Chapter 3

Privatization of Insurance Sector in India

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Privatization of Insurance Sector in India

The previous chapter has given us the detail about the origin of the insurance, origin of marine, Life and Fire Insurance and development of insurance in the Indian subcontinent. Nationalization and development of the insurance in the country and the state of Indian Insurance sector at the time of opening up of the insurance sector has been discussed in detail. In this chapter we will deal with the concept of privatization, the process of privatization in India and privatization of Indian insurance sector in detail which covers formation of the committee for reform in the insurance sector, establishment of IRDA, entrance of private companies and their performance.

3.1 Introduction

The Twentieth Century A.D. witnessed two great waves, the wave of nationalization in the first half of the century, the process of which extended to considerably large portion of the century and the wave of privatization in the last two decades of the century, the process of which is still rolling on. When the wave of nationalization started, countries believed that the change of the ownership from private to public will be able to solve most of the social, economic and political problems of the economies. The wave of privatization started in the last quarter of the century and soon the world economic system bowed down to this storm.
This cyclical shift of ownership from private to public and again from public to private taking their strength from each other's flaws seems to be mutually exclusive. This development over the century knowingly or unknowingly became a contest of ideology in spite of becoming a solution to the problems. It is very difficult to decide whether the entire process is less economic and more political or more economic and less political but the central thesis of the whole exercise lies in the assessing and redefining the role of Government, its duties and responsibilities and rebalancing the role of the state and private enterprises in the economy.

Since the days of great depression we have relied increasingly on the state for; maintaining employment, keeping inflation under control, maintaining prices and establishing rule for the settlement of industrial disputes. At the end of Second World War II the issue of the form of ownership, private or public came to surface especially in the West. Further, the role of state, both, in a free market economy and in a planned economy differs. But for an economy, the form of ownership whether private or public is not an end in itself but a means to an end.

3.2 Privatization

Privatization is the transfer of property or responsibility from the public sector. The term can be referred to partial or complete transfer of any property or responsibility held by Government. A similar transfer to the opposite direction could be referred to nationalization of some property or responsibility. The term was coined in 1936 in a chronicle published in the Economist. It is thought to be popularized by the economists
during the 1980s. Privatization may be understood as the process whereby activities or enterprise that were once performed and operated by the Government are performed, managed and owned by private business and individuals.

Privatization is only a modern name assigned to the concept of Laissez-faire coined by Adam Smith and other classical economists. But this time, the policy has not been renamed only but has also been revised and redefined in terms of its role in modern economies. And it has been adopted enthusiastically in belief that the privatization will automatically correct all the deficiencies. The word "Privatization" has been receiving much attention in business, Government and academic circles all over the world. In fact, the language and programme of privatization have spread so rapidly throughout the world that the phenomenon can be linked to a revolution or a boon.

In broader sense the term privatization may be interpreted to include and enlarge the share of private sector in the production of goods and services and fewer control and regulation by the state in the economic activities. Privatization may embrace any step towards liberalization or deregulation of activities such as removal of price and controls, reduction in duties and taxes and production, income and profits, relaxation in foreign collaboration, liberalize trade regime, removal of quantitative restrictions and free flow of foreign capital. The chief objectives of privatization are improving efficiency and competition, avoidance of political interference in enterprise management and widening of ownership of economic assets.
Though, the term ‘privatization’ was coined long before but the privatization as policy is the product of the 1980s. In recent past, the process of privatization initiated only after its practice was started. Generally, people use the term in the context of enterprises and shift in ownership but for the policy makers this is essentially a process of rebalancing the relative role of the state and the market. Thus, privatization may be described as a process by which some or a major part of the ownership and control of the enterprise shifted from Government to the private sector.

Peter Drucker used the term privatization in his famous book ‘The Age of Discontinuity’ in 1969. The first ever privatization was done by Mrs. Thatcher in UK. Mrs. Thatcher started this process by selling out all or part of 13 companies ranging from utilities like British Telecom and British Gas to some important industrial concerns. The German Democratic Republic (GDR) further gave impetus to the process by privatizing 4500 state owned units. Privatization did not touch only the industrial economies but it also swept through the transition economies in Latin America, Asia and East Europe. In a private enterprise economy, the role of the state is strictly limited to the task of providing a legal framework and ensuring that it is not being violated. The basic feature of this regulatory function is contract and private property. Ownership and control of production of goods and services is in the hands of private ownership.

Privatization covers a great range of ideas and policies. It is a policy movement and process that shows every sign of reconstituting major institutional domain of contemporary society. Paul Starr summarizes
Privatization as an Idea

To make the meaning of privatization as an idea more clear he came up with the distinction of public and private and offers the political meaning of privatization.

Distinction between private and public- When we distinguish public and private there are two ideas that public is to private as open is to closed and that public is to private as whole is to part. In public meeting, public conference or public place public is for open as private is for closed in private home, private life or private dairy. In public money, public opinion or public interest public means the whole and not necessarily means government. Here public stands for the common as opposed to that of a part or an individual. Distinction between public and private leads to a sharp conflict. Marketplace is essentially private to economists but public to sociologists and anthropologists. While economists use the public-private distinction to signify the contrast between state and market, social scientists include the market and politics in public and contrast them with private domain of a family. Though these complexities and manipulation do not invalidate their usefulness and underlying meaning, private or public is not enough to specify a form of organization and its relation to the state. Consequently it is very risky to generalize about the public versus privatization organizations.

Privatization as Political Activity- political meaning of privatization says that privatization includes (i) any shift of activities or functions from public to private sector, and (ii) any shift of production of goods
and services from public to private. Besides directly producing services, government establish legal framework and regulate the privately produced and consumed goods and services. Four types of policies can bring such a shift. First, the cessation of public programme and disengagement of government from specific kind of responsibilities. This is called privatization by ‘attrition’. In this case government runs down its services. Second, privatization may take the explicit form of transfer of public assets to private ownership, through sale or lease of public land, infrastructure or enterprises. Third, instead of directly providing some public services, the government may finance private services. Finally, privatization may result from the deregulation of entry into the sector previously treated as public monopolies. The extent of privatization may vary from total privatization as in the case of disengagement of government from some policy domain to partial privatization.

