best interest.19
3. **Inefficiency of Banc-assurance as an Alternate Channel**

Insurance is not a business of banks. Banks start this business due to the reasons of the shrinking in banking business by which revenue of bank increase, when the contribution of insurance grow, which facilitate to the banking business. Banks generally have a service oriented culture as against insurance companies that have an aggressive need-based selling philosophy. The rubbing-off of this selling culture on the bank will also help the bank with its own core business. The banc-assurance is more people-related than the insurance company, instead of this that banks and insurance have same business objectives.  

4. **Inappropriate Regulations**

The IRDA has done a very good job of ensuring a smooth transition from a single player market to a competitive one. It will continue to have a major role to play in the years to come in ensuring that each and every Indian citizen is approach with the right advise to cover the risk to his/her life and protect the family from adverse financial circumstances. But certain basic principle such as the regulations governing the training and licensing of the agent, the selling process, products, price etc. are not properly define by which real goal of insurance can be achieved.

5. **Defects in Growth Strategy**

India is a large market and has considerable potential. Currently, the industry needs to focus on meeting the challenges of increasing penetration and achieving the right level of protection for all Indian citizens. It will require quite a few insurers to achieve this goal. Products, process, and procedures need to be devised and implemented by all companies that ensure that, over the long term, agents are recruited and tainted to sell the right products to their customers. This will ensure the success of insurers as not only will their revenues be higher but also their costs will be lower due to higher productivity.
of agents, their lower tumor, and higher persistency of policies coupled with higher customer satisfaction. Putting this process in place will require time, effort, and capital. The pay-offs will occur in the long term. The growth rate of such companies will steadily increase over time.

6. Expansion of Distribution Costs

Increasing the distribution reach to less populated areas will increase the costs of insurers. Such costs will have to be estimated and priced into the products. Issues relating to cross subsidization may arise. Alternatively, insurers could introduce new products for these specific market segments and price them to recover the incremental costs of their distribution. Controlling the distribution of specific products through agents has always been difficult. Another method of controlling costs by increasing productivity is to get agents to focus on particular generic products. Historically, this has been difficult to achieve and may not be in the best interests of the customer.

7. Inadequate Actuarial and Underwriting Skill

Insurance requires special skill in actuarial and underwriting but these skills are inadequate in India. These skills are used by the foreign partner of Indian domestic companies and taking benefit from the inadequacy of India in actuarial and underwriting skill.

4. Insurance: Future Direction towards the Privatization

The insurance companies have a pivotal role in offering insurance products which meet the requirements and expectations of the customers and, at the same time, are affordable. The future growth of this sector will depend on effectively the insurers are able to come up with product designs suitable to our context and how effectively they are able to change the perceptions of the Indian consumers and make them aware of the insurable risk. The future growth also depends on how service oriented insurers are going to be. On the
demand side, the risk in incomes will trigger the growth of physical and financial assets. With the growth of infrastructure projects, the demand for insurance to cover the project and the risks during operations will increase. The other growth trigger is the increase in international trade. However, servicing of the large domestic market in India is a real challenge. Some of these challenges are pertain to the demand conditions, competition in the sector, product innovations, delivery and distribution systems, use of technology, and regulations.\(^2\)

To avoid these challenges and getting benefit from these challenges, some bold steps are necessary on the part of the government as well as insurers, which are as follows-

1. **Improvement in Product Strategy**

   The product market scenario has already started witnessing some revealing changes which are indicator of what is to be expected. Product offerings can be classified into two broad categories as -

   1. Customized high-end complicated products aimed at the high-end, financial-aware customer with risk appetite. Key-man insurance and ULIPs will belong to his segment.

   2. Simplified, OTC insurance products to cater the middle class and lower middle class segments. These products will essentially be a combination of endowment, money-back, and pensions in varying proportion.

   On other area of keen interest it can be imagine that what would be the future of ULIPs which have a very low proportion of risk cover and a very high proportion of investment and savings.

   It is pointed out that the IRDA is progressively moving towards development of insurance mainly as a protection device and the resistance from the mutual fund industry which sees insurance as a favored industry. We might
see a movement towards ULIPs with a less lop-side proportion of risk and saving.

The postulate that the average size of policy will go down as the insurance companies' increase their geographical spread is not something that can be taken as a certainty. The counter argument is that the balance in the product mix of insurance will ensure that average premium levels per policy remain stable. Even if there bofforming is out, it will be marginal. The proportion of key man policies ULIPs and high value policy will ensure that the new age players manage their average policy sizes. So ULIPs with high returns and greater flexibility are also on course for contemporary demand pattern.23

2. Improvement in Service Level

What makes the life insurance industry different from the other financial services is the long-term nature of the relationship of the company with its customers, often lasting a lifetime. The leaps in technology have us or track of the relationship with the customer and also given the information to analyze the changing needs/profile of the customers.

Moreover, the life insurance business is highly complex with the evolving statutory regulations that IT system must deal with. Also with the emergence of multiple channels such as banc-assurance, corporate agency, and broking, the company's IT system need to be adapted with the system of channel partners without compromising the information flow.

Some key benefits of technology have been reduction in turnaround time as well as multiple interaction points with the customer through emails, facsimile, websites, and ATMs, to name a few, which have resulted in improved disclosure to policy holder.24

3. Stabilizing Monitoring Compliance

As of now, significant expansion of the market through increased penetration is not evidence. Whether the sector is growing in absolute terms or
whether there is merely competition for existing business is a matter that call for strategic discussion specially in respect of monitoring compliance, between the insurers and regulator specific initiatives would be needed to achieve higher penetration and for moving up the ladder in comparison to other countries. So it is necessary to establish measurable benchmarks that will keep track on this developmental aspect of liberalization.

So some important steps necessary in the field of monitoring compliance are follows-

1. **Effective Campaign for Consumer Awareness**

   Increasing awareness of insurance among the consumer is a condition precedent for the penetration of insurance. Anecdotal evidence and empirical observations indicate that awareness of insurance among the consumer has improved substantially. This is attributing of effective campaign launched by IRDA and the combined impact of sustained wide ranging publicity by all the insurers. But insurance has been in spotlight at all times and in all fields. Our insurance industry is weakling in respect of awareness campaign especially in the field of insurance because infrastructure of insurance company is week and they are not providing appropriate statistical data towards the pricing to the customer. To improve this companies launching campaign on the market education level. But these campaigns are not appropriate. So their must be an independent regulator to manage the campaign about the insurance in co-operation with the insurance companies.

2. **Co-operation among the Public and Private Player**

   Another sector yet to participate in the new paradigm in insurance is the cooperative sector. This sector too has sought special dispensations in terms of capital requirements though it is yet to carry it with conviction to the regulator penetration of insurance in rural areas would involve low-cost policies. The co-
operative sector and the micro-credit organizations can play important roles in this regard.\textsuperscript{27}

In the life insurance sector, public and private sector insurers seems to be co-operating well in matters of common interest. Their approach to issues such as benefit illustrations, representations to IRDA and government, setting up of the mortality and morbidity information bureau, are examples of a mature approach to important common issues even as they compete in the field. Comparable trends are yet to be seen in the general insurance area. These gaps in coordination among the public sector companies are available.

