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An Analysis of the Evolution of Insurance in India

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Abstract

With over a billion people, India is fast becoming a global economic power. With a relatively youthful population, India will become an attractive insurance market over the next decades. This paper examines the Indian insurance industry. It starts by examining the details of the regulatory regime that existed before independence. This is important because the culmination of the Insurance Act of 1938 became the backbone of the current legislation in place. It highlights the importance of the rural sector – where the majority of the Indians still live. It shows how the recent privatization is playing out in the market. Based on recent economic estimates, the paper provides projections of segments of the market for 2025.

Title: An Analysis of the Evolution of Insurance in India[1]

Introduction

India had the nineteenth largest insurance market in the world in 2003. Strong economic growth in the last decade combined with a population of over a billion makes it one of the potentially largest markets in the future. Insurance in India has gone through two radical transformations. Before 1956, insurance was private with minimal government intervention. In 1956, *life* insurance was nationalized and a monopoly was created. In 1972, *general* insurance was nationalized as well (endnote 1). But, unlike life insurance, a different structure was created for the industry. One holding company was formed with four subsidiaries. As a part of the general opening up of the economy after 1992, a Government appointed committee recommended that private companies should be allowed to operate. It took six years to implement the recommendation. Private sector was allowed into insurance business in 2000. However, foreign ownership was restricted. No more than 26% of any company can be foreign-owned.

In what follows, we examine the insurance industry in India through different regulatory regimes. A totally regulation free regime ended in 1912 with the introduction of regulation of life insurance. A comprehensive regulatory scheme came into place in 1938. This was disabled through nationalization. But, the Insurance Act of 1938 became relevant again in 2000 with deregulation. With a strong hint of sustained growth of the economy in the recent past, the Indian market is likely to grow substantially over the next few decades.

The rest of the chapter is organized as follows. First, we study the evolution of insurance business before nationalization. This is important because the denationalized structure brought back to play important legal rules from 1938. Next we analyze the nationalized era separately for life and property casualty business as they were not nationalized simultaneously. Much of post-independence history of insurance in India was the history of nationalized insurance. In the following section, we examine the new legal structure introduced after the industry was denationalized in 2000. In the penultimate section, we examine the current state of play and projected future of the industry. The final section sets out conclusions.

Evolution of Insurance Before Nationalization

Insurance in the Colonial Era. Life insurance in the modern form was first set up in India through a British company called the Oriental Life Insurance Company in 1818 followed by the Bombay Assurance Company in 1823 and the Madras Equitable Life Insurance Society in 1829. All of these companies operated in India but did *not* insure the lives of Indians. They were insuring the lives of *Europeans* living in India (endnote 2).

[1] Tapen Sinha "An Analysis of the Evolution of Insurance in India," in International Insurance and Financial Institutions: Global Dynamics and Local Contingencies edited by J. David Cummins and Bertrand Venard, University of Pennsylvania Press (forthcoming).

Some of the companies that started later did provide insurance for Indians. But, they were treated as "substandard". Substandard in insurance parlance refers to lives with physical disability. In this case, the common adjustment made was a "rating-up" of five to seven years to normal British life in India. This meant, treating q(x), the (conditional) probability of dying between x and x+1, for an x year old Indian male as if it was q(x+5) or q(x+7) of a British male. Therefore, Indian lives had to pay an ad hoc extra premium of 20% or more. This was a common practice of the European companies at the time whether they were operating in Asia or Latin America. The first company to sell policies to Indians with "fair value" was the Bombay Mutual Life Assurance Society starting in 1871.

The first general insurance company, Triton Insurance Company Ltd., was established in 1850. It was owned and operated by the British. The first indigenous general insurance company was the Indian Mercantile Insurance Company Limited set up in Bombay in 1907.