Privatization as Theory
The theories of privatization can be divided into three views, economic theory of privatization, sociological theory of privatization and political view of privatization. Further there are two models of economic theories, privatization as reassessment of property right and privatization as reallocation of economic factors.

Privatization as Reassessment of Property Right- private ownership and competition are normally thought to go hand in hand but the two issues of ownership and market structure are often separate. Here a difference of opinion among the economists appears regarding the preference of two: private ownership and competition. Those who believe that the efficiency depends on private ownership favor
privatization even in the case of generally regarded natural monopoly but those who believe that efficiency may depend on privatization but privatization is not the only factor to increase the efficiency put emphasis on other policy issues like deregulation. The theory of property right explains the difference in organizational behavior solely on the basis of the incentive created by the ownership structure. According to this view property right specify the social and economic relations. Therefore, it becomes important that to whom these rights are assigned and how the rights of ownership are regulated and restricted by the state. More the individuals gain from property right more they are motivated to use property under their control and vice versa. Property right does not find even a single particular condition that might cause a public institution to perform well. It takes the market as condition for judging value and finds public institution deficient as they fail to measure up to that standard. It gives no weight to the monitoring capacity of the state and various institutions of a liberal democracy like press etc. It says that public sector is irredeemably inefficient and privatization is the only remedy. This theory is very radical and recommends privatization of public domain like grassland, ponds etc.

Privatization as a Relocation of Economic Functions- Though, this theory also carry a highly critical view of public institutions this is more rational and more qualified, it favor competition over privatization. This theory view competition as the critical issue and it is inclined to favor privatization insofar as it represents a move towards competition under conditions when markets should be expected to work efficiently. Mainstream views do vary, however, about the proper role of public
institutions in producing public goods and managing natural monopolies. According to this view imperfect information, externalities, increasing returns to scale, and (in some versions) inequalities of wealth prevent the market from achieving optimal performance; it is then a short—though not a necessary—step to say that where the market fails, some form of public ownership or regulation is justified but to perform better a market need not to be perfectly competitive and when market fails the performance of government will be only worse. Here comes the role of nonprofit sector. The theory does not allow sunk investments in organizational capacity and hence criticize relocating an industry in a different sector. The most serious defect of this approach is that, like all the economic models, it is principally concerned with efficiency and has little to say about the effects of organizational design on other values.

Privatization as Community Empowerment- Privatization as community empowerment talks to empower non governmental organization, community organization, self help group and other less formal mediating institution. Privatization as community empowerment stands in sharp contrast to the privatization as an extension of property right. It consider group right more important than individual right. This privatization with a human face has certain degree of resemblance with left wing interest in community organization and cooperatives. Community empowerment is good idea but if it is to come at all it will come from a more government intervention and not from privatization.

Privatization as Reduction of Government Overhead- According to this theory privatizing government enterprises and public services will
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direct aspirations into the market. Privatization can cure budget deficit to some extent. It term privatization as employment relation and shift in the wage burden from state to private enterprisers. In the case of privatization when anything goes wrong people redirect their anger to private service providers.

Meaning of Privatization as Political Practice

The meaning of privatization also depends on the privatizing nation's position in the world system, this contextual factor make visible the practice of privatization and the clash of the theory of privatization and the political practice of privatization. In the third world where the likely buyers of the public enterprises are foreign the privatization often means denationalization. The more dependent a nation on the foreign investment, the greater the likelihood that privatization will raise the prospect of diminishing sovereignty and excite the passion of nationalism. The conflict between privatization and national interest depends upon the nation's place in the world system. Weaker the nation more likely the conflict is. One social factor that the political owners and contractors in privatization represent specific interest groups is some time true. Privatization of some assets like radio station are not only economic but political as well, the state may place them into the hands its allies for political gains. The government may be politically benefited from the individuals and groups who gains from the termination of public sector enterprises. Further the government may under-price the share of public sector enterprises for political gains.
Route of Privatization

There are different routes or ways of achieving privatization. Different economies have different complexities, social and economic state, institutions and finally they may be at the different stage of economic development. These factors force an economy to adopt a route or a set of routes suited to the country. Policymakers are aware of the need to view privatization as a process of rebalancing, the relative role of state and market, but generally the concept is used in the context of enterprise. Privatization may be the transfer of ownership of PSEs, it may also be broadly defined as a process that aims at reducing role of the state and the public sector in the nation’s economic activities. These two important aspects of privatization may results into following two broad routes of privatization. These two broad routes are not mutually exclusive.

Related to the Role of State

(i) **Allowing private sector:** Under economic policy, certain sectors are reserved exclusively for the state sector. In such economy privatization may take the form of relaxation in such reservation.

Related to the Ownership of Enterprises

(i) **Sale of Assets:** This is called ‘divestiture’. Under this method, the state enterprises are sold to the private owners. This method has been proved successful. The process achieved through sale of equity. It is easier to complete this process in countries with well developed capital market but difficult in those countries with less developed capital
market. Further this sale can be made through Initial Public Offer (IPO) or strategic sale.¹⁴

(ii) **Denationalization**: This is the reverse process of the nationalization, there are large numbers of cases where the privatization have taken the route of denationalization.¹⁵

(iii) **Management Employee buyout**: This method is an alternative to sale in which Management and employee buy out major stake in their firm. State in this process do not face any major obstacle, it also creates sense of belonging among employees but under this process the state realizes very low revenue and the enterprise fails to bring new skill and technology in the firm.¹⁶

(iv) **Equal Access Voucher**: This form of privatization involves distribution of vouchers across the population and attempt to allocate assets appropriately and evenly among the voucher holders. Such a programme raises no revenue and is rare in practice.¹⁷

(v) **Leasing**: Leasing of the state owned enterprises to a private party is another important method in which the state do not sell but lease out the enterprises to private party.¹⁸

(vi) **Transfer of Management**: Under this method only the management of PSE is transferred.¹⁹

(vii) **Franchising**: Government may allow private parties for the production and distribution of goods and services. This system is particularly suitable for services.²⁰
(viii) **Liquidation**: Liquidation is the process by which the enterprise’s life comes to an end and the enterprise ceases to exist. Sometimes the Government uses this method of privatization as well.