The general insurance is a complex business both in terms of its fundamentals and operating practices. A key feature of the general insurance market is its skewed structure in terms of rates and terms. More than 60 percent of the business is controlled by a centrally administered rate structure known as the tariff; innovations in these segments are difficult since policy terms as well as the price are externally determined. Competition has to be mainly on promise of good service and performance thereof. The IRDA has recognized this but an action plan to move towards a free market rating regime with adequate safeguard is yet to be put in place. This, when it happens, will determine the future structure of the general insurance market in India, and this will happen when public sector done business in the cooperation of private sector. But in public sector companies, fear of competition, their remunerability in terms of observing price discipline, and conduct of their field force and support staff are anxieties that can not be wished away, and public sector are not cooperating with private sector, so there is need of a well directed measures must be taken.\textsuperscript{28}

3. Removal of Structural Inefficiencies of Public Sector Corporations

In short time since the market has been opened, the private sector companies have set a completely new paradigm of service in both life and
general insurance sectors. All companies have come up with benchmarks for each aspect of service and also internal measurement of quality. For instance, the structure, content, and appearance of documentation are comparable to any in the world. Best practices aimed at informing the customer in a transparent manner have indeed been brought in. These are more in evidence in life insurance possibly because of the long term nature of the business. Indian insurers in the public sector are responding slowly. Regulations have helped achieve standards of disclosure. Here again, in the life insurance sector, both LIC and new companies seem to have set high standards in settlement of claims. The general insurance sector has shown mixed performance perhaps due to the inherent nature of business. While the private sector general insurance companies have set good standards for claims settlement, the public sector insurers are yet to show resilience in the changed environment. This is sure to cause further dissatisfaction and consequent loss of good business. Though structural inefficiencies are stated as reasons for such a situation, the main cause seems to be a pervasive attitude problem coupled with a need for transparency claim handling.

4. Promote Professionalism among the Intermediaries

Some of the significant requirements introduced by IRDA to promote professionalism among intermediaries relate to minimum qualifications, mandatory training and passing an examination before a license is issued to an agent or a broker. The number of life insurance agent in the market has almost doubled to more than a million now.

But there is not evidence yet to show that more agent in the new paradigm show higher level of professionalism than those before. The uglier aspects of competition have been seen in the training, examination, and consequently in performance of the agents. Drop-out rates are still very high and productivity is quite low. Intermediaries such as agents and brokers from all parts of the country will help to play a significant role if insurance is to be
spread to all segments and regions of India. The present trend does not seem to show significant improvement in the quality of the distribution force to achieve higher penetration. Insurance agency is not yet seen as a viable career in terms of income security and social acceptance. Structure of remuneration, limits imposed by law, flexibility of ownership, and transferability of agency are some of the legal rigidities that stifle the development of professionalism among intermediaries.

Distribution is the key to development of insurance and achieving penetration. For the first time, we have licensed brokers in the market and their role will expand and develop. Increasing importance of bancassurance is a trend of significance and in due course will lead to launching of products jointly developed by the insurance and the banking sectors. Induction of corporate agency as a distribution arm has also been a development of significance. Even these are happening. Some adverse developments attributable to misuse of the trust reposed by the regulator appear to have raised concern. Corrective measures are being introduced as reaction to lack of compliance. The insurance industry should observe rules and regulations and avoid a situation where the regulator is obliged to introduce on the spot or ad-hoc directions instead of looking for systemic solutions that have a better chance of success in strengthening the market.

5. Implementation of Self-Regulatory Measures

In a healthy development, that IRDA has made known its intention have more self-regulating bodies for implementation of guidelines and ensuring compliance. The life and General Insurance Councils, the Actuarial Society, the Surveyors’ Association, the Brokers’ Association, etc. are examples. These are trusting and mature moves. Each player in the industry has a major responsibility in making a success of this approach. Lack of self discipline and consequent failure may result in frequent and rigorous regulatory intervention with attendant implications.
4. Adoption of Multi-Product, Multi-Channel and Multi-Segment Route

The key to market growth is though in integrated approach which includes creating awareness about insurance, enhancing reach through cost-effective distribution, and meeting customer needs through product innovation.

A two-fold approach is required while adopting these drivers of growth: increase the depth of penetration in the existing product market segments and drive the width of penetration leading to market expansion by targeting new segments. Given the complexity of the industry, insurers will have to adopt a multi-product, multi-channel, and multi-segment route to the market to achieve these objectives.

Awareness creation must be in line with the creation of distribution reach to ensure that the last mile fulfillment loop is closed. The conventional distribution network comprises of physical networks of branches (direct channel) and agents tied to the insurance companies. In the future, there will be a plethora of channels allowing the customer to choose which channel he is most comfortable with. The options include agents, brokers, direct field force, telesales, banc-assurance, alliances, and the internet.

With the advent of Broking Regulations in 2002, brokers have emerged as an important channel in the corporate segment. Brokers control at world wide close to 80 percent of the corporate business with the top two controlling more than half the total broking market.

Banc-assurance is also gaining prominence. Nearly 60 percent of the life insurance sold in the European countries is through this channel. Banc-assurance relies upon the vast distribution reach of banks and since they are in the business of providing financial solutions, insurance tries in nicely with the product basket. The insurance companies gain through access to an established network, familiarity of channel with financial products, and access to capital.
Banks gain through an enhanced product offering, fee income, and better utilization of their channels.

On the retail front, there is a shift worldwide to virtual channels like telemarketing and the internet which offer the twin benefits of unimpeded reach for the customers and low set up costs for the insurer. Most of these distribution channels are gaining prominence in India. As insurers seek to increase their market share and provide better service to their customers, they will increasingly explore these alternate channels of delivery to provide them with the necessary flexibility.

In addition, most customers who have taken insurance of some sort are usually under insured in terms of the potential risks they are exposed to. This applies to individuals as well as corporate and insurances must constantly educate their customers on the need for adequate coverage. There are also a large number of under served segments such as senior citizens, rural markets, and NRIs whose needs are still unmet. The appropriate product solution delivered through the right channels will be the key to penetrate there market.

Insurance product can easily be copied thereby limiting differentiation at the product level in such a scenario, competitive advantage will be gained through constant product innovation, cost effective distribution and quality of service delivery. This will allow the insurer to differentiate the overall value proportion offered to customer and adopt a pricing model based on the perceived value as against discounting.