Insurance business was conducted in India without any specific regulation for the insurance business. They were subject to Indian Companies Act (1866). After the start of the "Be Indian Buy Indian Movement" (called Swadeshi Movement) in 1905, indigenous enterprises sprang up in many industries. Not surprisingly, the Movement also touched the insurance industry leading to the formation of dozens of life insurance companies along with provident fund companies (provident fund companies are pension funds). In 1912, two sets of legislation were passed: the Indian Life Assurance Companies Act and the Provident Insurance Societies Act. There are several striking features of these legislations. First, they were the first legislations in India that particularly targeted the insurance sector. Second, they left general insurance business out of it. The government did not feel the necessity to regulate general insurance. Third, they restricted activities of the *Indian* insurers but not the foreign insurers even though the model used was the British Act of 1909.

Comprehensive insurance legislation covering both life and non-life business did not materialize for the next twenty-six years. During the first phase of these years, Great Britain entered World War I. This event disrupted all legislative initiatives. Later, Indians demanded freedom from the British. As a concession, India was granted "home rule" through the Government of India Act of 1935. It provided for Legislative Assemblies for provincial governments as well as for the central government. But supreme authority of promulgated laws still stayed with the British Crown.

The only significant legislative change before the Insurance Act of 1938, was Act XX of 1928. It enabled the Government of India to collect information of (1) Indian insurance companies operating in India, (2) Foreign insurance companies operating in India and (3) Indian insurance companies operating in foreign countries. The last two elements were missing from the 1912 Insurance Act. Information thus collected allows us to compare the average size face value of Indian insurance companies against their foreign counterparts. In 1928, the average policy value of an Indian company was 619 US dollars against 1,150 US dollars for foreign companies (Source: Indian Insurance Commissioner's Report, 1929, p. 23).

Foreign insurance companies were doing well during that period. In 1938, the average size of the policy sold by Indian companies has fallen to 532 US dollars (in comparison with 619 US dollars in 1928) and that of foreign companies had risen somewhat to 1, 188 US dollars (in 1928, the average size was 1,150 US dollars).

The Birth of the Insurance Act, 1938. In 1937, the Government of India set up a consultative committee. Mr. Sushil C. Sen, a well known solicitor of Calcutta, was appointed the chair of the committee. He consulted a wide range of interested parties including the industry. It was debated in the Legislative Assembly. Finally, in 1938, the Insurance Act was passed. This piece of legislation was the first comprehensive one in India. It covered both life and general insurance companies. It clearly defined what would come under the life insurance business, the fire insurance business and so on (see Appendix 1). It covered deposits, supervision of insurance companies, investments, commissions of agents, directors appointed by the policyholders among others. This piece of legislation lost significance after nationalization. Life insurance was nationalized in 1956 and general insurance in 1972 respectively. With the privatization in the late Twentieth Century, it has returned as the backbone of the current legislation of insurance companies. All legislative changes are enumerated in Table 1.

Table 1
Milestones of Insurance Regulations in the 20th Century

Year	*Significant Regulatory Event*
1912	The Indian Life Insurance Company Act
1928	Indian Insurance Companies Act
1938	The Insurance Act: Comprehensive Act to regulate insurance business in India
1956	Nationalization of life insurance business in India with a monopoly awarded to the Life Insurance Corporation of India
1972	Nationalization of general insurance business in India with the formation of a holding company General Insurance Corporation
1993	Setting up of Malhotra Committee
1994	Recommendations of Malhotra Committee published
1995	Setting up of Mukherjee Committee
1996	Setting up of (interim) Insurance Regulatory Authority (IRA) Recommendations of the IRA
1997	Mukherjee Committee Report submitted but not made public
1997	The Government gives greater autonomy to Life Insurance Corporation, General Insurance Corporation and its subsidiaries with regard to the restructuring of boards and flexibility in investment norms aimed at channeling funds to the infrastructure sector
1998	The cabinet decides to allow 40% foreign equity in private insurance companies-26% to foreign companies and 14% to Non-resident Indians and Foreign Institutional Investors
1999	The Standing Committee headed by Murali Deora decides that foreign equity in private insurance should be limited to 26%. The IRA bill is renamed the Insurance Regulatory and Development Authority Bill
1999	Cabinet clears Insurance Regulatory and Development Authority Bill
2000	President gives Assent to the Insurance Regulatory and Development Authority Bill