**Objectives of Privatization**

The basic objective of privatization is to improve performance of the PSEs, so as to reduce the financial burden on the exchequer. The other objectives aim at; increasing the size and dynamism of the private sector, redistributing the ownership more widely among the population at large, encouraging and facilitating private investment from both domestic and foreign sources, generating revenue for the state, reducing the administrative burden of the state and in the former socialist countries - launching and sustaining the transformation of the economy from a command to a market model. Following are important objectives of privatization.

- To improve the efficiency of the assets.
- To make the process of economic decision-making more rational and to keep these economic decisions clear of politics.
- To bring down public outlay, taxes and borrowing requirement.
- To promote private ownership and wide distribution of the resources and development of the capital market.
- To promote equity by redistributing the ownership.
- To encourage and facilitate private investment both investment from inside and outside the country.
- To reduce the state’s burden of governance.
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➢ To raise revenue for the state to invest in different development activities.\textsuperscript{24}

➢ To withdraw state on the behalf of public at large and to manage the business on behalf of shareholders.\textsuperscript{25}

➢ To create the fear of bankruptcy which lacks in public sector.

Rationale of Privatization

The rationale of privatization varies in different countries as the objectives of privatization differ. Some of the important and common grounds can be summarized under the following points.

➢ Profit orientations of the private firms force them to work more efficiently and effectively which in turn improve the productivity of the firms.\textsuperscript{26}

➢ Accountability and responsibility in private sector through proper division of work is more clearly defined.\textsuperscript{27}

➢ Private sector does not suffer with politically motivated appointments at top level.\textsuperscript{28}

➢ Public sector is too structured to take timely decisions but private sector does not suffer from delay in decision making.\textsuperscript{29}

➢ Market discipline is more pronounced in private sector.

➢ It reduces the fiscal burden of the state by relieve it from the burden of loss making PSEs and reducing the size of beaurocracy.\textsuperscript{30}
Privatization provides the state with the fund realized from the sales of PSEs which helps the Government in development plan.\textsuperscript{31}

Privatization helps to accelerate the pace of economic development as it attracts more resources from private sector.

Privatization also encourages entrepreneurship in the economy.

Privatization eliminates the monopoly of public sector enterprises.

Shortcomings of Privatization

The process of privatization does not only posses the merits but some demerits as well. Following are some of the important limitations of the privatization.

- Privatization may results in cutting some essential services which has been provided by PSEs.

- Privatization frequently results into downsizing.

- Public sector does not only focus on profit making but play an instrumental role in achieving some other important socio-economic objectives of an economy.\textsuperscript{32}

- The sale of PSEs to a private company may result into the substitution of public monopoly with private monopoly carrying all its sins and providing no relief to the customers.\textsuperscript{33}

- Corruption in the valuation of PSE for sale is perhaps one of the most important issues in privatization. Privatization thus as an instrument of checking corruption has virtually failed. In some
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countries, it exists to the extent that people refer privatization jokingly as Briberization.³⁴

➢ One of the most important arguments in favor of privatization that the change in ownership would improve the efficiency. Contrary to popular supposition neither the theory nor the empirical evidence on privatization provides unqualified support for this belief.³⁵

➢ Privatization of profit making PSE cause loss of revenue to the state.³⁶

➢ Privatization of defense and other strategic sector is against the national interest.³⁷

➢ Poorly planned privatization will do more loss than any good. According to Adam Smith Institute, London, many Government in Eastern Europe and in the former Soviet Union have committed the classic error of selling state monopolies intact into private hands without breaking them up or creating mechanism to regulate.³⁸

➢ Privatization will further increase the degree of already concentrated assets in few hands.

➢ Performance of any industry depends upon many factors beyond ownership and mere the ownership public or private does not determine the performance.³⁹
3.3 Privatization in India

Initially the most important reason for establishing PSEs in the sector other than of strategic and basic in nature and those providing public utility was the inability of private sector to invest huge capital in some industries. But unfortunately the state kept on investing and left hardly any sector. There were 1300 PSEs in India managed by Central, State or local Governments at the time of privatization of Indian economy. These enterprises managed as much as 55 per cent of the economy's (excluding household) capital stock and amounted for one forth of non-agricultural GDP of India.

India came with the policy decision of privatization in 1991. This policy decision was a part of the New Economic Policy launched in the midst of the economic crises. Earlier some cases of privatization were only the result of individual treatment. In July 1991, the Government of India came with a programme to sell off its equity in some of the PSEs. During July-December 1991, out of 246 Non-departmental Central Public Enterprises (CPE), only 40 Central Public Enterprise's equity was sold. The sale of equity ranges from only 10-40 per cent (except one case in which it was between 40-50 per cent). This privatization does not represent true privatization because commendable equities were not transferred and whatever was transferred went to Public Sector Financial Enterprises (PSFE).

Over the past decade, India has been undergoing a programme of economic reforms and at the same time the economy has been growing at higher rate. As part of reform programme, India has been using one
or more of the different routes of privatization for privatizing a particular sector, some sectors that were earlier reserved for the public sector have faced privatization in the form that new private enterprises are permitted in those sectors, in others it has been using some other routes. As the list of reserved sectors was too long in India, privatization through allowing private enterprises has been the most common and unavoidable route of privatization frequently used in combination with some other routes. In this way, Government of India (GOI) came with a comprehensive policy for different sectors like telecom sector, power sector, road, shipping, airway operation, mining, banking and insurance sector.