The effective deployment of IT is a key business driver with its ability to substantially reduce operating and distribution costs while providing readability. The strategic benefits of technology programmed such as straight through processing, enterprise application integration, and customer relationship management are well know but delivering the expected ROI on these investments is a key challenge. Success in this area will be determined by
an approach where IT is seen as a business enabler and where ownership of technology projects is rates with the business rather than with the IT department alone.\textsuperscript{30}

5. Constitution of a Role Model for Banc-assurance

The introduction of banc-assurance requires having appropriate awareness among bank employees and ensuring that they understand its mechanism. This involves a change in mindset and developing appropriate culture at the bank level. India had very little experience in this field and there were no role models.

So there is necessity for role models for banc-assurance which set an appropriate pattern for banking mechanism in the field of insurance. Some features of this role model are as follows-

1. It is recognized that sales people work for incentives. So, it is essential to develop the desire incentive and get the bank employees interested in the same. This also requires working with finance department to ensure that performance is linked with the payment of incentives and developing appropriate MIS for the same.

2. Interacting with the operations team and develop a CRM system through which the high, network cases can be closely monitored.

3. Manpower and structure issues involve creating a single window concept and, based on this, appointing a dedicated project manager. Finding and hiring such resources is very critical.

4. Monitoring of banc-assurance mechanism by holding regular meetings weekly meeting to quarterly review meetings. These meetings are also used to educate the bank staff and the management about banc-assurance using presentations and the problem solving approach.
5. To management involvement is critical as the implementation of banc assurance-mechanism involves developing and uncalculating an appropriate culture in the bank. This is also important for creating an appropriate ownership about the scheme.\textsuperscript{31}

5. **Insurance: Critical Analysis of Privatization**

1. **Privatization: Sellout Insurance to Multi-Nationals, Foreign Joint Venture**

The recent moves of the government, incensement in foreign equity from 26% to 49% clearly indicate that government selling the insurance sector to the big multinational, foreign joint venture.

The LIC with Rs. 6, 50,000 crore investible financial assets has the attraction of the investment modes provides much benefits. One can imagine insurance majors, having burnt their fingers in the global arena. Itching to gain control over this bounty with a relatively, small investment. LIC which for decades has been providing oxygen of cheap long term capital investment in infrastructural and social development in other words, our national building mission should not be allowed to fall prey to purely mercenary capital. But this is happen by the recent move of the government.

The two aspects are worth nothing here. One is the observation of the world Bank- supported “Commission of Growth and Development” headed by Michael Spence, co noble laureate with Joseph Stiglitz: “The view is that foreign saving is an imperfect substitute for domestic saving, including public saving to finance the investment is a booming economy requirements” in lay term it means that national interest and foreign corporate interests are incompatible.

Equally noteworthy is the indisputable fact that foreign institutional investors have withdrawn Rs. 1, 00,000 crore from the equity market this
calendar year till now. This is as per provisional data provided by the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). What is the guarantee that foreign players will uphold our interests above their own, when it comes to a financial crunch?

Another equally disastrous move is the amendment to the General Insurance Business Nationalization Act, aimed at allowing the four public sector general insurance companies to disinvest their shares and raise resources from the market. This steep to meet capital requirements is that the government is not in a position to provide them. Hence the initial public offering route is touted as the best option. In effect, it will pave the way for privatization of a fundamentally strong public sector.

With total capital of Rs. 350 crore, all the four companies are adequately capitalized and have adequate provisions to meet the requirements of solvency margins. Their combined profit in 2007-08 was Rs. 2794 crore and they paid Rs. 449.49 crore as dividend to the government. Their combined investment in the Indian economy is Rs. 62,922 crore, and they maintain reserves and surplus of Rs. 13253.51 crore. Their asset worth is Rs. 79,198.47 crore. Any move to sound the privatization horn of such a sector would be deleterious to both our economy and national interests.

2. Privatization: Linking Insurance to a Speculative Bubble of Casino Capitalism

Another retrograde amendment sought in the Insurance Act is to relax the stipulation of the insurance funds be invested only in government securities and approved investments. Movement of these outside the country is expressly prohibited. Bowing to private demands, these funds may even been allowed to be parked offshore. In the prevailing volatile global share and stock market scenario it would be a sure recipe for disaster, since we would be voluntarily linking ourselves to the speculative bubble of casino capitalism. There are
some points for discussion on the hand, how much speculative money is moving around the worlds, as well as, how the size of the global real economy, in which goods and services are produced and traded, is estimated at $4.81 trillion. On the other hand the size of the global financial economy, the total amount of stocks, securities and deposits, adds up to $15.18 trillion. The financial economy thus swollen to more than three times the size of the real economy, growing especially rapidly during the past two decades.

Some caveats need to be entered here, in the glamour to attract foreign capital and especially in the wake of the collapse of American Imitational Group, the world’s largest insurer. The sub prime crisis has devastated foreign insurance players. The insurance companies like MetLife, New York life, U.K. Prudential, Aviva, Fortis, and Allianz are undergoing turmoil in their countries of origin. Yet our confidence in their purposed expertise seems unshaken! How else can one explain the efforts to allow Lloyd’s of London to enter the reinsurance market, so far as the exclusive domain of GIC of India? It is worth remembering that Lloyds was left financially hamstrung by the payment of $7bn, it made for Scottish windows in 1999. Let us also not forget that in the period from 1988 to 1992, it was rocked by losses amounting to $14.09 billion, which lead to an article in the wall street journal questioning “the ability of Lloyd’s to continue as an on going force in the market place: should not we question the wisdom or rather the lack of it that can envisage lending hospitality to a company with such a track record.

3. Privatization: Promoting Jealous among the Insurers, Public and Private Sector Corporation

The goal behind the privatization was to ensure much better conditions for consumers, meaning thereby more product would be available and the premium rate would fall, even the nationalized public sector companies would be force to deal with such reality of competition.
But the result is negative the companies not only private players but public players increasing the rate of premium and reducing the number of policies offer. Privatizations promoting a jealous attitude among private and public players, both are anxious to show profit on all lines of activities.

What this means most starkly is that the cross-subsidization which was characteristic of the insurance sector earlier, and which indeed is typical of most public sector service provision, is disappearing. Now however, the general as well as life insurance companies showing profit rate or margins which are comparable to those of the private sector, they are likely to turn more cautious and stingier about providing insurance cover to a range of consumers, simply in order to maintain “competitive” profitability.

What does this mean for consumers? It means the complete opposite of what was promised when the insurance sector was liberalized. Thus, not only have premium rates gone up quite sharply, but it may became more difficult to be eligible for a whole range of policies in areas where they really require it, that is, where they are in fact at risk.

Also, rates of claim settlement were earlier in India the highest in the world, at more than 90 percent in life insurance and 70 percent in general insurance, compared to around 40 percent internationally in both. These are now likely to fall as companies try to ensure higher profit margins through this means as well. This means that in the event of some misfortune, which may be covered the policy on paper, the policy-holder would be less likely than before, to get his or her claim settled.  

