CHAPTER-2

CONCEPTUAL BACKGROUND
2.1 The concept of Insurance

Insurance is a contractual agreement whereby one party agrees to compensate another for losses in return for the payment of consideration. We call the party agreeing to pay for the losses the **insurer**. We call the party whose loss causes the insurer to pay the claim payments the **insured**. We call the payment that the insured receives as **premium**. We call the contract a **policy of insurance**. We call the insured’s possibility of loss the insured’s **exposure to loss**. We say the insured transfers the exposure to loss to the insurer by purchasing an insurance policy.

So in simple terms, insurance is a pooling arrangement whereby contributions are collected from all members who join a pool. The amount so collected is utilised to compensate members who suffer loss. The arrangement works because generally not all the members who join the pool suffer the losses.

2.1.2 The Fundamental Principles of Insurance

1. **The principle of utmost good faith:**- This principle is based on the assumption that it is the duty of the insured and the insurer to disclose all the relevant facts. This is relevant to both life and general insurance. But unfortunately the root cause of the two basic problems of life insurance industry i.e. premature surrender and policy lapsation is the violation of this first and basic principle of insurance as the insured does not disclose all the relevant material facts to the insurer at the time of policy initiation which ultimately leads to decline of claims by the insured thus creating the problems for both the insured and insurer. And the insurer or the FPA who represents the insurer does not disclose all the material facts to insured (due to numerous reasons which are discuss later) thus leads to policy lapsation and creates a bad image of the company and industry.
2. **The principle of insurable interest:** - The legal right to insure - it is a must for an insurance contract to have validity. This principle is also relevant to both life and general insurance.

3. **The principle of indemnity:** - This principle determines the extent of insurer’s liability in the case of loss. The need for determining the liability is however, largely applicable to general insurance alone.

4. **The principle of contribution:** - A corollary of the indemnity principle exclusively applicable to general insurance. It tells us how the liability is to be met when the insured has taken insurance with more than one insurer.

5. **The principle of subrogation:** - Another corollary of the indemnity principle and again exclusively applicable to the general insurance, refers to the rights that an insurer acquires vis-a-vis the insured when the insurer has paid him an indemnity.

6. **The principle of proximate cause (causa proxima):** - The rule that determines how to proceed with the processing of a claim lodged by an insured, when a loss could apparently be traced to more than one event, some of which are not covered by the insurance contract.

**2.1.3 The concept of Life Insurance**

The three major concerns of any person could be, dying too early, living to long and/or living with disability. Besides, there are other concerns about taking care of children and their future and about creating wealth that most individual cherish. So in order to encounter the above mentioned risks or concerns of an individual a life insurance contract comes into.

So we can say that a life insurance contract is a protection against the loss of income that would result if the insured passes away. The named beneficiary receives the proceeds and is thereby safeguarded from the financial impact of the death of the insured. The goal of life insurance is to provide a measure of financial security for one’s family after one die.
2.1.4 Types of Life Insurance

(i) Term Insurance:- Term insurance pays a death benefit to the legal heirs if the person insured dies during the term of the policy. Such a policy provides cover for a specific period of time only and may be described as temporary insurance. Term insurance plan offers pure risk cover without any element of saving or returns. Hence they are the most inexpensive form of insurance plans. The assured is payable only if the insured dies during the selected period, and in case the insured does not die during the tenure of insurance, nothing is payable. The term insurance plans are of different types and may be offered to an insured based on its needs and requirements. Some of the term insurance plans type’s are- Level term insurance, decreasing term insurance, increasing term insurance, Renewable term insurance and Convertible term insurance.

(ii) Whole life insurance:- Whole life insurance guarantees a death benefit cover throughout the course of life, provided the required premiums are paid. The advantage of whole life insurance is that the policy, if kept current, covers you over one’s entire life, as opposed to term insurance that covers an insured only for a specified period of time. Whole life insurance policies pay out on the death of the assured, whenever it occurs. Premiums may need to be paid throughout the life of the assured, or lesser limited period.

(iii) Endowment insurance:- Endowment insurance is a plan where the benefit is payable to the insured only on survival of the specified term. Combining the features of term insurance and pure endowment are endowment policies which payout either on death of the assured, whenever it occurs, or after a fixed number of years. Should the insured survive the term of the policy, the policy is said to be mature. Hence the claim, under an endowment policy may arise either by death or by maturity.
(iv) **Annuities**: Annuities are a form of pension in which an insurance company makes a series of periodic payments to a person (annuitant) or his or her dependents over a number of years (term), in return for the money paid to the insurance company either in a lump sum or in instalments. Annuities start where life insurance ends. It is called the reverse of life insurance. Annuity stops on death of a person, whereas theoretically, life insurance starts on the death of the assured. Annuities are of two types-

   a. **Immediate Annuity**: Immediate annuity begins at once or immediately on expiry of the designated period. Immediate annuity is purchased with a single premium called purchase price. If the person buying the annuity dies during the term, his/her legal heirs or nominees get the remaining instalments of the annuity.

   b. **Deferred Annuity**: Under a deferred annuity plan, the annuity payments to the annuitant commence at some specified time or specified age of the annuitant. This type of annuity can be funded either by a single payment or a series of regular payments.

(v) **Unit Linked Policies**: A unit linked policy is a life insurance policy in which the benefits depend on the performance of a portfolio of shares. Each premium paid by the insured person split. A part is used to provide life insurance cover, while the balance is used to buy units in a unit of mutual fund after deduction of costs, expenses, etc. In this way, a small investor can benefit from investment in a managed fund without making a large financial commitment. The unit-linked policies can go up or down in values as they are linked to the value of shares.

(vi) **With profits and without profits insurance policies**: The insurance company charges premiums based on the mortality rates, interest earned on investments and expenses.
If these factors are favourable to the life insurance companies, then they can earn a profit or surplus. The surplus generated has to be retained. A major portion of the surplus, however, is distributed to the policyholders. So a life insurance policy, that has additional amounts added to the sum assured, or paid separately as cash bonuses, as a result of a surplus or profit made on the investment of the fund by the life insurance company is called a with profit policy.

The surplus generated by the insurance company which is distributed to the policyholders is known as bonus, and policies without bonus are called without profit policies.
2.2 HISTORY OF LIFE INSURANCE AND CURRENT SCENARIO

2.2.1 Origin of Insurance in India

In India, insurance has a very ancient and deep rooted history. One can easily find the records of ancient insurance in the writings of Manu (Manusmrithi) Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra). The writings talk in terms of pooling of resources that could be re-distributed in times of natural calamities such as fire, floods, epidemics and famine. That was probably a predecessor to our today’s insurance. Ancient Indian history has preserved the earliest traces of insurance in the form of marine trade loans and carriers’ contracts. Insurance in India has evolved over time heavily drawing from other countries, England in particular.

2.2.2 History and Developments

i) Pre-Liberalization Era

Life Insurance companies came to India primarily to insure the lives of the Europeans. 1818 saw the advent of life insurance business in India with the establishment of the Oriental Life Insurance Company in Calcutta. This Company however failed in 1834. In 1829, the Madras Equitable had begun conducting life insurance business in the Madras Presidency. 1870 witnessed the enactment of the British Insurance Act and in the last three decades of the nineteenth century, the Bombay Mutual (1871). Oriental (1874) and Empire of India (1897) were started in the Bombay Residency. This era, however, was ruled by foreign insurance officers who did good business in India, namely Albert Life Assurance, Royal Insurance, Liverpool and London Globe Insurance and the Indian offices were up for tough competition from the foreign firms.

In 1914, the Government of India initiated publishing returns of Insurance Companies in India. The Indian Life Assurance Companies Act, 1912 was the first statutory measure to regulate life business so in 1912 the Life Insurance Companies Act was passed making in
compulsory for the companies to file with the Government the premium rate table and certified valuation of those companies by an actuary. This Act primarily provided for information to be furnished by the companies to the Government with the comfort provided about their viability through an assessment by an actuary. The Act did not envisage extensive supervision and regulation of the companies by the Government.