Extending the ongoing process, the Government of India announces in the budget 1998-99 that the stake of Government would fall to 26 per cent in PSEs except in the strategic enterprises where the Government will continue to hold the majority of shares. In the same year, the Government of India announced that the enterprises only covered in; (i) Arms and ammunition and defense equipments (ii) Atomic energy except use of nuclear power in agriculture and, (ii) Railway transport are under the category of strategic enterprises. From the year 2000 onwards, privatization can to be identified with a particular method of sales called ‘strategic sale’ the transfer of a controlling stake to a private party at one go. In the following budget of 2000-01, the state was willing to reduce the Government’s share even below 26 per cent in non-strategic enterprises if any economic urgency arises.
India in Post Privatization Period

India has witnessed positive development since privatization on various paradigms. Compared with the historical trend, the impact of these policies has been positive and significant. The growth of economy during 1992-1993 to 1999-2000 was close to 6.5 per annum. The balance of payment position has also improved. Exports have done well, current account deficit have come down and foreign exchange reserve has increased. Industrial growth increased during the period 1993 to 1996 to over 9 per cent per annum. The inflation and fiscal deficit came down in late 1990s as compared to early 1990s. The average export-import ratio has increased in 1990s. Therefore it may be said that privatization has been helpful in the development of Indian economy.

3.4 Privatization of Indian Insurance Sector

The entire financial sector in general and the insurance sector in particular have been highly regulated throughout the globe. Beyond regulation insurance sector was reserved for the PSEs in most of the developing countries. The Uruguay Round of GATT advocated the removal of restrictive and non-tariff trade barriers so that there shall be free flow of international services to Less Developed Countries (LDCs), strengthening domestic capacity and improving efficiency and competitiveness will ultimately enhance economic growth.

In India, the process to initiate Insurance Sector Reform as part of macro economic reform started with the Committee on Reforms in the Insurance Sector constituted in April 1993. The Committee submitted its report in January 1994. In the process of insurance reform, the passage
of Insurance Regulatory and Development Authority (IRDA) Bill in 1999 marked a definite point in the move towards privatization of the Indian insurance sector. This comprehensive bill allowed the entry of private enterprises in the sector. The entry of private companies was allowed in both life and non-life sector. The sector was opened in August 2000 for registration of the companies. Global insurance giants started entering the sector soon after the opening of the sector. In the very first year, sixteen private companies, ten in life insurance and six in non-life insurance entered into the insurance sector. With these new companies, the strength of life insurers went from one to eleven and general insurers from four to ten. Earlier both LIC and GIC were enjoying monopoly in their respective sectors. Since opening-up, the private enterprises are striving to increase their share in the insurance market, at the end of March 2005 the premium share of all private life insurers together was 21.93 per cent and their share in policy was 8.50 per cent. In general insurance business private sector together captured 20.2 per cent of the gross direct premium.

Following are the major policy initiatives taken towards privatization of Insurance sector in India.

**Committee on Reform in the Insurance Sector**

The Committee on reform in Insurance sector was appointed in April 1993, under the Chairmanship of Mr. R. N. Malhotra. The Committee constituted a working group from amongst senior executives of the LIC and GIC to collect, gather and analyse data and informations regarding the theory and practice of insurance in India and that of some other countries. The Committee in its report, after discussing in very brief the
economic reforms undertaken by the Government of India and presenting the insurance industry at a glance, has a detailed discussion on the insurance intermediaries and their role in the development of the sector, insurance surveys, insurance product pricing, investment of insurance fund, rural and social sector coverage, reinsurance operation in the country, pension fund, the need of information technology in insurance business and insurance regulation. After giving recommendations on all the above matters, the committee further recommended about restructuring and privatization of the insurance sector. Though, the committee gave its recommendation on various issues covering from the appointment and training of agents to restructuring of the industry. Following are its recommendations which are directly related to privatization:

➢ There is an urgent need to activate the insurance regulatory apparatus even in present set up of nationalized insurance. The committee also outlined some principle functions of the regulatory authority. The regulatory authority should be professional and financially and otherwise independent on the line of Security Exchange Board of India (SEBI).

➢ The private sector should be allowed to enter insurance business. A single company should not be allowed to transact business in both life and general insurance. The number of new business should be controlled.

➢ The minimum paid up capital should be Rs. 100 crore. However, a lower capital requirement can be prescribed for state level co-operative institutions taking up life insurance business.
The promoter’s holding in a life insurance company should not exceed 40 per cent of the total paid up capital. However, if the promoters wish to start with a higher holding they should bring down their holding to 40 per cent within specified time period. Further, the promoters can not bring their share below 26 per cent. No person other than promoters can hold more than 1 per cent share of the company.53

Entry should be allowed at selective basis. Foreign companies should be required to float an Indian company and these companies should be allowed preferably in a joint venture with Indian partner.54

Before the private sector is allowed to enter into the Insurance sector the regulation and prudential norms should be finalized and the controller of insurance should start functioning effectively.55

If the new entrants are coming into life insurance business they should be required to write a specified portion of their business in rural and social sector and it should be ensured that the new companies are not hesitant in writing small policies. The new entrants to General Insurance should also be required to have a specified portion of their business as rural and non-traditional business. In case they fail to do so they must be subject to panel assessment by regulatory authority.

Tariff Advisory Committee should be de-linked from GIC and function as separate statutory body under such supervision of the
regulatory authority as may be necessary without becoming a part thereof.56

- Claims should be settled promptly and in case of delay for no fault of insured, an interest at the rate of 2 per cent higher than bank rate should be paid.57

- The system of licensing of surveyors by the controller of insurance should be given up as it has not served any useful purpose.58

- The minimum limit of compulsory survey should be raised from 20,000 to 1 lakh.59

- Unit-linked pension plan should be permitted. This product possesses great attraction and potential and it is very popular in the developed countries. 60

- To reduce the litigation the insurance ombudsman should be set-up by the general insurance industry.