4. Privatization: Paving ways to the Stratagem in Insurance Litmus Test

The insurance is an intensively people-oriented business and human resources will be the undoubted differentiator like in any other retail industry.
The quality of manpower attracted and retained by insurers and how their abilities and ambitions are harnessed would be the litmus test for the industry.

But there are stratagems to the insurance litmus test because the insurers have become selective in recruiting agents; they do not judge to the agent on the point of technicality of business as well as behavioral skill which is important for the progress of the business of particular company. The people are taking training forge certificates in money without actually undergoing the actual training process. Other distribution channel also has specific minimum eligibility requirements. This thing possibly lead failure of private player would adversely affect those who had sunk their life savings in such companies. The high incidence of such cases was indeed why the companies in India had been nationalized in the first place. There was the potential misuse of the huge pool of savings raised by this sector, which could be utilized for productive investment, including by the state.$^{34}$

5. Privatization: making Insurance a Privilege only for Richest

Access to the social security is a fundamental right. While the country is expecting its gross domestic product to grow faster, a balanced growth is a major concern as the gap between the rich and the poor would be widened further in a country like India. Insurance sector definitely will have an impact on reducing this gap, though it may take many years to build a bridge between the have and the have-nots.

Today insurance is driven by the non-governmental organization and micro financial institutions. Whether these organizations alone would be able to make financial inclusion a success story? There is still a layer called below poverty line not covered by these agencies.

In the last several years, insurance or getting insured was the privilege of the rich. Even in the last years of existence, the state-owned life insurance corporation or other general insurance companies preferred to insure the
household which have strong assets or a good income level, even in rural they also have competition with Private Sector Corporation of making profit not for the welfare of the people.35

3. Pension: Era of Privatization and Globalization

The social security schemes in India have taken impressive steps already. It has experienced phenomenal growth, complemented by the country’s improving economic fundamental.

Nevertheless, it appears that we are just at the beginning of an exciting ride. It would be worth nothing here the huge untapped potential in the largely undeveloped private market.

The pension system in India is still in an embryonic stage to say the least. Although India is the world’s second most populous country, its fertility rate began dropping, noticeably in the 1980’s. By 2050, it is expected the rate will level off to the point that is close to the rate of population replacement. India’s elderly people’s population is already growing quickly. Between 1951 and 1991 the number of elderly increased from 20 million to 57 million. By 2016, the elderly population is expected to number 43 million.36

Because of ever-increasing longevity, a system of retirement provision based on inter-generational income transfers faces crisis. And, with more people living longer, and working populations reducing, the “new math” is that these are fewer workers supporting each retires.

This trend is set to continue. One solution is to move to self-financing of old-age income, with the government creating the institutional and financial infrastructure to enable and encourage people to save and invest assets for their own retirement income.
The government's initiative to set up the new pension system and to encourage the development of a structure for privately managed pension is a notable example of this.

The NPS introduce defined contribution, fully funded, individual retirement account pensions, with the fund management of these entrusted to private fund managers.

The aim of any pension reform initiative is to reduce the unfunded liability, reduce the role of the state as pension providers and increase the pension coverage.

The introduction of new pension system would arrest the increase in the unfunded pension liability of the government employees pension by covering the new government employee from January, 2004, reduce the role of the government in supporting the other unsustainable defined benefit pension liability, which would ultimately fall on the government; provide universal access to people, enabling those who do not have access to any vehicle to build up assets for old age income, and once the new system settles down, the government could have increased resources to consider strengthening the means tested tax financed pension for those who do not have adequate income to self-finance their old age income.

When a change in the pension system is envisaged there are always concerns, that whether this properly doing work, fulfilling the goal behind it or not.37

1. Pension: Government Goal behind the Privatization

The privatization is a process not an event, in respect of which the governmental initiatives have to be pursued continuously with patience as the result may not be forthcoming over short to medium term horizon. The governmental goals behind the privatization are as follows.38
1. **Privatization should increased Coverage at adequate level for Old Age Income**

India faces a huge challenge in improving pension coverage (only about a fifth of the labor force is covered), particularly among workers who are not employed in the formal private or government sector. Of the total earning workforce of 450 million, 85%, or about 380 million works in sector other than the formal private sector and the government are usually classified as belonging to the unorganized sector. However, the primary occupations of workers in this category are wide-ranging including self-employed farmers and wage labor, self-employed business owner, salaried or contractual employee in the informal sector, self-employed professional, and other. There is great diversity in term of size and regularity of income, saving potential and overall awareness of the need for and ability to save for retirement. This poses serious challenges in achieving pension penetration under such situation privately managed, voluntary system cape the problem and permit individual to voluntarily join the scheme. So the government introduce NPS, therefore, should be flexible to this groups of individuals. They can save their money in the tier II of NPS which define the voluntary schemes for the employees of income group.39

2. **Privatization removes Unfunded Liability of Government**

The privatization of pension sector reduced the unfunded liabilities of the government. Under the privately managed, mandatory fully funded new pension system, the 10% of the salaries of the employee reduce every month, to which they can not withdraw in their service time, at the age of retirement (60 years) they can withdraw only 60% of their investment. They mandatory purchase annuities of remaining 40% from IRDA approved Life Insurance Corporation of India, which provide life time benefit to person concern. The person who has the scheme before attaining the age of 60 year, they can
withdraw only 20% remaining 80% will be invested in the annuities sold by LIC, which pay life time pension benefit to the person concern.

3. **Privatization reduces the role of State as Direct Pension Provider except tier one.**

The privatization reduce the role of the state as direct pension provider, because there are not any unfunded liability on the part of the state, as well as not contribution on the part of the government as prescribed under mandatory, publicly managed, tax funded pillar for social insurance where defined benefit plans are in action, as the government contribution 1.16% of wage to employee pension scheme under non-governmental sector employee.

This privately manage, mandatory fully funded pillar does not cast duty on the government to contribute any condition of the pension of government employee under governmental as well as non governmental sector.

4. **Privatization increase the role of State as Facilitator in Regulatory Mechanism for ensuring Sustained Development**

The state introduces a unique system for pension regulation in the name of new pension system. The NPS open a single Individual Retirement Account (IRA) such account to have a unique number for life into which regular contribution will be made. On retirement the individual should be required to use the accumulated assets to buy annuities from annuity providers. Under this system point of presence (PoPs) to be located all over India to include bank and post offices. PoPs will be visited by the account holder to carry out transactions. The PoPs will be connected through a centralized record keeping agency (CRA). The CRA will pass on the contribution to the pension fund manager (PFMs) for investment management. Retirement advisors advise to individuals on number of issue including selection of pension schemes of and on the PFMs. The Indian pension Authority should be created to regulate the system. The Banks or PFMs should be annuity provides as well as the LIC.
should sell the annuity. These whole regulatory mechanisms regulate by the state. So these system increase the regulatory role of the state.  