The first two decades of the twentieth century saw considerable growth in insurance business. From 44 companies with total business-in-force of Rs. 22.44 crore, it rose to 176 companies with total business-in-force of Rs. 298. During the mushrooming of insurance companies many financially unsound concerns were also floated which failed miserably. In this background came the major enactment of the entire Indian Insurance history. In 1928, the Indian Insurance Companies Act was enacted to enable the Government to collect statistical information about both life and non-life business transacted in India by Indian and foreign insurance including provident insurance societies. In 1938, with a view to protecting the interest of the Insurance public, the earlier legislation was consolidated and amended by the Insurance Act, 1938 was the first major legislation governing not only life insurance but also non-life insurance to provide strict state control over insurance business. This legislation is so comprehensive and well drafted that it remains relevant even today and so far only modifications and additions have been made, where required, leaving intact a substantial portion of the legislation. The Insurance Amendment Act of 1950 abolished Principal Agencies. However, there were large number of insurance companies and the level of competition was high. There were also allegations of unfair trade practices. The Government of India, therefore, decided to nationalize insurance business. In spite of sound legislative framework the life insurance industry had to be nationalized in 1956 because of threat of insolvencies and gross misuse of policyholders funds by the insurance companies.
With the issuance of an ordinance 19\textsuperscript{th} January, 1956, the nationalisation of insurance industry in India came into existence leading to formation of LIC which came into existence by absorbing 154 Indian insurers, 16 non-Indian insurers and also 75 provident societies-245 Indian and foreign insurance in all. The monopoly of LIC lasted till the 90s as after that the insurance industry in India was privatised.

On different occasions, the nationalization of insurance industry has been justified on the grounds that-

(i) With the nationalization of insurance industry, the resources that will be generated would be huge, which can easily be mobilised by the state for the development of the country.

(ii) With the presence of such a huge market in India, the existing insurance companies were only be able to meet the insurance needs of the urban areas but a huge customer base is left out in the rural India, this gap can be filled only by the nationalisation of the insurance industry thus reaching out to the farthest investor in the remotest part of the nation.

(iii) The governance standards in some of the companies were low and there was a threat of insolvency

\textbf{Table- 2.2.1 Important milestones in the Indian life insurance business pre-liberalisation:}

<table>
<thead>
<tr>
<th>Year</th>
<th>Milestones in the life insurance business in India</th>
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<tbody>
<tr>
<td>1912</td>
<td>The Indian Life Assurance Companies Act enacted as the first statute to regulate the life insurance business</td>
</tr>
<tr>
<td>1928</td>
<td>The Indian Insurance companies Act enacted to enable the government to collect statistical information about both life and non-life insurance business</td>
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<tr>
<td>Year</td>
<td>Description</td>
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<tr>
<td>1938</td>
<td>Earlier legislation consolidated and amended to by the Insurance Act with the objective of protecting the interests of the insuring public.</td>
</tr>
<tr>
<td>1956</td>
<td>245 Indian and foreign insurance and provident societies taken over by the central government and nationalized. LIC formed by an Act of Parliament, vis, LIC Act, 1956, with a capital contribution of Rs. 5 crore from the Government of India.</td>
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*Source: Academic Open Internet Journal Vol.22*

(b) **Post-Liberalisation Era:-**

It was felt in 1990s that the scale of economic activity attained in the mid- eights and the momentum generated through the reforms process in other sectors of the economy can not be sustained by state controlled insurance industry and that insurance penetration and enlargement of the market can be accomplished only when a large number of companies complete with each other. It was also realized that the objectives of the nationalization of the industry can largely be accomplished through appropriate regulatory measures and a state monopoly was no longer necessary.

2.2.3 **Reforms in Insurance Sector during Liberalization era**

The Malhotra Committee appointed in 1993 to examine the structure of the insurance industry and recommend changes to make it more efficient and competitive concluded that the time was ripe to dispense with state monopoly and allow private enterprise to enter the insurance sector for the following reasons:

(i) With the privatisation of the insurance sector, the growth of the sector would be very rapid which is unprecedented.

(ii) Public sector companies are strong enough to face the competition from the private players successfully.
(iii) Premium collected from such a big market would serve well the purpose and would be a great source of funds for long term investment in infrastructure development of the nation.

(iv) Privatisation of the insurance sector would not only provide a wide range of product selection to the investor but it will also bring better quality of service which was the need of the hour.

(v) With the privatisation of the insurance sector the economic activities will get boosted as the risk coverage would be available at very reasonable cost which ultimately give motivation to the corporate and individuals of the nation to take initiatives and bear risk for which they were hesitating before.

(vi) New avenues like health insurance and pension would be opened up with the expertise that is available in the rest of the world and

(vii) When banking industry, mutual funds, merchant banks and other non-banking financial institutions are exposed to competition than why insurance sector can’t be privatised and exposed to competition.

In order to make the transition from State monopoly to free market smooth, the Committee recommended that only strong and serious players should be permitted to enter the market and an independent regulatory mechanism should be established to instil confidence among the prospective policyholders in the financial viability of the private insurance companies. The independence of the regulator is also to signal the commitment of the Government to ensure that the private companies can operate on a level playing field and no preference is shown to the State owned enterprises.

The recommendations of the Malhotra Committee were widely discussed and there was support for the opening of the sector with a strong and effective regulatory authority. The government established in interim regulatory authority by executive order in September 1996.
and decided to bring in legislation to establish an independent regulatory authority for the insurance industry along with modifications required to remove the State monopoly in this area.

The enacting of any legislation is a time consuming process even in normal circumstances. In the case of insurance industry however, the issue became more complicated. In December 1996, the government introduced the Insurance Regulatory Authority Bill 1996 for establishment of an authority to protect the interests of holders of insurance policies and to regulate, promote and ensure orderly growth of the insurance industry. The bill was referred to the standing committee of the Ministry of Finance which submitted its report in May 1997. The bill incorporating the recommendations of the standing committee was taken up for consideration but it could not be passed and was withdrawn by the government. In 1998, a new government came to power at the centre. In the budget speech of 1998, the policy of the government was announced to open up the insurance sector and also to establish a statutory regulatory authority. Accordingly, the Insurance Regulatory Authority Bill 1998 was introduced in the Lok Sabha in December 1998 to permit the entry of private "Indian companies" into the Insurance sector and to make certain consequential amendments to the Insurance Act, 1938. The Bill was referred to the Standing Committee on Finance in January 1999 for examination and report. The standing committee while recommending the Bill suggested some amendments. These amendments were accepted by the government and the Bill was circulated in March 1999. This Bill too could not be taken up for consideration consequent on the dissolution of the Lok Sabha.

A fresh Bill was introduced by the new government in the second half of 1999 by incorporating the provisions of the Insurance Regulatory Authority Bill 1998 and the amendments suggested by the standing committee on finance. The amendments pertained to
foreign equity being restricted to 26% name of IRA being changed to IRDA as also emphasis on development of social, rural and unorganized sectors.

The IRDA Bill was passed in December 1999 and became an Act in April 2000. In July 2000, immediately after the first meeting of the Insurance Advisory committee, 11 essential regulations relevant for players entering the Indian market were notified. In October 2000, six licenses to new players in the life and non-life sectors were issued. India thus became a liberalized insurance market.

While the long debates in the 90s and the twists and turns that surrounded the opening up of the sector for private participation had at times, thrown up serious concerns about the implementation of insurance reforms in this country, once the legislation was put through, the actual process of inducting private players into the market had gone off smoothly. I do not think there is any other sector in this country where the transition from state monopoly to free market has been as hassle free as the insurance sector.