- The provision of the Insurance Act 1938, regarding solvency margin should be revised.61

**Justification of Privatization of Indian Insurance Sector**

- The majority of area previously reserved for the public sector had been privatized but the LIC was a monolith and there was very little competition among subsidiaries of the GIC. The question arises that why a consumer of insurance service should not be provided with a wider choice to get benefit of the competition in
terms of number of product, lower prices and better consumer services.62

➢ The insurance awareness among the Indian people in general and among the non-holder of insurance policy in particular is very low.63

➢ Information, speedy communication and a risk free environment act as spring board of economic growth. Therefore, the insurance sector must come out and get the benefit of global changes. Insurance business remains a monopoly in very few countries.64

➢ Though the LIC and GIC have done a commendable job in spreading the insurance business across the length and breadth of the country they still fall far behind the international standard and even from many Asian Countries in terms of technology and managerial skill, cost efficiency, product range and innovation. It was estimated that only 22 per cent of insurable population was covered by the life insurance at the time of privatization, LIC have only 65 million policyholders whereas the estimated population of middle class itself is 250-300 million. Only 13.4 million new policies issued every year. Further, only 10 per cent of the workforce has old age income security in terms of pension. These indicator compared with broad economic variables suggests that there exist huge potential market. This potential itself calls private players.65

➢ Analysis of operational efficiency of LIC shows that life insurance policies are looked upon by the people as financial instrument
and people compare it with other instruments like, mutual funds, Term deposits etc. in terms of safety, return and liquidity. Taking notice to these factors it is therefore, needed to introduce competition to meet this challenge by providing tailor made products.

➢ With the introduction of new technology, the productivity will increase which in turn would create demand for skilled human resources. Increased volume of business would raise the overall employment in the sector.

➢ Privatization of insurance would increase the overall efficiency through increased utilization of resources.

➢ Large amount of fund will be mobilized domestically through the insurance.

➢ Privatization would also increase the scope of the operation of insurance business from limited area to the untapped area.

➢ Privatization will enable MNCs to enter into the Indian insurance sector which will bring new technologies and managerial skill, economy of scale, greater actuarial understanding, and better portfolio management.

➢ Experiences of the countries which have already liberalized their financial market and insurance market advocate to open-up the Indian insurance industry. Communication and information technology revolution and many other factors have made the world financial sector highly dynamic and closely integrated. In
this situation integration of Indian insurance with rest of the world is inevitable.

➢ When Indian became the member of WTO it was obligatory to dismantle the non-tariff barriers and open the market. Further General Agreement on Trade in Services (GATS) force to open up the insurance services.

**Uniqueness of Privatization of Indian Insurance Sector**

Generally, people relate privatization with the change in ownership of enterprise from public to private, it may be selling, leasing or any how getting rid of PSEs. But this is not the case all the time. When India initiated privatization of insurance sector, it had two alternatives; (a) selling of PSEs to private hands and (b) allowing private sector to enter into the industry and compete the existing public sector insurance companies. The later option was considered better, therefore, Government of India opted for the same. It was concluded that the coexistence of private and public companies together would unquestionably benefit the economy.

The option India opted for, combine the benefits of both public sector and private sector and simultaneously avoid the drawback of the existence of either of the two in the absence of the other (public sector and private sector existing alone). Insurance sector in this way has generated competition without dismantling the PSEs. It was also not the case that the insurance sector needed to privatize because it was making losses. Privatization of this kind is required in order to generate competition, to eliminate the deficiency and to improve the market
conditions. In nutshell, it can be said that this kind of reform will avoid all the drawbacks of the existing of a monopoly on one hand and at the other; it may provide all the benefits of the existence of a PSE.

1.5 Regulation of Insurance Sector in India

One of the important purposes of the insurance law is to provide proper guidelines for the conduct of the insurance business. It is necessary for the normal growth of the business. Insurers are repositories of public trust. They sell promises to indemnify the insured upon happening of specified events and these promises should be kept. The policy contract drawn by the insurer is also much complex which could not be understood by all the people very easily. Further, insurance involve large number of people and huge amount of funds. These funds are invested for a return. Insurers therefore, are subject to regulation by the state in one form or the other with the objective that if the business is conducted by competent persons it will not result in insolvency and it will also protect the legitimate interest of the insuring public. Not only the banking sector but the insurance sector as well is vulnerable to the 'bank run' syndrome, where a single insolvency is potent enough to create panic and destabilize all the things. The regulatory authority apart from all its duties should ensure the confidence of consumers in the insurance.

Beyond protecting the interest of the policyholders the main objective of a regulator is to promote competition and efficiency. For this very main objective, various secondary objectives arise. One of the secondary objectives is to provide level playing field among the promoter. Level
playing field not only among the domestic insurers but also between the foreign and domestic insurers is must.

**Background of Regulation**

Though, the first Insurance Company in India was established in 1818, in the nineteenth century no policy decision was taken for the enactment of insurance. This absence of regulation was one of the major causes of the establishment of large number of foreign and domestic companies in the 19th century AD. The first step in this regard was taken in the form of Insurance Act 1912. Until 1912, the Indian Companies Act 1883 was governing these insurance companies. The main short-coming of the Insurance Act 1912 was the fact that there was no provision at all to cover the non-life insurance. After 1912, the Insurance Act 1938 came into being, this was the first comprehensive piece of insurance legislation governing both life and non-life insurance business.