Source: Author

To implement the 1938 Act, an insurance department (that became known as the insurance wing) was first set up in the Ministry of Commerce by the Government of India. Later, it was transferred to the Ministry of Finance. One curious element of classification used (Appendix 1) was to include automobile insurance in the "miscellaneous" category. Later in the century, automobiles became the largest single item of general insurance. However, it continued to be included in that category making it difficult to delineate the effects of losses due to pricing that drove this sector. For example, the Tariff Advisory Committee effectively fixed prices for a number of general insurance lines of business. Most premiums were below what would have been actuarially fair (especially for auto). But reporting auto insurance under the miscellaneous category masked this underpricing.

When the market was opened again to private participation in 1999, the earlier Insurance Act of 1938 was *reinstated* as the backbone of the current legislation of insurance companies, as the Insurance Regulatory and Development Authority Act of 1999 was superimposed on the 1938 Insurance Act. This revival of the Act has created a messy problem. The Insurance Act of 1938 explicitly forbade financial services from the activities permitted by insurance companies.

By 1956, there were 154 Indian life insurance companies. There were 16 non-Indian insurance companies and 75 provident societies were issuing life insurance policies. Most of these policies were centered in the cities (especially around big cities like Bombay, Calcutta, Delhi and Madras).

Mortality Tables. Before the mortality of Indian lives were used for constructing mortality tables for India, it was common practice to use the British Office Table O(M) based on the British experience during 1863-1893. As was noted earlier, the table was used with a rating up of five to seven years to approximate Indian lives. The first ever Indian table based on assured Indian lives was created based on the experience of Oriental Government Security Life Assurance Co. Ltd. for the period 1905-25 (Vaidyanathan, 1934). It was noted that the lowest mortality was experienced by the Endowment policies and the highest mortality was experienced by the Whole Life policies. Subsequent updates were produced by the Life Insurance Corporation in the 1970s (called LIC 75-79) and in the 1990s (called LIC 94-96).

Given that the Life Insurance Corporation was a monopoly, it had no incentives to update mortality tables frequently. Indeed, the Malhotra Committee noted this fact as follows. "Quite a few persons including, notably, representatives of consumer groups have told the Committee that Life Insurance Corporation premium rates had remained unrevised for a long period and were unjustifiably high in spite of the fact that trends in mortality rates all over the country are continuously showing improvement" (Malhotra, 1994, Chapter V, Section 5.4, p. 33). The Report recommended that such tables be published every ten years (Malhotra, 1994, Chapter V, Section 5.12, p. 37).

Evolution of Insurance During Nationalized Era: 1956-2000

Rationale for Nationalization. After India became independent in 1947, National Planning modeled after the Soviet Union was implemented. Nowhere it was more evident in the Second Five Year Plan implemented by the Prime Minister Jawaharlal Nehru. His vision was to have key industries under direct government control to facilitate the implementation of National Planning. Insurance business (or for that matter, any financial service) was not seen to be of strategic importance.

Therefore, there are two questions we need to address. First, why did the Government of India nationalize *life* insurance in 1956? Second, why did it *not* nationalize *general* insurance at the same time?

We deal with the first question first. The genesis of nationalization of life insurance came from a document produced by Mr. H. D. Malaviya called "Insurance Business in India" on behalf of the Indian National Congress. Mr. Malaviya had written a dozen books. This was one of the more obscure ones (endnote 3). In that document, he made four important claims to justify nationalization. First, he argued that insurance is a "cooperative enterprise," under a socialist form of government, therefore, it is more suited for government to be in insurance business on behalf of the "people". Second, he claimed that Indian companies are excessively expensive. Third, he argued that private competition has not improved services to the "public" or to the policyholders.