2.2.4 Insurance Regulatory and Development Authority of India (IRDA)

After the liberalisation of the financial sector after 1991, the government of India constituted the ‘Malhotra Committee’ for suggesting reforms in the insurance sector. This committee recommended the opening up of the insurance sector and suggested setting up of a statutory body called Insurance Regulatory Authority. In 1996, interim IRA was formed and in 1999, the IRDA bill was passed. IRA was renamed as Insurance Regulatory and Development Authority to reflect on the development of the insurance sector.

IRDA Act provides for the establishment of an authority to protect the interests of holders of insurance policies, to regulate, to promote and ensure orderly growth of the insurance industry and for the matters concerned or incidental thereto. The insurance authority called IRDA has been established under this act.

The authority consists of the following members:
1. A Chairperson
2. Not more than five whole time members
3. Not more than four part time members

The members would be appointed by the Central Government for tenure of five years. The attempt is to make sure that every aspect of the practice of insurance is represented by the expertise of the members. Beside the formal forum of the members, the IRDA also encourages a process of dialogue between the practitioners and the authority through the council of the heads of insurance companies.

The important functions of IRDA:-

1. To exercise all the powers and functions of the controller of insurance.
2. Protection of the interests of the policyholders.
3. To issue, renew, modify, withdraw or suspend certificate of registration.
4. To specify requisite qualifications and training for insurance intermediaries and agency.
5. To promote and regulate professional organisations connected with insurance.
6. To conduct inspections, investigations etc.
7. To prescribe the method of insurance accounting.
8. To regulate investment of funds and margin of solvency.
9. To adjudicate upon disputes.
10. To conduct inspection and audit of insurers, intermediaries and other organisations concerned with insurance.

The opening of the sector has resulted in a large number of business concerns and banking establishment entering the insurance arena resulting in a sudden increase in the capacity to underwrite risk. Most of the senior managers in these establishments come with diverse backgrounds and their appetite for taking risks varies widely. The competitive pressure for
obtaining a distinct market share may lead them to adopt unsound practices. The supervisory system has to be, therefore, geared to assess effectively the financial soundness of the insurers and ensure that these companies have safeguards in position so that they are at all times, in a position to meet their obligations to the policyholders.

These concerns regarding solvency are generally addressed through prudent regulatory measures. Such measures include stringent capital and solvency requirements, prudent investment and reserving rules and regular monitoring of the activities of the insurers to ensure that they comply with the regulations. In view of limited experience, we had to necessarily turn to international practices in deciding on the appropriate regulatory framework.

Besides monitoring financial solvency of insurance companies, supervision of insurance operations includes in many countries the control of how insurance providers conduct their business. Competition rules, transparency and information requirements from the core of market conduct regulations. Effective market place operations require the presence of free and open information exchange. Market discipline can provide the right incentives for companies to act prudently and in the best interests of owners and customers. However, when accurate and timely information is not made available, it becomes more difficult for bad performers to be disciplined. The Regulators have to necessarily accord high priority for information dissemination as an effective check against improper market behaviour.

Keeping in view the history of bankruptcies and unhealthy practices that lead to the nationalization of the insurance industry, a conscious decision was taken to allow only strong corporate with proven track record to enter the insurance market. This has been sought to be achieved by prescribing a high level of entry level capital coupled with stringent solvency
requirements. In order to avoid fragmentation of the market and to prevent entry of unsound operators the minimum capital requirement has been placed at Rs. 100 crs for company.

Financial strength, track record and reputation of the promoters with regard to compliance with regulations and the strength of internal control systems; commitment to contribute to India's development as a regional insurance hub and an international financial centre. IRDA has been keen to see the industry develop in terms of product innovation and the use of alternative distribution channels. Applicants with a strong record in these areas, or in specialist and niche fields, and who are committed to underwrite health insurance business have received favourable consideration. The emphasis is on encouraging only those applicants who have a sound track record in their respective fields. Many of the Indian promoters have collaborated with foreign insurance companies who had long years of experience in marketing insurance products in emerging markets. Verification with the home regulator of these companies was done to ascertain their record of compliance with regulations.

While rigorous scrutiny of applicants at the entry level would ensure that only companies with sound finances are licensed to do insurance business, it is equally important that they remain solvent at all times. Insurance is a long term business and those who wish to enter the business should have the ability to inject more capital as the business expands. In order to protect the interests of the policyholders the solvency requirements have been placed at 1.5 times the normal solvency requirements or Rs. 50 crs whichever is higher. While the Insurance Act prescribed that assets should match the liabilities the prudential requirement has been kept deliberately at a higher level so that there is complete protection to the policyholders.

The life insurance contracts in India are not pure term contracts but mostly endowment contracts where the policyholder expects the company to return to him at the end
of the contract period what he has paid as premium with a reasonable return. A proper management of these resources is a major task undertaken by the insurance company. While in most countries the Regulations do not prescribed the manner in which these funds are to be invested, in India the Insurance Act itself prescribed the investment pattern to be adopted by the insurers. Fund management is a highly specialized activity and it is often contended by the insurers that rigid patterns prescribed under the Act leave little flexibility to the managers to obtain maximum return. There is merit in this contention and it is true that a balance is struck between safety and proper return. The rigidities of the system are partly overcome by the insurers by offering Unit Linked policies where the policyholder is given the opportunity to choose the investment pattern depending on his risk appetite. While it is a transparent unbundled product, it is essential that proper disclosures are made by the companies upfront so that the investor knows what risks he has to shoulder when he opts for this product. The Government proposes to address the concerns of the insurers on investments when it undertakes the amendment of the Insurance Act.

Prudential investment norms have been notified to further enhanced the financial flexibility and risk management ability of insurers, and for better management of investment portfolios. It is believed that as financial complexity and contagion exposure increases with globalization, prudent investment management becomes increasingly critical to insurers in maintaining stability in their operations. In addition guidelines on related-party transactions to ensure management integrity and public accountability in the conduct of insurance business have to be in place. The guidelines issued by the Authority reinforce the fiduciary duty owed by insurers to properly manage insurance funds in an independent and transparent manner for the interest of policyholders at all times. The total investment portfolio of the insurers as on 31-03-2005 stands at Rs. 4,65,864 crore compared to Rs. 2,18,472 crore as on
31-03-2001. The share of the investment in infrastructure out of the total investment of Rs. 4.65 lakh crs is Rs. 49,810 crs.

Sound regulations coupled with periodic inspections to ensure adherence to the regulations is the best protection that can be offered to policyholders. In addition to a rigorous scrutiny of the companies at the entry level, diligent monitoring of their activities which special reference to maintenance of solvency margins and prudent investment policy would ensure that the companies remain viable with ability to meet their commitments. The experience so far in India is that the local partners are sound with an excellent track record in their respective fields, and their foreign collaborators are very well established insurance companies with vast experience in both developed and emerging insurance markets.

The high initial capital requirements and the cap on Foreign Direct Investment at 26% did not deter the Indian entrepreneurs and the major foreign insurance companies from collaborating to form Indian insurance companies. We have today 15 private life insurance companies and 14 private general insurance companies doing business in this country. They obviously feel that these stipulations are irritants but are not strong enough to be a deterrent for entry of private players into this area. It is nearly 15 years since the Government monopoly was removed and it would be worth examining what the expectations were in 2000 and how far they were realized.

As we travel 15 years down the line, we find that most of these expectations have been found to be realistic and the benefits are being reaped though the pace at which the benefits are materializing could have been better. The total premium collected by the insurers, both life and non-life in the year 2012-13 is Rs. 1,00,335 crore (Rs. 82,854 crore in life and Rs. 17481 crore in non-life ) compared to Rs. 44,705 crore ( Rs. 34,898 crore in life and Rs. 9807 crore in non life) during the year 2007-2008. It represents a 125% increase in the last four year over the base year 2000-01. If we take the four year block prior to the opening of the
sector, we find that the total premium collected in 1996-97 was Rs. 23,625 crore (life: Rs. 16,277 crore non life Rs. 7,348 crore) which has grown to Rs. 44,705 crore by 2000-2001 representing an increase of 89%.