After independence, Life Insurance Corporation Act 1956 was passed to nationalize life insurance business in the country. This act resulted into formation of LIC of India in the public sector. All other companies transacting in the life insurance sector ceases to exist and their business was taken over by the LIC of India. In the same fashion General Insurance Business (Nationalization) Act 1972 was passed to takeover the non-life business of the country. Finally, the IRDA Act 1999 came into being, which is considered as the most important event in the nationalized Indian insurance industry.
Insurance Regulator and Development Authority (IRDA)

The Malhotra Committee strongly recommended the establishment of Insurance Regulatory Authority (IRA). Later the Government of India inserted the word 'Development' to the bill and the recommended IRA became IRDA. India is the only country in which the regulatory authority is carrying the additional responsibility of development. The authority consists of one Chairman (appointed by central Government) and nine other members. Out of these nine five members are whole time and four of them are part time members. The Chairman and whole time members shall hold office for 5 years and are eligible for reappointment. The Authority shall furnish every year its report to the central Government in the manner prescribed.

Powers and Functions Delegated by the Authority

The Authority has delegated the power of licensing of new agents and renewal of the insurance agent's license through a designated officer nominated by the respective insurers on their behalf. The designated officer is responsible to make it sure that all the regulatory aspects of the license have been complied with before issuing the license. The entire process is web based and has been able to save time and ensure effective monitoring. The conducting of agent's licensing examination has been delegated to the Insurance Institute of India, Mumbai.

Mission Statement of IRDA

➢ To protect the interest of and secure fair treatment to policyholders.
➢ To bring about speedy and orderly growth of the insurance industry, for the benefit of common man and to provide long term funds for accelerating the growth of economy.

➢ To set, promote, monitor and enforce higher standard of integrity, financial soundness, fair dealing and competence of those it regulates, clear and correct information about product and services and make them aware of their duties and responsibilities in this regard.

➢ To ensure that insurance consumers receive precise, clear and correct information about product and services and make them aware of their responsibilities and duties in this regard.

➢ To ensure speedy settlement of claims, to prevent the misuse of insurance funds, and other malpractices and put in place effective grievance redressed machinery.

➢ To promote fairness, transparency and orderly conduct in financial market dealing with insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players.

➢ To take action where such standard are inadequate or ineffectively enforced.

➢ To bring about optimum amount of self-regulation in day to day working of the industry consistent with the requirements of prudential regulation.
Some Important Regulations made by IRDA

IRDA acts as facilitator, regulator and watchdog of the insurance industry. To achieve its objectives IRDA has made some regulatory provisions covering all vital issues. Following are some of them.

IRDA and solvency margin of insurers

Determination of solvency margins- Life insurers

1. Interpretation.- In this schedule- (a) “Available Solvency Margin” means the excess of value of assets (furnished in IRDA-Form-AA) over the value of life insurance liabilities (furnished in Form H ) as specified in regulation 4 of Insurance Regulatory and Development Authority (Actuarial report and Abstract) Regulations, 2000) and other liabilities of policy-holders’ fund and share-holders funds; (b) “Solvency Ratio” means the ratio of amount of Available Solvency Margin to the amount of Required Solvency margin.

2. Determination of Solvency Margin.- Every insurer shall determine the required solvency margin, and the solvency ratio in Form K as specified in IRDA (Actuarial Report and Abstract ), Regulations, 2000.

Determination of Solvency Margins- General Insurance

1. Interpretation. - (a) “Available Solvency Margin” means the excess of value of assets (furnished in Form IRDA- Assets-AA), over the value of liabilities (furnished in Form HG), with further adjustments as shown in Table III of Form KG. (b) “Solvency
Ratio" means the ratio of the amount of Available Solvency Margin to the amount of Required Solvency margin.

2. Determination of Solvency Margin. - Every insurer shall determine the required solvency margin, the available solvency margin, and the solvency ratio in form KG. 69

IRDA and Obligation of Insurers to Rural and Social Sector

The objective of this regulation is to make it mandatory on the part of the insurers to cover rural and social sector

1. Provisions for rural coverage (Life) - all the life insurance companies are required to cover seven per cent policy in the first financial year and nine per cent in the second financial year. Likewise, twelve per cent policies in the third financial year, fourteen per cent in the forth financial year, sixteen per cent in the fifth financial year, of total policy written direct in the year in the rural sector.

2. Provision for Rural Coverage (Non-life)- all the companies participating in general insurance business should write two per cent of their policies in first financial year, three per cent in second financial year, five per cent thereafter, of total gross premium income written directly in that year in rural sector.

3. Social Sector, in Respect of All Insurers- all the companies shall write five thousand lives in the first financial year, seven thousand five hundred lives in the second financial year, ten thousand lives in the third financial year, fifteen thousand lives in
the forth financial year; and twenty thousand lives in the fifth financial year and thereafter in the social sector.\textsuperscript{70}

IRDA and Investment Regulation

Keeping in view, the importance of investment, all insurance companies are required to submit to the authority a detailed statement before the start of an accounting year. Under section 27, 27A and 27B of the IRDA Act, the authority has mandated the pattern of investment to be followed by the insurance companies. Provisions for proportionate investment in Government securities, approved securities, approved investments in infrastructure and social sector has been prescribed. Different pattern of investment for Life insurance business, pension and general annuity business, unit linked life insurance and general insurance business has been provided.

1. Life Business. - Every Insurer carrying on business of life-insurance shall invest and at all times keep invested his controlled fund (other than funds relating to pension and general annuity and unit linked life insurance business in the following manner:- (i) Government securities - not less than 25 per cent. (ii) Government securities or other approved securities including (i) not less than 50 Per cent. (iii) Approved investments as specified in Schedule I (a) Infrastructure and Social Sector less than 15 per cent. (b) Other to be governed by exposure norms as specified in regulation 5 not exceeding 35 per cent.

2. Pension and General Annuity Business.- Every insurer shall invest and at all times keep invested funds belonging to his Pension Business, General Annuity Business in the following manner:- (i) Government
securities - not less than 25 per cent. (ii) Government securities or other approved securities including (i) - not less than 40 Per cent. (iii) Balanced to be invested in approved investments- Not exceeding 60 per cent.