Preventative activities such as better public health, medical check-up, hazard prevention activities did not improve. Fourth, lapse ratios of life policies were very high leading to "national waste."

His argument for high cost of Indian insurers is the only one that he beefed up with data. Others were made in vague terms. Therefore, we take a closer look at his evidence. Based on some data, he presents what he called "overall expenses" of insurance business operation in India, USA and UK. His calculations are shown in Table 2. He showed that it costs Indian insurers 27%-28% of premium income for insuring lives whereas in the USA, the corresponding figure is 16%-17%. In the UK, it is even lower at 13%-14%. On the face of it, this argument seems watertight. Unfortunately, this is not the case. On closer inspection on how the numbers were arrived at, we find that for the calculation, the *denominator used for India is not the same* used for the USA or the UK. Specifically, for the Indian numbers, the denominator uses premium income only, whereas, for the other two countries, the denominator uses *total* income that includes premium income *and* investment income (as is customary world over).

Table 2

Overall Expenses of Life Insurance Business in India, USA and UK (all figures are in percentages)

Year	India	USA	UK
1950	28.9	16.8	13.0
1951	27.2	16.5	14.1
1952	27.1	16.7	14.2
1953	27.3	17.0	14.5

Source: Malaviya, Insurance in India, document undated.

The Finance Minister C. D. Deshmukh announced nationalization of the *life* insurance business. In his speech, he justified the action as follows.

"With the Second Plan, involving an accelerated rate of investment and development, the widening and deepening of all possible channels of public savings has become more than ever necessary. Of this process, the nationalization of insurance is a vital part." He then went on to declare, "The total [life] insurance in force exceeds Rs. 10,000 millions, that is a little over Rs. 25 per had. Quite recently it was claimed on behalf of a private enterprise that business in force could be increased to Rs. 80,000 millions and per capita insurance to Rs. 200. I am in complete agreement. There can be no doubt as to the possibilities of life insurance in India and I mention these figures only to show how greatly we could increase our savings through insurance." He added, "Thus even in insurance which is a type of business which ought never to fail if it is properly run, we find that during the last decade as many as twenty five life insurance companies went into liquidation and another twenty five had so frittered away their resources that their business had to be transferred to other companies at a loss to the policyholders."

Thus, the nationalization was justified based on three distinct arguments. First, the government wanted to use the resources for its own purpose. Clearly that meant that the government was not willing to pay market rate of return for the assets (otherwise, they could have raised the capital whether insurance companies were private or public). Second, it sought to increase market penetration by nationalization. How could nationalization possibly deepen the market that private insurance companies cannot? There are two possibilities. (1) Nationalization would create a monopoly. If there are economies of scale in the market, it would thus become possible for government to cut the cost of operation per policy sold below what private companies could. (2) Through nationalization government could take life insurance in rural areas where it was not profitable for private businesses to sell insurance. Third, the government found the number of failures of insurance companies to be unacceptable. The government claimed that the failures were the result of mismanagement.

Given that by the end of the century the government would *de-nationalize* life insurance, we would examine in some detail whether nationalization did succeed in these three areas. The government did succeed in channeling the resources of life insurance business into infrastructure.

The Life Insurance Corporation of India, as of March 2001, had a total sum assured of 155 billion US dollars. The value of Life Fund was 40 billion US dollars. The book value of Life Insurance Corporation's "socially oriented investments" (endnote 4) – mainly comprising of government securities holdings – at end-March 2001 amounted to 27 billion US dollars (73% of a total portfolio value of 37 billion US dollars). In total, 84% of Life Insurance Corporation's portfolio comprises of exposure to the public sector (see Bhattacharya and Patel, 2003, Appendix 2).

The Reserve Bank of India Weekly Statistical Supplement, October 11, 2003 shows that 52% of the outstanding stock of government securities is held by just two public sector institutions: the State Bank of India and the Life Insurance Corporation of India approximately in equal proportions.