The assumption that the sector has the potential to grow at a much faster rate than what we had witnessed when it was under State monopoly has been established beyond all doubt. It would be worthwhile examining at this state the relative contributions of the private and public sector in this expanding industry. In the case of life insurance the private sector accounts for 9% of the gross premium with the remaining 91% accounted for by Life Insurance Corporation (LIC). The issue for consideration is whether the acquisition of the market share by the private companies is at the expense of the LIC. The LIC’s gross premium has grown by 115% in 2004-05 over the premium collected in 2000-01. If we compare this post liberalization growth with the growth for the corresponding number of years prior to 2000, we find the between 1996-97 and 2000-2001 the LIC registered a growth in gross premium of 114.36% (Rs. 16,277 crs in 96-97 to Rs. 34,898 crs in 2000-01). The LIC has obviously not lost its growth momentum and the market share of the private players has come out of an enlarged market. I do believe that this enlargement of the market is mostly due to the efforts of the private players themselves. The private insurers realized that the strength of the LIC lies in traditional products and their vast network covering a large number of middle income customers. They realized that the high network individuals and the young professionals understand investment products and they have not been tapped to the full extent and they would be willing to experiment with new products if there are reasonable prospects of higher return than the conventional products. The new insurers introduced Unit Linked Products and created a new market segment hitherto unknown.

In the case of general insurance also the premium registered an increase of 78% in 2004-05 over the period obtaining in 2000-01. (Rs. 17,480 crore in 2004-05 compared to Rs.
9807 crore in 2000-01). During this period the percentage growth in the premium of public sector was 43% compared to 33% registered during 1996-97 to 2000-01. Even here the premium of the private sector did not come at the expense of the public sector though private sector accounts for 20% of the premium collected in 2004-05.

Indian insurance business, which remained underdeveloped with low levels of insurance penetration and insurance density, has shown signs of improvement. The insurance penetration i.e. premia as percentage of GDP has increased from 2.32% in 2000 to 3.17% in 2004. The insurance density i.e. premium per capita has increased from USD 9.90 in 2000 to USD 19.70 in 2004. The overall world rankings in terms of total premium volumes have improved from 23rd in 2000 to 19th in 2004 and our share in the world market has increased from 0.41% to 0.65% during the same period. The world ranking in terms of life insurance premium volumes has improved from 20th in 2000 to 18th in 2004 and the share in world market has increased from 0.50% to 0.91%. Similarly in non-life insurance rankings in terms of premium volumes has improved from 29th in 2000 to 27th in 2004 and the share of world market has increased from 0.25% to 0.31%. While the improvements are not dramatic, we are confident that we are moving in the right direction.

As regards products, there is no denying that there is a wide array of products for the consumer chooses from. The insurers undertake periodic surveys to assess the requirements of different sections of the population and device appropriate products to suit their needs. The foreign promoter brings to the Indian insurance scene his long years of experience in various markets, developed and the emerging markets. There is a bewildering variety of products and most consumers feel the need for expert guidance from the Agents and the markets force to enable them to select the right policy.

2.2.5 Agency system in Post liberalization era in India
The ever expanding Insurance market in India demands a large sales force. The insurers have, therefore, been recruiting agency force on a regular basis. Presently there are more than 20 lakh individual agents and nearly 5000 Corporate Agents. In recent years an important development came into light is the arrangements between the insurers and commercial banks for selling and marketing the insurance products either as Corporate Agents or on referral basis providing database to the insurers.

In order to properly and effectively professionalise the insurance agency system, different training and tastings in detailed manner were introduced by the authority. The demand for tied agency force has led to a situation where the resources of the training institutes have been overused. The inspections by the Authority of these institutes have revealed a number of spots where improvements were required. In some of the cases it was found out that the training institutes lacks the basic infrastructure to carry out classes and the faculty was not on their permanent rolls rather on ad hoc basis which led to the conduction and completion of course in a very casual and short cut style due to which many FPAs didn’t get adequate training. Some of the institutes which were licensed even gotten worse as they outsource the training to some other institutes or rather we can say started franchising for carrying out training. On the other hand the insurers in the race to recruit more and more FPAs ignored the level of training of the agents. Looking at these pathetic conditions of insurance training the Authority had, during 2004, streamlined the system of training and made it perfectly clear to the insurers, for the required attention to be paid by them on the insurance training of their sales force. A fresh and revised set of guidelines had been issued regarding the training norms, as the authority was very keen on the point that an insurance agent should be fully equipped with the required knowledge not only of the product but also with market and industry. Now the insurance agents are not only mere insurance salesman but now they have a bigger task of acting as an advisor and counsellor to the investors.
The importance of a well trained and educated sales force can never be undermined. As an insurance agent is a person who represents an insurer, it is very much supposed from him that he should first recognise the needs of the client, and then suggest a product which fulfils the investor’s needs. This need based selling will earn an FPA not only commission but also respect, long term relation with the insured and a long lasting retained and satisfied investor to the insurer, on the contrary if the FPA fails to deliver such performance, possibilities are there that the insured may feel unsatisfied or cheated and may look for the earliest opportunity to surrender the policy. The large lapsation and attrition rate in the contracts bears silent testimony to this fact. Another unhealthy and unethical practice came to light is the paying of rebates to solicit business. Sec. 41 of the Insurance Act, 1938 strictly prohibits rebating for procuring business. Apart from the statutory imposition, the practice also is generally responsible for the poor retention ratios. A professionally trained agent, fulfilling his role as the primary underwriter, can contribute a great deal in bringing down the retention ratios.

The institution of corporate agents was a new experiment started by the Authority to facilitate sale of insurance policies through existing institutions which are in contact with a large section of the population in the discharge of their normal activities. The corporate Agent model is expected to bring down costs of procurement of business substantially to the insurance company while benefiting the corporate with the fee based income which improves its revenue stream. The insured himself, should feel comfortable with this model as he would be dealing with an Institution that is familiar to him. In parts of Europe the Bancassurance model has worked well and the experience of the three parties to the transaction, namely, the Bank, the insurance company and the customer has been positive. You would notice in India that the insurers are keen to have working arrangements with Banks so that they have access to their databank which is a valuable resource for the insurer to build his customers base. I am
confident that in the years to come Bancassurance would be a critical intermediary in the spread of insurance in the country.

The introduction of brokers in the Indian insurance industry in the liberalized scenario is another significant development. Brokers act as representatives of the policyholders although they are paid by the insurers. As a result, they are expected to bring better service to the clients in several areas like:

- Keeping an eye on the industry, the credibility of the players and the level of after sales they provide.
- Product analysis that are available in the market, and then advising and counselling the clients to choose a product based on their requirements.
- Assisting the clients in fulfilling the formalities of a proposal and winding up of the deal successfully and providing any sort of after sales assistance if required.
- Helping the policy holder in the settlement of claims.

Although an agent is also expected to render most of these services, but in order to meet the needs and requirements of such a vast customer base like in India the additional distribution and sales force can never be extravagant.

2.2.6 Indian Insurance Market- Current Scenario

The insurance sector in India was privatised 15 years ago. For years now, the private players are active in the free market environment. The insurance market in India has been through drastic changes which includes presence of a fairly large number of insurers both life and non-life segment. Most of the private insurance companies have formed JVs partnering well recognized foreign players across the globe.

There are now 29 insurance companies operating in the Indian market – 14 private life insurers, nine private non-life insurers and six public sector companies. With many more JVs
in the pipeline, the insurance sector in India today stands at a crossroad as competition is getting dense and companies prepare survival strategies in a detariffed market.

The government of India since privatization of the insurance sector has been under tremendous pressure both by the domestic players as well as from the foreign players to increase the foreign direct investment (FDI) limit from the current 26% to 49% which would help JV partners to siphon in funds for expansion. Looking into which the Current NDA government has finally shown the green signal for the raising up of the foreign stake upto 49% and Indian companies stake by 51%.