3. **Unit Linked Life Insurance Business.** - Every insurer shall invest and at all times keep invested his segregated fund of unit linked life insurance business as per pattern of investment offered to and approved by the policy-holders. Unit-linked policies may only be offered where the units are linked to categories of assets which are both marketable and easily realizable. However, the total investment in other than approved categories of investments shall at no time exceed 20 per cent of fund.

4. **General Business** - Every insurer carrying on the business of general insurance shall invest and at all times keep invested his total assets in the following manner (i) Central Government securities being not less than 20 per cent. (ii) State Government securities and other Guaranteed Securities including (i) above being not less than 30 per cent. (iii) Housing and Loan to Government for Housing and fire fighting equipment, being not less than 5 per cent. (iv) Investment in approved investments as specified in Schedule II (a) Infrastructure and social sector- Not less than 10 per cent. (b) Other to be governed by Exposure norms as specified in regulation 5 not exceeding 50 per cent. 

**IRDA and Accounting Standards for Insurance Companies**

The Authority has made regulations for preparation of financial statements and auditor's report of insurance companies. These were
formulated by a committee in association with the Institute of Chartered Accountants of India (ICAI), New Delhi. All the insurer whether transacting in life insurance or general insurance or reinsurance business are required to furnish the financial statements in accordance with the regulations framed by the authority. The financial statements have to be compiled in accordance with the accounting standards prescribed by the Institute of Chartered Accountants of India.

1. **Accounting standards prescribed for life insurance:**
   a. Accounting Standard 3 - Cash Flow Statements - shall be prepared only under the Direct Method.
   
   b. Accounting Standard 17 - Segment Reporting - shall apply irrespective of whether the securities of the insurers are traded publicly or not.

2. **Accounting standards prescribed for general insurance:**
   
   b. Accounting Standard 13 (AS 13) - Accounting for Investments, shall not be applicable.
   
   c. Accounting Standard 17 (AS 17) - Segment Reporting - shall apply irrespective of whether the securities of the insurer are traded publicly or not.

Apart from the financial statements, every insurer has to prepare a management report as part of its Annual Report covering the following aspects:
a. Validity of Registration

b. Shareholding pattern

c. Investment of policyholders funds outside India

d. Maintenance of solvency margins

e. Review of assets to the effect that the same are shown at amounts not exceeding their realisable or market value

f. Disclosure on overall risk exposure and strategy adopted to mitigate the same;

g. Ageing of claims & trends of average claim settlement time during the preceding 5 years.

IRDA and Actuarial System

The Authority has also evolved the system for the Appointment of Actuaries for both life insurance business and general insurance business carried on in the country. A life insurance company cannot transact life insurance business unless it has appointed an actuary. The Authority is fully aware of the importance of Appointed Actuary system in life insurance business. The Authority has prescribed the eligibility criteria in its Appointed Actuary Regulations. Normally an actuary can be Appointed Actuary of a life insurance company if he/she is a Fellow Member of Actuarial Society of India, possesses a certificate of practice issued by the Actuarial Society of India and if he/she fulfils the conditions specified in the Appointed Actuary Regulations. The Appointed Actuary must be an employee of the life
insurance company. The main purpose of such privileges is to ensure the stability and solvency of the insurance company.

Likewise, every general insurer is required to appoint an Appointed Actuary for certain limited purposes such as determination of the rates for in-house products and certification of the Incurred but Not Reported Reserves (IBNR). The Appointed Actuary of a general insurer need not be an employee of the company and can be a consulting actuary in view of the shortage of actuaries in general insurance business in India.

The Actuarial Society of India has been entrusted with the preparation of guideline notes (actuarial standards) for the actuaries with the concurrence of the Authority. The Actuarial Society of India has come out with the first guideline note which deals with the role of Appointed Actuary in the life insurance business.73

The Concept of Priority Sector in Insurance

Taking the reference from banking sector, a similar concept of priority sector has been mooted in the insurance sector. This concept given by Minister of State for finance is in its infancy. This priority sector scheme is not mandatory and any concrete and decisive step in this regard is yet to be taken.74

1.6 Private Players in Indian Insurance Market

Life Insurers

There were fourteen life insurers claiming their market share in India in 2004-05. Out of these one company (LIC) is a public company and all
other are private companies entered into the market only after the privatization of insurance sector.