5. Privatization ensuring Regulatory Mechanism for Security of the saving

The privatization should provide optimum return to those who save for old age income through different vehicle, because the privatization provides an adequate regulatory mechanism for the ensuring security during accumulation period. The NPS have risk sharing arrangement between individual members, insurance companies, as well as the governmental companies and the government for addressing the risk in an affordable manner. If define annuity provision etc.

6. Privatization provides Resources to the State for Means Test Tax Financed Pension

Tax incentives are instrument of growth of pension market. Tax incentives have always encouraged the growth of individual pension products and employer sponsored schemes. It is also used as a vehicle for providing incentives for more savings, fostering industrial development, providing selective concession and checking inflationary pressures. For these reasons the benefits of taxation are incentives to promote the pension fund establishment, which also will help in generating tax revenues. Tax authority, therefore, encouraging such tax incentives to employers as well as employees and also other individuals.

The privatization provide a system in which some voluntary schemes as well as mandatory scheme are their. In which the employee can save more than the limit of 10% to avoid the tax, by which government benefited because much saving of the employee for future increase the annuity business by which government will be benefited.
2. *Pension: Pitfall of Privatization; Unseen by the Government*

There are so many reasons of the failure of privatization of pension in India which could not been seen by the government which is as follows—?

1. Privatization contains no social insurance components like disability and survivors' benefit. Retiree would have to buy them separately. Benefits may be reduced by as much as 30 per cent in some cases. Current retirement benefits are barely adequate and a retiree wants reliable sources of income.

2. Privatization initiate to having individual retirement account in private pension fund which would be prohibitively expensive to administer. In some cases where contributions are small, administrative costs may be as high as 25% of contributions.

3. Privatization gets the employer off the hook. Risk shifts from corporations to employees. Most employees prefer the stability of pension plans to higher volatile monetary value of the fund. For less wealthy, assured income has always been economically better than higher but volatile and uncertain financial wealth.

4. The privatization would be add to the problem of agency risk, which has not been taken note of government, would have to add a so called pillar that will guarantee a minimum pension to employees whose own defined pension fall below a specified minimum. Along with tax subsidy, policy makers should factor into the cost of government providing guarantee for policy holders.

5. Privatization providing fund investment to the employees those who do not have any knowledge about the fund sound choice. So they bear he risk, under such situation the government bear the liability for mandated saving.
6. Privatization contains the provision of no early or premature withdrawal which make pension system unattractive.

7. Privatization does not provide self selected annuity buying system. It cost these responsibilities on pension fund manager.  

3. Pension: Failure of Privatization; Reasons some Prerequisite Act

1. Suitable Legislative Framework

Governmental Initiatives

The government of India on 1st January 2004 enacted the Pension Fund Regulatory and Development Authority by ordinance, an executive order. The PFRDA Bill 2005 is envisaged to apply to:

1. New pension system; and
2. Any other scheme of pension not regulated by any other enactment and would exclude from its purview
3. All provident fund and employee pension scheme,
4. Contracts referred to in sub-section 2(II) of the Insurance Act-1938, and
5. Any other pension scheme which the central government may exempt from the application of the proposed PFRDA Act.

The area which has been excluded by the PFRDA is added with greater potentiality by LIC. These areas are as follows:

1. The instruments under EPFO such as employee’s deposit link insurance
2. The employee pension scheme, 1995
3. The Gratuity Saving and risk cover products, whether under Payment of Gratuity Act, 1972 or under any other scheme.
4. The saving and risk products during accumulation and beyond under “approved superannuation funds”

The new pension system defines-

1. Defined contribution based mandatory tier I scheme where the new entrant to the central government will make a mandatory contribution of 10% of the salary and dearness allowance, which will be matched by the central government.

2. An optional tier II withdrawable account in the absence of facility of general provident fund. The government is to make no contribution to this account.

Under this system the contribution from the subscriber are collected in an individual pension account using point of presence and central record keeping agency and accumulated by pension fund manager in the three optional fund under option ‘A’ investment will be the predominantly in fixed income instruments and some investment in equity. Under option ‘B’ there will be greater investment in equity. Option ‘C’ implies equal investment in fixed income and equity instruments.

At the time of exit, it is mandatory for the employee to invest 40% of pension fund in purchasing annuity from the annuity provider and remaining 60% paid in lump-sum at the time of exit.

Lacunas in the Governmental Initiatives

The government takes steps in respect of privatization of pension through some legislative framework. But the legislative framework in this regard hit by some defects which are pointed out by the Standing Committee as well as some imminent personalities such defect are as follows-
1. This framework does not define any provision regarding the investment of fund collected under second tier.

2. This framework does not define that to whom government appoint point of presence (not only to the bank and post office) pension fund manager, annuity provider and retirement advisor.

3. This framework provides responsibility of PFM, POPs, independent pension advisor as well as annuity advisor, which has been governed by IRDA. How IRDA, accept the rules of PFRDA.

4. This framework provide responsibility on the LIC of EDLI schemes, pension schemes, gratuity saving and risk cover product without making amendment in the regulation and role of trustees, gratuity or superannuation fund, regulation of funding, regulation of actuarial management of these fund, review of the tax incentives etc. as well as the role of trustee.

5. This framework does not define the criteria of appointment of any authority.

6. This formwork does not define any provision for the foreign direct investment.

2. **Strong Regulatory Authority for Regulating Different Actives**

**Governmental initiatives**

The pension regulation is a complicated matter for which strong regulatory authority which regulate to the whole system must be required as parent authority. The PFRDA-Bill, 2005 define the provisions regarding the establishment of PFRD authority as strong body to regulate whole system with some power, functions and duties.

The PFRDA-Bill 2005, define that PFRDA shall be established by notification in the official gazette. Such body shall be body corporate having
perpetual succession and common seal with power subject to the provision of this Act, to acquire, hold and disposes of property.

The authority shall consist of a chairman and not more than five members, among them three will be whole time member and two other will be part time member.

The authority shall have the power to regulate the new pension system and approved other schemes of pension with specific reference to subscriber’s interest; the committee has various duties and functions as confined to establishing a mechanism for redressing the grievances of subscribers which are to be determined by regulations. It provides power to make panel or remedial measures against the intermediaries, if needed, in the interest of subscribers. Committee felt these are in very general term as one among the duties and functions of the authority.

The authority also has the power to delegate its authority to any person or member subject to the condition.

**Lacunas in the Governmental Initiatives**

The government takes the initiatives on the establishment of a strong regulatory body. All steps are in right direct but some lacunas are their, which are as follows.

1. The framework on the establishment of PFRDA does not define strong and urgent need of their establishment for the protection of old-age income security.
2. This framework does not define the selection criteria as well as qualification criteria for the non whole time member.
3. This framework does not define any nominated member.
4. This framework does not define insurance by Authority towards the subscribers in respect of contribution to various pension schemes and
funds investment option under pension scheme, intermediaries and other operational costs under the NPS.