There are opportunities in the pensions sector where regulations are being framed. Very less no. of Indians above the age of 60 receives pensions. The IRDA has issued the first license for a standalone health company in the country as many more players wait to enter. The health insurance sector has a very promising growth potential, and as it matures and new players enter, product innovation and enhancement will increase. The salient features of the Indian insurance market are as follows-

(a) **Domestic players still rule the market:** No doubt there is huge untapped market for insurance in India and it can accommodate as many foreign players but still the domestic insurers rule the market despite of the fact that foreign players bring latest technology in service enhancement with them, but the fact is that they are facing tough time in facing competition with these local players. Also as the private sector controls over 26.18% of the life insurance market and over 26.53% of the non- life market, the public sector companies still call the shots.

The nation's largest life insurer, Life Insurance Corporation of India (LIC) had a share of 74.82% is new business premium income in November 2005 which has now reduced to a considerable extent. Similarly, the 4 public – sector non- life insurers- New India Assurance, National Insurance, Oriental Insurance and United India Insurance- had a combined market
share of 73.47% as of October 2005. ICICI Prudential Life Insurance Company continues to lead the private sector with a 7.26% market share in terms of fresh premium, whereas ICICI Lombard General Insurance Company is the leader among the private non–life players with 8.11% market share. ICICI Lombard has concentrated on developing the market for general insurance products and increasing penetration within existing customers through product innovation and distribution.

(b) Reforms in distribution system: It is needless to say, that the investor profile in the insurance industry is changing with the introduction of large number of intermediaries or new agency system such as brokers, corporate agents, and bancassurance. The industry is now facing a much aware investor who knows what they want and when, and are more demanding in terms of better service and agility in responses. With the detariffed regime move in 2007 of the insurance industry there will be considerable improvement in customer service levels, product innovation and newer standards of underwriting.

(c) Cut throat Competition: In a de-tariffed environment, competition will manifest itself in prices, products, underwriting criteria, innovative sales methods and creditworthiness. Insurance companies will face-off each other to capture market share through better pricing and investor segmentation.

The battle has so far been confined in the big urban cities, but now it’s moving gradually to rural and semi-urban markets as now cities can’t hold such competition.

(d) International level of operations: As the world is looking upto India for growth and expansion, Indian firms are becoming increasingly world class. Take the case of LIC, which has set its sight on becoming a major global player following a Rs. 280-crore investment from the Indian government. The company now operates in Mauritius, Fiji, the UK, Sri Lanka, Nepal and Saudi Arabia. The year 2005 was a testing phase for the general insurance industry with a series of calamities battering the Indian sub-continent. However, with robust
reinsurance programmes in place, insurers have successfully managed to come over the crisis without any adverse impact on their balance sheets. With life insurance premiums being just 25% of GDP and general insurance premiums being 0.65% of GDP, the opportunities in the Indian market place is immense.

2.2.7 Life Insurance Corporation of India (LIC)

Life Insurance Corporation of India (LIC) was founded in September, 1956 by an Act of Parliament, i.e. Life Insurance Corporation Act, 1956, with huge capital investment from the government. The erstwhile Finance Minister, Shri C.D. Deshmukh, while drafting the bill laid the objectives of LIC thus: to conduct the business with the utmost efficiency, in a spirit of trusteeship; to charge premium no higher than warranted by strict actuarial considerations; to invest the funds for obtaining maximum yield for the policy holders consistent with safety of the capital: to render prompt and efficient service to policy holders, thereby making insurance widely popular.

Since nationalization LIC has built up a huge network of 2,048 branches, 100 divisions and 7 Zonal offices expanded over the nation. The Life Insurance Corporation of India also conducts business abroad and has establishments in Fiji, Mauritius and United Kingdom. LIC is associated with JVs abroad in the field of insurance, namely, Ken- India Assurance Company Limited, Nairobi; United Oriental Assurance Company Limited, Kuala Lumpur and Life Insurance corporation (International) E.C. Bahrain. The Corporation has registered a joint venture company in 26th December 2000 in Kathmandu, Nepal by the name of Life Insurance Corporation (Nepal) Limited in collaboration with Vishal Group Limited, a local industrial Group. An off- shore company L.I.C. (Mauritius) Off- shore Limited has also been set up in 2001 to tap the African insurance market.

2.2.8 Potential Opportunities for Insurance Industry in India
• India with about 200 million middle class household shows a huge untapped market for players in the insurance industry. Global exhaustion of markets specially the markets from the developed nations has compelled the global insurance companies to look upon India as an attractive market with huge prospects and potential to be tapped in future. The insurance industry in India has come to a position of very high potential and competitiveness in the market. Indians, have always perceived life insurance as a tax saving device, which is now changing drastically and now they have started taking insurance as an investment avenue with good returns plus added advantage of risk coverage, all thanks to ULIPs which is very well positioned and marketed by private sector in India.

• Insurance sector has always been consumer centric. After the entry of the foreign players the industry is seeing a lot of competition and thus development and enhancement of the customer service in the industry. Computerization of operations and updating of technology has become imperative in the current scenario. MNCs are bringing in international best practices in service through use of latest style of management and technologies.

• The front line sales that is FPAs, still remain the main source through which insurance products are sold. The concept is very well established in a developing country like India.
2.3 INTRODUCTION TO UNIT LINKED INSURANCE PLAN (ULIP)

2.3.1 ULIP-Unit Linked Insurance Plan

Insurers have developed plans that combine the benefits of life insurance as well as giving various options of participating in the growth of the capital market. Such plans are called Linked Life Insurance plans. They are also called Unit Linked Insurance Plans or ULIPs in short. A ULIP is a life insurance policy which provides a combination of life insurance protection and investment. ULIPs contribute nearly 50% of the premium for some insurers and more than 85% of the premium for some others.

2.3.2 How an ULIP Works?

In the case of a ULIP, the proposer offers to pay a certain sum towards premium. Insurers insist that this amount should be in multiples of say Rs. 500 or Rs. 1000 with a minimum of say, Rs. 5000 or Rs. 10000. The term of the policy is also specified. It should not be less than 5 years or age 70 for whole life plans. The premium may be paid as a Single premium at the start or periodically over the term or less, as in the case of limited payment policies in yearly, half yearly, quarterly or monthly installments. The sum assured (SA) or death cover, payable in the event of death during the term, is related to this premium, usually as a multiple like 5 times the annual premium or 1.5 times the single premium. The minimum SA according to IRDA guidelines has to be 1.25 times single premium or 5 time annual premium. Out of the
premium, annual or otherwise as the case may be, a certain amount is adjusted towards the cost of the insurance (death) cover. Some portion may be adjusted towards charges. The balance, called the allocated premium, is invested in a fund that the proposer chooses, from among a set of options. The allocated premium is more in the second year and still more in the third and later years because some charges are not levied in every year. The allocated premium is used to buy a certain number of units in the chosen fund at the price at which the units are being offered on that day. This price called the NAV, which varies every day, is explained later. The death benefit is fixed but the maturity benefit is not guaranteed. The maturity benefit depends on market condition and the fund in which the premium has been invested, on the date of maturity.

In linked policies, the SA may be expressed as an integrated benefit, which means that on the happening of the event, the SA or the value of units in the fund, whichever is higher, is payable, in this case the life cover will reduce as the value of the units increases. As the risk cover decreases, the premium adjusted towards the cover will decrease and the amount allocated to investment will increase.

The alternative to the integrated benefit, is to pay a fixed SA as an additional benefits on death, in addition to the value of the units in the fund. In this case, the charge for the risk cover will increase and the allocation to the fund will decrease every year. This is sometimes called the Double Death Benefit.

### 2.3.3 Basic Features of ULIPs

Some of the other features offered by insurers along with ULIPs are the following. These are not offered by all insurers. They are also not available with the ULIPs offered by the same insurer.
The policyholder can pay additional premium for investment at any time.