<table>
<thead>
<tr>
<th>Insurers</th>
<th>Premium 2004-05</th>
<th>Premium 03-04</th>
<th>Premium Market share (%)</th>
<th>Number of Policies/ schemes 04-05</th>
<th>Number of Policies/ Schemes 03-04</th>
<th>Policies Market Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bajaj Allianz</td>
<td>86001.80</td>
<td>17970.51</td>
<td>3.39</td>
<td>288191</td>
<td>185350</td>
<td>1.10</td>
</tr>
<tr>
<td>ING Vsysa</td>
<td>28,162.46</td>
<td>7255.66</td>
<td>1.11</td>
<td>111141</td>
<td>90977</td>
<td>0.46</td>
</tr>
<tr>
<td>AMP Samar</td>
<td>9,118.44</td>
<td>2788.16</td>
<td>0.36</td>
<td>35268</td>
<td>46282</td>
<td>0.13</td>
</tr>
<tr>
<td>SBI Life</td>
<td>48,293.56</td>
<td>20247.71</td>
<td>1.91</td>
<td>129974</td>
<td>86495</td>
<td>0.49</td>
</tr>
<tr>
<td>Tata AIG</td>
<td>30,022.07</td>
<td>18015.47</td>
<td>1.18</td>
<td>228894</td>
<td>161967</td>
<td>0.87</td>
</tr>
<tr>
<td>HFDC Standard</td>
<td>48,615.08</td>
<td>29933.26</td>
<td>1.92</td>
<td>206320</td>
<td>203205</td>
<td>0.79</td>
</tr>
<tr>
<td>ICICI Prudential</td>
<td>1,58,408.46</td>
<td>75091.03</td>
<td>6.25</td>
<td>614673</td>
<td>436196</td>
<td>2.34</td>
</tr>
<tr>
<td>Birla Sunlife</td>
<td>62,128.31</td>
<td>44986.19</td>
<td>2.45</td>
<td>198370</td>
<td>155998</td>
<td>0.76</td>
</tr>
<tr>
<td>Aviva</td>
<td>19,229.27</td>
<td>7713.84</td>
<td>0.76</td>
<td>83209</td>
<td>71001</td>
<td>0.32</td>
</tr>
<tr>
<td>Kotak Mahindra OM</td>
<td>37,475.21</td>
<td>12408.24</td>
<td>1.48</td>
<td>63468</td>
<td>51071</td>
<td>0.24</td>
</tr>
<tr>
<td>Max New York</td>
<td>22469.01</td>
<td>13148.80</td>
<td>0.89</td>
<td>216671</td>
<td>145581</td>
<td>0.83</td>
</tr>
<tr>
<td>Met Life</td>
<td>5603.71</td>
<td>2338.16</td>
<td>0.22</td>
<td>46682</td>
<td>25124</td>
<td>0.18</td>
</tr>
<tr>
<td>Sahara Life</td>
<td>167.09</td>
<td>−</td>
<td>0.01</td>
<td>10214</td>
<td>−</td>
<td>0.04</td>
</tr>
<tr>
<td>LIC</td>
<td>1978593.20</td>
<td>162404.2</td>
<td>78.07</td>
<td>24027393</td>
<td>26968069</td>
<td>91.50</td>
</tr>
<tr>
<td>Total</td>
<td>2534287.67</td>
<td>1866939.69</td>
<td>100</td>
<td>26260468</td>
<td>28626916</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Adopted from Journal of IRDA May 2005

As the table depicts the life insurance industry undertakes a premium of Rs. 25,34,287.67 lakh during the financial year 2004-05, the LIC underwrote premium of Rs. 19,78,593.20 lakh during the period which accounted for the 78.07 per cent of market share, followed by ICICI Prudential and Bajaj Allianz with premium underwritten of Rs. 1,58,408.46 lakh and Rs. 86,001.80 lakh respectively which accounted for the market share of 6.25 per cent and 3.39 per cent respectively. The 1st year premium of new players was Rs. 5,55,694.47 lakh. In terms of the number of policies underwritten, the market share of private companies
and LIC was 8.5 per cent and 91.5 per cent respectively. The difference of premium wise market share and policy wise market share shows that the private companies are taking limited but big policies.

**Non-Life Insurance**

In the non-life sector there were thirteen companies working in 2004-05. Out of these eight companies are new, these companies entered into the market after insurance reform in the country. These companies are Royal Sundaram, Tata AIG, Reliance Genera, IFFCO-Tokio, ICICI Lombard, Bajaj Allianz, HDFC Chubb and Cholamandalam.

**Table No. 3.2**

<table>
<thead>
<tr>
<th>Insurers</th>
<th>Gross Direct Premium Rs. in lakh</th>
<th>Market Share 2004-05</th>
</tr>
</thead>
<tbody>
<tr>
<td>Royal Sundaram</td>
<td>25,802.00</td>
<td>33,150.00</td>
</tr>
<tr>
<td>Tata AIG</td>
<td>35,331.92</td>
<td>46,886.82</td>
</tr>
<tr>
<td>Reliance General</td>
<td>16,105.56</td>
<td>16,167.96</td>
</tr>
<tr>
<td>IFFCO-Tokio</td>
<td>29,563.76</td>
<td>50,738.69</td>
</tr>
<tr>
<td>ICICI Lombard</td>
<td>50,672.18</td>
<td>88,519.71</td>
</tr>
<tr>
<td>Bajaj Allianz</td>
<td>47,630.86</td>
<td>85,275.43</td>
</tr>
<tr>
<td>HDFC Chubb</td>
<td>11,166.78</td>
<td>17,777.88</td>
</tr>
<tr>
<td>Cholamandalam</td>
<td>9,668.31</td>
<td>17,010.66</td>
</tr>
<tr>
<td>New India</td>
<td>4,04,569.00</td>
<td>4,20,703.00</td>
</tr>
<tr>
<td>National</td>
<td>3,41,700.00</td>
<td>3,82,498.16</td>
</tr>
<tr>
<td>United India</td>
<td>3,03,805.57</td>
<td>2,95,183</td>
</tr>
<tr>
<td>Oriental</td>
<td>2,83,211.00</td>
<td>3,03,823.00</td>
</tr>
<tr>
<td>ECGC</td>
<td>44,512.90</td>
<td>51,764.50</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1603739.84</strong></td>
<td><strong>1809525.80</strong></td>
</tr>
</tbody>
</table>

Source: Adopted from Journal of IRDA May 2005

It can be seen from the table number 3.2 that the gross direct premium collection by Royal Sundaram was Rs. 25802.00 lakh in 2003-04 which increased to Rs. 33150.00, that of Tata AIG was Rs. 35331.92 lakh in
2003-04 which rose to Rs.46886.82 lakh. Reliance General's gross premium collection also increased from Rs. 16105.56 lakh in 2003-04 to Rs. 16167.96 lakh in 2004-05. Likewise all other companies like IFFCO-Tokio, ICICI Lombard, Bajaj Allianz, HDFC Chubb, Cholamandalam, New India, National, Oriental and ECGC recorded increased gross premium collection but United India was the only company which recorded decline in the same. The private companies together claimed 19.63 per cent of market share and the remaining share was occupied by the PSICs. Among private companies ICICI Lombard occupied the highest market share of 4.89 per cent. However, New India with 23.25 per cent of market share remained at the top.
References:


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54. Ibid. p. 92
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56. Ibid. p. 43
57. Ibid. pp. 31&32
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63. Ibid. p. 6
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72. Ibid. pp. 135-146
73. Ibid. pp. 36-42