5. This framework does not define the provision for advisory committee for PFRDA which doing a huge wore like IRDA to which advisory committee are attached.

6. This framework does not define any provision for strong delegated authority to which PFRDA can delegate authority.\(^4\)

3. **Institution of “Ombudsman” for Resolution of Dispute**

**Governmental Initiative**

The government under PFRDA Bill considered sole ombudsman for the resolution of dispute. Only PFRDA have power to impose penalty on any person, member, intermediaries or companies in respect for the violation of the business of pension regulation. The Authority shall have the power to appoint the investigation officer and report to the PFRDA.

Any court does not have power to intervene in the dispute. The direct appeal should be file to the Supreme Court against PFRDA.

**Lacunas in Governmental initiatives**

The government was on mistake to give such power to the PFRD. Their must be a separate body “Ombudsman” among the members of PFRD, for whom strong selection and qualification criteria must be their.

4. **Pension Protection Fund in case of Insolvency of Pillar-II**

**Governmental Initiatives**

The government, under PFRDA Bill, made provision for the establishment of the subscriber education and protection fund. This fund shall
be utilized for the protection of the interest of subscribers in accordance with regulation made for the purpose.

**Lacunas in Governmental Initiatives**

The fund which has been constituted in the name of subscriber education and protection fund shall be invested for the variety of purpose such as subscribes education and their protection. The word protection includes various important and their allied matter. Their must be separate fund in the name of “pension protection fund” to protect the rights in case of insolvency of tier 1 pension funds, insolvency of PFMs, fraud & other things.

4. **Pension: Broad Directions towards the Privatization**

1. **Change in the Structure of New Pension System**

   The basic architecture of new pension system is hence one where individuals deal with point of present (bank & post office) which carry these instructions to the depository. The depository would maintain the database of all individual accounts as well as the instructions given by each individual. The depository would consolidate individual instructions into blocks of funds, which would be handed over to pension fund managers. In this system, pension fund manager would be able to focus purely on fund management.

   No doubt this system yields the lowest transaction costs. But there must be a method which could also be devised to facilitate direct interaction between the individuals and pension fund manager and hence in due course attempt should be made to phase out the depository corporation so as to facilitate direct interaction between individuals and pension fund managers.

   There must be user-friendly computer terminals which permit the workers to calculate the expected value of his future pension, based on the money in his account, and the year in which he wishes to retire.
The worker must be given the facility of early retirement, when they have sufficient saving in their account to found a reasonable pension. Under such situation 50% of the average salary of previous 10 years, as long as it is higher than the minimum pension should be awarded at the place of system provided under new pension system, in which only 20% money he can withdraw remaining 80% invest in annuity where pension depend on the annuity business.

2. No Cap on the Number of Pension Fund Manager

The model of private pension should be implemented using private pension fund managers. The OASIS report recommends the establishment of six pension fund manager so as to simplify the choice for individuals. But this objection is misplaced, as, even if individuals themselves do not posses the knowledge of financial instruments, the market force would enable them to decide to employ a PFM. Under such situation who would make the choice on their behalf. Hence this number should be determining by the free interplay of market forces. The most efficient fund managers would survive while the rest would be weeded out and hence there should no cap on their number.

3. Much Wide Investment Option and Prudential Regulations for PFMs

Each pension fund manager should offer at least three different types of investment alternatives:

1. Safe income
2. Balanced income
3. Growing income

In this respect regulations need to be laid down to harness the rate of return of the asset class and prevent malpractice and defrauding. In addition assurance also needs to be made for ensuring the safety of return.
In India, the fund deposited into pension accounts is invested mostly in government securities and securities under the special deposit scheme. The returns of these are highly limited. Under such situation if employee invests to the pension fund in the equity market, the return from the equity could be greater than the government bond. No doubt equity investment is risky but also yields greater return. Hence the strategy to reduce risk and earn maximum return would be to:

1. Phase out equity exposure after 50 years
2. International diversification would greater reduce risk and volatility. Expected rate of return taken as an average varies only slightly across different countries.

The OASIS report recommends the following strategy to be adopted for three asset classes:

1. **For the first five years, all domestic equity investments should be implemented using index fund on the NSE-50 or the BSE-100 indices only.** There should be no “active fund management” (where fund managers have discretionary control of which shares to buy). Pension funds should not engage in off-exchange transactions on domestic equities: this help ensure a high degree of transparency in all transactions and a lower incidence of murky market practice. These rules would make it possible for pension assets to harness the equity premium” (the higher return of equities) while suffering from none of the risks that flow from giving fund managers complete freedom in forming share portfolios.

2. Investments in corporate bonds should be limited to investment grade corporate bonds in India, which are liquid. Liquidity helps ensure that the secondary market prices of bonds (which are used in valuation of pension assets) are reliable. The definition of a liquid bonds should be as
follows: the average impact cost (on the most liquid exchange in India) at transaction sizes of Rs. 100,000 should be below 0.3% pension fund should not engage in off exchange transactions on corporate bonds: this helps ensure a high degree of transparency in all transactions and a lower incidence of murky market practice.

3. International equity investment should only be implemented using index funds. It has been proved that if passive fund management is adopted, returns can be maximized by investing in international index funds, which are more or less stable and hence involve a lower risk thus guaranteeing safer returns.

The OASIS report has suggested certain stringent criteria for PFMs such as:

1. In the safe income style PFMs would have to guarantee that they would not underperforms the weighted average returns of all managers in that style by worse than 2% point in a year.

2. Further, the PFM also has to assure that it collects Rs. 10 billion worth of assets within 2 years or its fees would be dropped by 20% in the next year.

4. Different Investment Alternatives

While international diversification sharply reduces risk, it also reduces return accessible to under raged investments since equity premium internationally is lower than that of India. The lower volatility of the world stock market index as compared to the much less diversified NSE-50 index will ensure higher rates of return.

The OASIS report recommends passive fund management by using index funds in its recommendations. This however seems to be just a half-hearted attempt to the whole privatization approach. Undeniably, index funds have the following advantages:
1. If markets are fairly efficient then it is difficult for active fund manager to obtain excess returns after considering extra fees and costs. Active fund management is a method of trying to earn excess returns. In this process, active fund managers expand resources on fund management and incur trading costs. Index funds lower expenditure by avoiding information collection and processing. Broadly index fund also engage in smaller trading volumes, which help, enhance returns through lower costs of transacting.

2. There is greater difficulty in monitoring the activities of an agent. If a layer of intermediaries in the form of pension committee is introduced then incentive schemes need to be devised to make both committee and the PFM to act in the best interests of workers, which is highly difficult task in itself.

3. In the case of quasi-nationalization of pension accounts, when the bulk of the investment is done in equities there may be a large political risk where the government can use this control for meeting its political ends. However this can be avoided if workers have their own IRAS and are given the choice of choosing a fund manager.