Partial or total withdrawal is allowed. Sometimes there are conditions attached. Some insurers, not all, charge a redemption fee in such cases.

There is no annual bonus but there may be a loyalty bonus paid at the end.

Insurers offer policyholders a choice of funds in which their moneys may be invested like-

a. **Equity Funds**: In this type of fund, sometimes also called Growth funds, there would be more investments in equities which are shares stocks traded in the stock market.

b. **Debt Funds**: In this type of fund also called Bond funds, the investments are primarily in Government and Government guaranteed securities and such safe debts and other high investment grade corporate bonus.

c. **Money Market Funds**: In this type of fund, sometimes also called Liquid funds, the investment may be more in short term money market instruments such as treasury bills, commercial papers, etc.

d. **Balanced funds**: In this type of funds, the investments are in both equity as well as debts.

All these funds will remain invested in a mix of instruments, the differences being mainly in the proportions in various kinds of instruments. One fund may have more of debt instruments, which guarantee a certain fixed return, while another fund will have a larger proportion of equity shares, which may appreciate in value more than debt instruments. Insurers use different names to differentiate between the funds. Some of these names are Accelerated, Builder, Cash- plus, Conservative, Defensive, Dynamic, Enhancer, Gift, Income, Magnifier, Multiplier, Preserver, Protector and Secured. The name does not indicate the manner in which the funds will be invested or will grow. It would be necessary to track the record of the fund to evaluate how well it is doing.
• Insurers allow policyholders to switch their moneys from one fund to another during the term of the policy. Some insurers charge a fee for every such switch. Some other allow a certain number of switches free and then charge a fee for every switch thereafter.

2.3.4 Flexibility in an ULIP

• ULIPs provide a lot of flexibility to the policyholder. The option of switching is one provision that gives the flexibility. Policyholders are also allowed to make a hump sum additional contribution at any time. The risk cover will remain the same, but the amount going into the fund for investment will change. Top–up is the expression used to refer to the policyholder increasing the contribution for investment. There could be a top-up charge. The IRDA guidelines stipulate that top-up is allowed only if the regular premium is paid up–to-date and also that if the top-up amount is more than 25% of the regular premiums paid up-to-date, the life cover will increase by 1.25 times the excess top-up amount. There will also be a lock–in period of three years for each top-up amount, except during the last 3 years of the policy.

• Policyholders may also be allowed to redirect the current premium into any fund, in any proportion, irrespective of the fund in which the earlier premiums have been invested. This facility allows the policyholder to take advantage of the market conditions, without exercising the switching option.

• Policyholders may not pay the premium in a year, subject to certain conditions. If that happens, no new units will be added to his fund but some units will be reduced to pay for the annual charges for cover for administration, for fund management, etc. This is called premium holiday. The arrangement can also be terminated at any time and the amount in the fund withdrawn. The loss will only be a normal fee

2.3.5 Net Assets Values or NAV
The NAV of a fund represents the net value of the fund on a particular date and reflects the total value of the assets of that fund, after some adjustments for expenses. For example, the Equity Fund comprising of contributions from many policyholders would have been invested in a variety of equity shares in the stock market along with other instruments. The total market value of these shares and other instruments on any day, divided by the Units in that Equity fund would be the NAV for that day. As market values of shares vary, the NAV will keep varying from day to day.

The NAV becomes the basis for new entrants and for exits from the fund. For example, if a new policyholder wishes to have Rs. 10000 invested in an Equity Fund and on that particular day, the NAV of that fund is Rs. 20, he will be allotted 500 units from that fund when he wishes to exit from that fund, because of switching or final termination of the contract, he will get 500 units at the NAV of that date, which may be less than or more than Rs. 20, at which he got in. If he is getting into another fund on the day, he will be given the number of units of that fund, calculated at the NAV of that fund on that day.

In actual practice, the NAV used at the time of entry, called the officer price, and the NAV used while exiting, called the Bid price, will be different, like the difference between the buying and selling rates of foreign currency. This difference is called the bid-offer spread and is normally around 0.5%. Some insurers do not have this difference for some plans. Both offer and bid prices are the same in NAV. Some insurers offer units at Rs. 10 per unit for a specified period from the date the scheme begins.

Insurers publish the NAVs of the various funds, which are offered to the policyholders. This enables policyholders to track the growth of the various funds and to decide whether to continue in the same fund or to switch to other funds. The value
of a person's investment on any day is the number of units held by him multiplied by the NAV.

2.3.6 Lock in Period

Lock-in period is that period during which withdrawal is not allowed. Previously it was 3 years according to IRDA guidelines but now it has been extended to 5 years. The surrender value will be allowed only after 5 years.

2.3.7 Riders

As in traditional policies, additional benefits are made available through riders, usually riders provide for:

(i) Accident benefit
(ii) Disability benefit
(iii) Increase/ decrease in death benefits
(iv) Critical illness rider
(v) Major surgical assistance benefit
(vi) Hospital cash benefit
(vii) Spouse insurance benefit etc.

Additional premia will have to be paid for these rider benefits.

2.3.8 Charges Applicable in an ULIP

The following charges are applicable in the case of ULIPs. They are subject to various conditions and very between insurers. They may be related to SA or to premium, may be constant figures or percentages, and may have minimum and maximum limits. The charges are recovered (i) by way of deduction from the premium and / or (ii) by cancelling some of the units.

(i) *Accidental benefit charges* - If the accident rider is availed of.

(ii) *Administration or fixed charges* - Are the fees for administration of the plan.
(iii) **Flat fee**- It is charged every month, regardless of the size of premium.

(iv) **Fund administration charges**- Being a percentage of the fund and deducted daily for managing the fund of the investor or the allocated units in case of ULIPs.

(v) **Fund switching charges**- They are levied when there is a switch from one fund to another.

(vi) **Mortality or risk cover charges**- It is the premium for the death cover.

(vii) **Service Tax**- Is also charged, usually on a monthly basis.

(viii) **Surrender charges**- May be charged for partial or full encashment of units before a certain period of time.

### 2.3.9 IRDA Guidelines for ULIPs

The IRDA has issued guidelines on various matters relating to ULIPs some to there are:

- The limits on SA, and top–up conditions referred to earlier in this chapter.
- Surrender benefit only after 5th policy anniversary.
- SA can be reduced up to the extent of partial withdrawals during 2 years prior to death and after age 60.
- Lock- in period for each top-up amount, for partial withdrawal, except during last three years of contract.
- Death benefits to be guaranteed.
- Maturity benefits may be guaranteed at levels reasonable in relation to current and long- term interest rate scenario.
- Policy to become paid up, if there is default in premium after 5 years.
- Opportunity to be given to revive lapsed policy.
- Auto cover facility allowed for full SA for limited period.
- No auto cover facility if at least 5 years premium not paid.
• If policy is not revived, surrender value to be paid at the end of 5th policy anniversary or end of revival period, whichever is later.

• No risk covers after policy term.