4. A native comparison of returns across alternative funds in an efficient way to measure, fund manager ability especially when there are significant differences in the levels of risk adopted by different funds. A casual comparison should give way to a more scientific process of evaluation. Hence for a deciding on a pension fund manager, more objective sets of guidelines are required. Active fund managers may be able to fulfill requirements of size at the selection but may fall short on grounds of performance, thus blaming the authority for a wrong selection of pension fund manager. Hence, in the case of pensions, poor
asset return should be traced back to poor returns on the index which would in turn infuse greater accountability.

However, the advantage of the index funds do not necessarily means that active fund management is in any way disadvantageous. Index funds themselves impose certain negative externalities:

1. Distorted cost of capital for index stocks.
2. Inferior corporate governance.
3. Diminishing market efficiency
4. Enhanced concentration in the fund industry.

In India, market in efficiencies may still arise on account of:

1. Poor information access: inferior disclosure laws
2. Inferior human capital
3. Higher transaction costs

But this does not mean that the individuals should not be given a choice to try their hand at active fund management.

Even though the argument of increased transaction costs may hold active fund management in itself, has a high educative value and one should not discount the existence of certain enterprising individuals who would be able to use these inefficiencies and earn a higher rate of return on their deposits.

Moreover, individuals themselves should be given a choice of whether they would like to adopt passive or active fund management for their accretion along with the freedom to choose their fund managers. However there could be an argument that the "moral hazard" problem enters into picture. That is, in case individuals are baked by too many government guarantees then they would be prompted to take more risks than they would ordinarily have taken and hence would opt for the riskier strategy of Active Fund Management. But
this problem can easily be solved. The individual who are ready to take the chance with active fund management should be allowed to do so at their own risk. Hence in the three-fold scheme recommended by the OASIS report an additional active fund management scheme should also be introduced and PFMs should be provided the option of carrying this style too.  

5. Participation of Insurance Sector

The reform in the pension sector is also closely connected with the insurance sector. The common ground between the two pointed the following considerations:

1. On retirement, pension assets may be invested with annuity providers, who form an important component of the insurance sector.

2. Moreover, both pension fund management and insurance deal with similar kinds of investments, i.e. long term. Hence a reform carried out in one of them will necessarily have a positive external effect on the other and as such both share a symbiotic relationship.

Private pension business is a part of insurance business in India. After nationalization of the insurance sector in 1956, the LIC of India became the only player. The monopoly of the LIC seriously hampered the development and growth of the private annuity market. The Malhotra Committee (1994), the expert group that studied the insurance sector, suggested opening up the insurance industry. Following the committee's recommendations, the government liberalized the insurance sector in the year 2000. As a result, private corporations including foreign entities are now being permitted to enter the private market.

The IRDA has recently released investment norms for insurance firms intending to enter the private pension market. The IRDA (investment) Regulations, 2000 suggested that the pension and general annuity business,
every insurer shall invest and at all time keep invested assets of pension business, General Annuity Business and Group Business in following manner.

1. Government securities, being not less than-20%
2. Government securities or other approved securities inclusive of above, being not less than-40%
3. Balance to be invested in approved investments as specified and to be governed by exposure /prudential norms specified in regulation not exceeding 60%

For the purpose of this sub regulation:

1. No unapproved investments shall be made.
2. All investment shall be made in graded securities and the grading shall not be less than of very strong rating by a reputed and independent rating agency.
3. Every insurer shall invest assets in securities which are actively traded in any stock exchange in India and which are attributable to segregated funds, in respect of linked business.

The IRDA regulations fall short on many counts:

1. The OSAIS report recommends a minimum investment in foreign equity, but the IRDA regulations are silent with reference to the investment in foreign equity. So in India there is need to liberalized system and allow Active Fund to be invest in foreign equities and common stock of corporation, to enable the PFMs to harness the highest rate of returns. As and when the PFMs gain experience investment ceiling ought to be raised.

2. The investment in government and other approved securities is laid down to be a minimum of 90% in the IRDA regulations. This falls somewhere in between the safe and balanced income styles of the IRDA
approach. The regulations of the IRDA approach therefore discount the possibility of implementing a growth based pension fund investment schemes.

3. The sub-regulations make it amply clear that passive fund management is being favored over active fund management.

Under such situation the PFMs should be granted adequate flexibility to make their portfolio choice.\textsuperscript{48}

6. Government Guarantee in Distress

To reassure the people to switch the new system government guarantees play a vital role. These guarantees may take the following three forms depending upon the level of "welfare function" that the government takes upon itself to perform:

1. The government provides welfare type pension funded from general revenue for workers with fewer than 20 years of contributions.

2. When workers with at least 20 years of continuous service, do not have enough capital accumulation in their accounts to found a pension that meets the legally defined minimum pension, the government may add the money necessary to provide that pension.

3. Similarly if the funds in the retirement account of a worker are depleted before a worker dies then the government may give the worker the minimum pension.\textsuperscript{49}

7. Strong Administrative Authorities

The Indian Pension Authority (IPA) would oversee the entire working of the system and handle the administration. The interim PFRDA an also help in ensuring that procedure of collections of pension contributions, record keeping,
member information dissemination etc. are efficient with low transactions costs. It could also undertake studies of modalities for introducing the Central Record Keeping Agency, point of presence mechanism and criteria for selecting pension fund manager. These tasks require a new separate regulator, which has been referred to a PFRDA. The proposal is for SEBI to be a regulator for perfuming some function of pension regulation as CRA, with PFRDA.\textsuperscript{50}

8. **Removal of Subsidies**

The present contribution of 1.16\% of wages by the government to the employee's pension scheme should be discontinuing. Instead this contribution to the senior citizen's fund for the first 3 years of incorporation of fund should be discontinue and this discontinued funds plus 25\% of the premature and lump sum withdrawal tax on provided fund under the new IRA system should be transferred to this fund annually.

9. **Coverage of Unorganized Sector**

The absence of a unique social security number in India along with the high costs associated with implementation make it impossible to have a mandatory pension scheme for all. Especially with regards to the unorganized sector, the PPF scheme has clearly failed in attaining its objective of inducing savings. Even the LIC has neglected annuities and pension schemes, which have considerable potential among the self employed and only 100 million people, are covered by provident fund or pensions. LIC has no low premium policies like term or whole life insurance. Instead, it concentrates on expensive endowment policies.

The New Pension System regulated by PFRDA has provision for voluntary participation which has the potential for significant coverage in respect of unorganized sector but it must be clearer.
10. Uniform Tax Incentive

In India vary small proportion of population pays income tax or other direct, the effect of which that this burden shift on poor classes.

Under such situation the better idea is that their must be a uniform tax incentive for all workers-for example by providing a direct payment of tax to the retirement and saving account. But one problem by this system come out, that the people’s saving decrease, under such situation preferential treatment to the tax paying should eliminate and the costs of these preferential treatment should distribute among low income group of workers which increase saving habits.