2.3.10 Growth of Unit Linked Business in India

India has seen a tremendous growth on the unit linked front over the recent years. The growth has been fuelled by the booming stock markets & lower interest rates. Before the introduction of the unit linked product, the prospects/policyholders who are interested in investing in stock markets either had to purchase the stocks on their own in the primary/secondary or invest in mutual funds. With the introduction of the unit linked product, the prospect has an option to invest in the stock market via purchase of a unit linked life insurance policy in addition to the life insurance cover. A unit linked policy scores over mutual fund via tax advantages and life cover (now SIPS can offer life cover as per recent SEBI guidelines). Also, as per the recent SEBI guidelines exits under closed ended schemes are not permitted.

a) Policy-Wise growth of ULIPs: The unit-linked business, in respect of the industry as a whole, which was 4%(96% for non-linked) of the total policies in the year 2006 grew to 21.76%(non-linked fell to 78.24%) in the year 2008. The graph below shows how the unit linked policies progressed policy wise (year on year) across groups. As can be seen from the graph, group 1 is a major contributor to the total number policies in both linked & non-linked business. However, group 1’s share in the of total linked policies increased in the year 2006-07 but has decreased marginally in the year 2007-08 while group’s 2 & 3 has shown the reverse trend. It is important to note that groups 1 & 2 have minimum exposure to non-linked business on the policy count and almost the total business comes from group 1. It is also observed that linked business is a major contributor to the total policies for most of the companies in the year 2008.
Graph- 2.3.1 Policy wise growth of ULIPs:

![Graph showing policy wise growth of ULIPs]

Source: www.irda.gov.in

b) Sum Assured-Wise growth of ULIPs: The unit-linked business, in respect of the industry as a whole, which was 7.1%(92.9% for non-linked) of the total sold in the year 2006 grew to 28.68%(non-linked fell to 71.32%) in the year 2008. The graph below shows how the unit linked business progressed sale wise (year on year) across groups. As can be seen from the graph, group 1 is a major contributor to the total sale in both linked & non-linked business. The share of group 1 which was 60.09% of the total linked sold in the year 2006 grew to 72.83% in the year 2008 while the shares of groups 1 & 2 which were 32.35% & 7.56% fell to 19.65% & 7.53% respectively. It is also observed that linked business is a major contributor to the total sold for most(14) of the companies in the year 2008.

Graph- 2.3.2 Sum assured wise growth of ULIPs:
C) Premium –Wise growth of ULIPs:

The unit-linked business, in respect of the industry as a whole, which was 20.36%(79.34% for non-linked) of the total premium in the year 2006 grew to 46.1%(non-linked fell to 53.9%) in the year 2008. The graph below shows how the unit linked business progressed premium wise (year on year) across groups. As can be seen from the graph, group 1 is a major contributor to the total premium in both linked & non-linked business.

The share of group 1 which was 84.91% of the total linked premium in the year 2006 fell marginally to 83.82% in the year 2008 while the shares of groups 1 & 2 which were 11.52% & 3.57% grew to 12.02% & 4.16% respectively. It is also observed that linked business is a major contributor to the total premium for most (15) of the companies in the year 2008.

Graph- 2.3.3 Premium wise growth of ULIPs:
2.4 INTRODUCTION TO THE ROLE OF FPA

2.4.1 Introduction to an Insurance Agent/Financial Planning Advisor (FPA)-

According to the Section 182 of the Indian Contracts Act, an ‘agent’ is a person employed to do any act for another in dealing with a third person. In the insurance industry, the term
‘agent’ is ordinarily applied to a person engaged by the insurer to procure new business. The insurance act defines an agent as the one who is licensed under Section 42 of the act and is paid by way of commission or otherwise, in consideration of his soliciting or procuring insurance business, including business relating to the continuance, renewal or revival of policies of insurance. He is, for all purpose an authorised salesman for insurance business and needs a license.

From the above definitions we can easily conclude now that an agent is a professional. A professional has to study and master a body of specialise knowledge. A professional constantly enhances his knowledge and skills and simultaneously helps others similarly placed professionals. Such personal growth and development will be measured, in the case of an agent, partly by the business that is done and by the commission that is earned. It is also measured in terms of the reputation that the person enjoys in the market. Agents can be spoken of well, as a person who knows, who can be trusted to look after the customer’s interests, who does not mislead, who is nice to deal with, and so on. It is such reputations that help one to collect more and more references from satisfied policyholders and thus expand one’s circle of contacts. Product knowledge is the primary requirement, but product knowledge does not end with knowing the broad terms and conditions of the various plans of insurance. The agent must have the knowledge of all the products offered by the insurer for whom he works and not only of the few which are mostly sold.

2.4.2 Procedure for becoming an FPA

The insurance Act, 1938 lays down that an insurance agent must possess a license under section 42 of the Act. The license is to be issued by the IRDA. The IRDA has authorised designated persons, in each insurance company, to issue the license on the behalf of IRDA.

- The fee for a license is Rs. 250 for individual as well as corporate agents. A license is granted for three years. It may be renewed after 3 years.
A license is issued by the IRDA may be to act as an agent for a life insurer, for a general insurer or as a composite insurance agent working for a life insurer as well as a general insurer.

The prerequisites for getting an insurance agents license are:

1. It should not be a minor
2. Have passed at least the 12th standard or equivalent examination, if it is to be appointed in a place with a population of 5000 or more, or 10th standard otherwise.
3. Have undergone practical training for at least 50 hrs in life or general insurance business, as the case may be, from an institution, approved and notified by the IRDA.
4. Have passed the pre-recruitment examination conducted by the Insurance Institute of India or any other examination body authorised by the IRDA.
5. The license once issued, can be cancelled whenever the person acquires a disqualification.
6. Applications for renewal have to be made at least 30 days before the expiry of the license, along with the renewal fee of Rs. 250.
7. Prior to renewal of the license, the agent should have completed at least 25 hours of practical training in life or general insurance business.

2.4.3 Methods of Remunerating an FPA

A life insurance agent works on commission basis. He is paid a percentage of the premium collected through his agency. Section 40A(1) of the Insurance Act stipulates that the maximum amount which can be paid to a life insurance agent, by way of commission or remuneration in any form, shall be 35% of the first year’s premium, $7\frac{1}{2}$% of the second and third year’s renewal premium and 5% of subsequent renewal premium.
New agents may be paid a stipend to be adjusted the commission to be earned, as and when the business begins to come in. Brokers are paid on a totally different basis.

2.4.4 Responsibilities and functions of an FPA (agent)

An agent, individual or corporate, is the main component of the distribution channel for the life insurance business. He would be required to solicit and procure new life insurance business, in a manner that is consistent with the interest of the policyholder and of the insurance company. For this purpose he would have to do the following things-

- Contact prospects for life insurance, study their needs and persuade them to buy.
- Complete all related formalities, including filling up of proposal forms, collecting premium, arranging medical examination, collecting proofs of age or income etc as required by the underwriter.
- Keep in touch with the policyholder to make sure that renewal premiums are paid in time and assure that policy continues, avoiding any lapsation and thus finally leading to the claims.
- Assist in settlement of the claim, by helping the claimants to complete the necessary formalities and requirements.
- Placing the best interests of the client above one’s own direct or indirect benefits.
- Holding in the strictest confidence and considering as privileged, all business and personal information pertaining to the client’s affair.
- Making full and adequate disclosure of all the facts to enable clients make informed decisions.

The regulations framed by the IRDA lay down a code of conduct which incorporates some of these concepts. The code says interalia that agent shall-

1. Identify himself and the insurance company he is working for.
2. Disclose the license to the prospect on demand.
3. Explain all the available options to the prospect.

4. Recommend a suitable plan taking into account the needs of the prospect.

5. Disclose the scale of commission, if asked for by the prospect.

6. Explain the nature and importance of the information required in the proposal form.

7. Make all enquiries about the prospect.

8. Inform the insurer about the any material facts, including the habits that could adversely affect the underwriting decision.

9. Render necessary assistance to policyholder or the claimants or beneficiaries in complying with the requirements asked for by the insurer.

10. Advise the policyholder to effect the nomination.

2.4.5 Contributions of FPAs to Life Insurance Business

An insurance agent or an FPA is the corner stone of the solid edifice of life insurance industry and it is very much from the following facts-

- In Life Insurance Corporation the year 2001-2002 recorded a phenomenal growth of 137% in first premium income.

- The sum assured under new policies sold, registered a growth rate of 54% and the number of policies sold grew by 16%.

- The ratio of first insurance to the total business completed for the year 2002-2003 comes to 80.15%.

- The average sum assured per active agent in 2002-2003 is 19, 51,767.

What is it that takes this performance forward? One reason no doubtedly is the large network of agents on rolls of LIC. The tremendous success is of course on account of constant and tireless efforts of LIC agents who bring new business to the corporation with increasing growth rate.
2.4.6 Issues and Concerns to the Role and Functions of FPAs in Current Times

Of late serious concerns are voiced about the proprieties in business, because increasingly there are reports of improper behaviour. Some of the world’s biggest companies have been found to have cheated through false accounts and dishonest audit certification. The funds of banks have been misused by their management s to bolster the greed of some friends.

An FPA is in a position of trust. On his assurance, the policyholders entrust their small savings to an insurer, trusting it to look after these funds and look after their dependents in later years. Issues of propriety and ethics are of extreme importance in this business of insurance. Unethical behaviour happens when the interest of self are considered more important than of the other. Things would be good if the agent always kept the interest of the prospects in mind. Things go wrong when the agent becomes concerned with the commission that he will earn from the policy, rather than the benefits to the prospect. Some agents think that they are doing good turn, when they do not reveal some vital information in the proposal form, for fear of the underwriter raising awkward questions. In fact they are doing wrong to the prospects, because if there happens to be an early claim- who can guarantee that this will not happen- the claim may be repudiated, and then the loser at that time is the prospect’s family. The commission collected by the agent is not affected but the loser is also the entire life insurance industry, both agents and insurers.

There could be a likelihood of ethics being compromised in the following situations-

- Having to choose between two plans, one giving less commission than the other.
- Placing above the one’s own interest direct or indirect benefits over the prospects.
- Temptation to recommend the discontinuance of an existing policy and taking out a new one.
• Excess pressure by the insurers on salaried agents to meet out the sales target may lead to unethical sales of policies to policy holders.

• Ever increasing complexities of insurance products specially those which are market driven like ULIPs, as they are not easy to understand which may lead to mis-selling of these products by the insurance advisors.

2.4.7 Introduction to an Actuary

An actuary is a person who has passed specialised examinations conducted by the Actuarial Society of India or the Institute of Actuaries, London. Actuaries are technical experts who have received specialised training in the mathematics of insurance. Their job is to ensure that the insurance products provided by the company are mathematically sound. They undertake various activities like calculation of mortality rates, estimating expenses to be incurred by the insurance companies in administrating various policies, and determining the rate of return that will be earned by the company on its investments. Based on the above, they decide on the premiums to be charged on various policies. As is obvious from the above, a good actuary has to be good economists, a good statistician as well as a good security analyst. Every insurance company requires good actuaries to continuously study its operations and advise the management on the appropriateness of their policies.

2.5 INTRODUCTION TO ATTITUDE
2.5.1 What Is an Attitude?

Most of us at some point or the other have been asked what we ‘think’ or ‘feel’ about a particular object, issue, activity or person. We have also responded to such questions with an expression of our attitudes. That is, our responses would have indicated whether we generally like or dislike the object, issue, activity or person under discussion.

Social psychologists have viewed attitude as a major basic construct leading to behaviour. That is attitude have been considered as a major factor affecting behaviour. Attitudes affect and influence the perception of products, brands, people, exposure to and comprehension of information, choice of friends and so on.

Attitudes have usually been associated with the notion of ‘liking’ or ‘disliking’ someone or something. That is, attitudes are inner expressions or feelings that reflect whether a person is favourably or unfavourably predisposed to a product or brand or establishment. From this perspective, it is seen that attitudes are not directly observable and hence have to be inferred as what people say or what they do. In this context, attitudes can be defined as-

- A learned orientation or disposition, towards an object or situation, which provides a tendency to respond favourably or unfavourably to the object or situation Rokeach, 1968.
- Attitudes are likes and dislikes Bem, 1979.
- Attitudes are an overall evaluation that allows one to respond in a consistently favourable or unfavourable manner with respect to a given object or alternative Engel, 1990.

2.5.2 Understanding Attitudes

An attitude is not a simple entity but is form from a combination of mental processes and expressed by actions.

Many psychologists are of the view that, at some level, attitudes contain three components:
a) **A Cognitive Component** - The knowledge and perception about a product. For instance, the size, shape, colour, price etc. of the product.

b) **An Emotional Component** - What the person subjectively feels about the attitude product - that is whether he or she is favourably inclined towards.

c) **A Behavioural Aspect** - What is the response of the person towards the attitude object?

### 2.5.3 Relationship between Attitude and Behaviour
Marketers are most interested in predicting and then being able to alter the behavioural components of attitudes. Marketers’ wants consumers to like their products, purchase them remain loyal and even recommend its usage to others. All this will require action of some sort.

![Fig. 2.5.1 A simple model of the relationship between attitudes and behaviour.](image)

As seen from the above figure of a simple model, positive cognitive and emotional perception of an object leads to positive behaviour and vise versa. But unfortunately various psychological researches have proved that there is no clear relationship between measured attitudes and external factors, which are beyond our control.

### 2.5.4 Factors Involved in Attitude Formation
Attitudes are learned though there are different approaches on how learning works and is acquired by individuals, generally it is viewed that people learn things from the environment in which they interact. Thus for attitude formation we have to consider all those factors which
people learn. Broadly, these can be analysed in form of group and personality, personal experience, direct marketing and mass media.

1. **Family:** The family of an individual plays a very important role and is an extremely important source of influence on the formation of attitude. In fact it is the family provides the individuals many of the basic values and a wide range of central beliefs.

2. **Reference groups:** The reference groups serve important inputs to a consumer’s learning of his attitudes and awareness of alternative behaviours and life styles.

3. **Social factors:** The social classes perform the important task of transmitting cultural behavioural pattern to specific groups and families. So consumers within a particular social class will be influenced by the value pattern and attitude formation of members in the same social class.

4. **Personality factors:** Personality factors are important in attitude formation. Many researches show positive relationship between consumer’s personality variables and particular attitudes.

5. **Direct experiences:** Very often attitudes towards goods and services are formed through the consumer’s direct experience with the product or service. Realising this marketers have frequently attempted to stimulate trial of new products by offering samples, discounts and other sales promotion offer.

6. **Direct marketing:** Direct marketing efforts by marketers help in creating a positive attitude in the minds of the consumers. Marketers are increasingly using highly focused direct marketing programmes to target ‘consumers’ with the product and services that fit into their interest and life styles.

2.5.4 **Attitude Measurement**

Attitudes are subjective attributes of people. They are also regarded as construct in the sense that they are conceptualisation of human qualities which are formed based on either rational
consideration or on the basis of statistical evidence. This means individuals may vary along a number of attitudinal dimensions. Psychologists have devised numerous methods for the measurement of attitude. The most significant ones are-

- **Thurston type of scale**- In this type of scale, the statements relating to the attitude object are both favourable and unfavourable and are placed in 11 piles with most favourable statement placed on pile no. 1, to the most unfavourable one being on pile no. 11.

- **Likert’s scale**- Likert’s attitude scale uses five to nine points. The statement relating to the measurement of attitudes is given to the respondent, who is then asked to check one of the points given for every statement. These points show degree of agreement or disagreement with the given statements. A positive aspect of the Likert’s scales is that in this scaling technique, it will be possible to make numerous statements because for every aspect only one statement is required, which will have both positive and negative degrees.

- **Semantic differential**- This technique calls for successive allocation of a concept to appoint in the multidimensional space by selecting from among a set of given scaled semantic alternatives. It consists of several or many pairs if opposite adjectives or phrases, with scale values in between. While using this scale technique, the respondent will mark the position along the each scale that reflects his or her attitude to the attitude object. The scale values often ranging from 1-7 are associated with the different responses. The individual’s score is usually the sum of the values.

### 2.5.4 Conclusion

Attitudes, beliefs and cognitions tend to be consistent with each other and play a critical role in influencing consumer behaviour. Since attitude formation is facilitated by direct personal experience, influence of peers, friends and relatives, and exposure to the mass media,
marketers are trying to understand the underlying factors which influence and bring about attitude changes. The changing attitudes will eventually change consumer behaviour.