11. Early Withdrawal

One important problem attached with the NPS is “not premature withdrawal”. This problem can be solve by the government by segregated different fund constituted for different purpose, when person concern demand for withdrawal of their pension fund, the government give than out of the fund constituted by the segregation of different fund.51

5 Pension: Critical Analysis of Privatization

1. New Pension System: A Bull Run rather than Bear Run

The new pension system does not give any explicit or implicit assurance of benefits except market based guarantee to be purchase by the subscriber. Under this system the private fund managers will offers an array of schemes with different risk return profiles. The subscriber divided his contribution into these schemes, and has the option of changing this combination at any time. The final pension wealth will depend on the performance of the schemes chosen by the subscriber. The subscriber takes the entire investment risk. The premise is that the fluctuations in over the working life of the subscriber.
However, the subscriber is exposed to two major risks at the time of exit. If there is a major market shock at the time of retirement leading to a fall in assets price, the entire accumulate wealth is at risk, subscribers in few years to their entry in the business would likely ride over this shock, but the subscriber retiring at that time will be affected adversely. Second, the subscriber has to purchase an annuity at the time of exit, and is similarly exposed to any sharp downturn in the annuity market at that time.

So there are interring temporal variations in yield (bull and bear phase). To these variations one should add even larger interpersonal variations in return if employees were free to choose their own portfolio.

The uncertainty and risk in the New Pension System can not be avoided because on the one hand the pension under that system which is un indexed devastatingly affected by inflation, on the other hand the longevity risk which can be avoided by the annotation of an average about 15% of the capital sum but it also covers the account management, investment management, commission and other selling costs as well as the profit, of insurance company and the cost of adverse selection. So the NPS is a Bull Run system rather than a bear run.

2. New Pension System: A Flag off Retrograde move towards Privatization rather than Centralization

The new pension system has three main trust areas viz. one is switching over to the “Defined Contribution” concept from that of the “Define Benefit” concept, second is shifting to personal and social insurance schemes from social assistance schemes and third one is diverting the Social Security Funds from the debt market to equity market. These recipes are also brandied as moves aimed at identifying the appropriate mix of public sector-private sector participation in social security”. These move have some dangerous implications, which are intended to flag off retrograde move towards
privatization, as the private sector seeks to participate in social security only eyeing the huge corpus of private pension funds that could be generated, which could be diverted to the equity market in the country. It is well known that the private pension fund manager are purely guided by speculative motive and are not to concerned about the well being of client.

3. **New Pension System: An Investment Centric rather than Social Insurance Centric**

New pension system on the one hand promotes a unique system of pension fund accumulation, investment as well as their distribution. The fund accumulated in the Individual Retirement Account through the post office and bank, which has been administer by the central record keeping agency as well as private fund manager by investing the accumulated fund amount in the individual retirement account in the annuity market. The expenses of all these management activities should be bear by the employee. On the other hand the integration of disability benefits as well as retirement benefit for previously disabled employee and their surviving dependent would also be difficult. If for any reason the accumulated fund in individual account is not significant, the employee is more likely to select single life insurance as against the joint-and-survivor annuities. The less fortune would be forced to fall back on family and/or private charity.

Under such situation we can say that New Pension System is an investment central rather than social insurance centric because the government instead of addressing the basic and more fundamental issue relating to social security or social safety net pushing for reform of such type which will spell disaster.

4. **New Pension System: A Role Model like a Santa Clauses for the Government rather than a Responsible One**

The state of the government that, the combined liabilities of pension for civil servants of states and the centre were estimated at Rs. 65,000 crore as at the end of 2004-5, which would increase about Rs. 1,00,000 crore in the fiscal
year 2009-10. This remark is a crude attempt to alienate the employees from the public.

The present fiscal related problem cited by the government for the unsustainability of the present pay-as-you-go pension scheme is of its own making. The present pension scheme was introduced in the past as a substitute to the existing contributory provident fund scheme, to which the central government had been making a matching contribution. It was replaced by the general provident fund with only the contribution by the employees and in view of its matching contribution, the central government brought in place the present pension scheme.

The government, over the past years, merrily used up the funds, which were due on the erstwhile contributory provident fund schemes and failed to make any provision for an appropriate funding arrangement in place for meeting the pension liability towards its employees. For this the employees can not be penalized as is being resorted to now.

The present problem has arisen when government did not exercise enough discipline in managing its own fund and associated pension costs. As a populist measure, successive governments made the benefit formula more and more generous which has resulted in considerable increase in pension payments. So the problem is nothing but is behave of the government like a Santa Clauses.

5. **New Pension System: A Costly One in terms of Revenue Forgone rather than Promoting One in Savings**

The new pension system also accompanied by another retrograde move that is change in the tax treatment for contributions to the pension schemes, shifting from EEE formula, where the moneys were exempt from taxation at all three stages of contribution, accruals and withdrawals to the EET formula
where the terminal benefits will be taxed at the applicable rates in the year of receipt.\textsuperscript{61}

This move of the government in respect of NPS goes against the basic philosophy of encouraging long term contractual savings which provide long term fund for investment.\textsuperscript{62}

6. **New Pension System: A Green Signal for FDI**

The new pension system opening up pension sector for foreign direct investments, which means a green signal for foreign corporate to garner the huge pension fund for their speculative hunt of profit.

4. **Concluding Remark**

After the broad discussion of privatization of insurance and pension, the conclusion is that the both sectors definitely will progress as the results are showing year by year. But there must be cautious concern about the lacunas of the privatization process otherwise the aim behind it that is social security will be collapse. For removing the lacunas which was unseen by the government, there is demand of some future directions by which the government can fill the gap from loss to benefit.

Under such situation responsibility come on the government that government remains conscious about the social security in the name of insurance and pension.
Notes and References


3. Ibid, page no. 22.


7. Supra note- 4, page 563.


9. Supra note-4.

10. Supra note-6, page no. 311-312.

11. Ibid, page no. 399-400.


13. Rama Chandra, The Present Situation of Insurance in India and Development of Private Insurer within the Next Five to Ten years, page

15. Supra note-6, page no. 337.

16. Supra note-14.

17. Supra note-2, page no. 15-16.

18. Supra note-14, page no. 96.


20. Supra note-14, page no. 98.


23. Supra note-14, page no. 100.


26. Id.

27. Ibid, page no. 102.

28. Ibid, page no. 103-104.


35. The Hindu, 26th December 2008.


40. Supra note 38, page no. 11.

41. Ibid, page no. 18.


44. Supra note 37, page no. 22.


46. Supra note 38, page no. 17.


48. Ibid page no. 15-16.

49. Ibid, page no. 17.


51. Supra note 47, page 17-18.


53. Supra note 43, page no. 5.

54. Supra note 45, page no. 4.


60. Supra note- 44, page no.4.