Did the nationalization and consequent creation of monopoly actually reduce the cost of issuing life insurance policies? If we take a simple view of the world and calculate overall costs, we arrive at the results shown in Table 3. If we calculate overall expenses as a percentage of premium income, we arrive at the following. In 1957, the expenses were 27.7%. By 1963, the expenses rose to 29.3%. It fell back to 27.9% by 1982. By 1992, it had fallen to 21.5%. In 2002, it rose to 22.9%. Could we conclude that in the decade of late 1980s, the economies of scale kicked in? The answer is negative. The reason is explained in the Malhotra Committee Report (Malhotra, 1994, Chapter V, Section 5.5, p. 34). The expense ratio reported there was 29% in 1958 and 25% in 1992. The Report excludes group polices from its calculation. Group polices are much cheaper to sell (per policy). These policies did not exist in 1958. But, starting in the 1980s, they became commonplace. Thus, the naïve calculation along this line will lead us to believe that the expense ratio has come down substantially whereas in reality, that is an incorrect conclusion. A number of government reports have come to the same wrong conclusion (for example, the Annual Report of the Ministry of Finance 1995-96, p. 3).

Table 3: Financial Performance of Life Insurance Corporation of India 1957-1992 (all figures are in millions of US dollars)

INCOME	1957	1963	1972	1982	1992
Total premium income	139.02	253.42	516.16	1284.81	2836.36
Income from investment	30.28	59.04	180.93	727.22	1511.72
Total income	169.30	312.45	697.09	2012.03	4348.08
OUTGO					
Commission etc. to agents	12.08	23.65	48.74	108.33	274.36
Salaries & other benefits to employees	19.14	37.40	76.95	126.27	284.02
Other expenses of management	7.22	13.25	18.15	41.14	90.91
Taxes Etc.			0.26	56.75	150.11
5 % valuation surplus paid to Govt.		2.85			37.43
PAYMENTS TO POLICY HOLDERS					
Claims by maturity	32.64	52.49	101.99	369.94	796.73
Claims by death	12.40	21.13	34.57	91.14	180.47
Annuities	0.78	0.67	1.99	8.23	37.00
Surrenders	6.90	8.55	25.43	82.49	257.39
Total outgo	91.16	160.00	308.08	884.28	2108.42
Excess of income over outgo	78.14	152.45	389.01	1127.74	2239.67
Operating cost/Premium income	27.70%	29.30%	27.90%	21.50%	22.90%
Operating cost/Total income	22.70%	23.80%	20.60%	13.70%	14.90%

Source: Calculation based on Malhotra Committee Report, 1994, Appendix XXVI, p. 148.Note: All figures are converted into US dollars using the average exchange rate of that year.

The second question why general insurance was not being nationalized in 1956. The Finance Minister addressed it in his speech as follows. "I would also like to explain briefly why we have decided not to bring in general insurance into the public sector. The consideration which influenced us most is the basic fact that general insurance is part and parcel of the private sector of trade and industry and functions on a year to year basis. Errors and omission and commission in the conduct of its business do not directly affect the individual citizen. Life insurance business, by contrast, directly concerns the individual citizen whose savings, so vitally needed for economic development, may be affected by any acts of folly or misfeasance on the part of those in control or be retarded by their lack of imaginative policy."

Thus, he did not deem general insurance to be "vitally needed for economic development." The only way this view could be justified is if we view insurance as a vehicle for long terms investment and if we ignore the elimination of uncertainty through insurance as a relatively minor benefit. After all, general insurance reduces uncertainty for non-life category the same way life insurance reduces uncertainty for life.

Rural Insurance. In his Budget Speech, Mr. Deshmukh had specific hopes for rural insurance. He announced, "It will be possible to spread the message of insurance as far and as wide as possible, reaching out beyond the most advanced urban areas and into hitherto neglected, namely, rural areas."

After nationalization, Life Insurance Corporation has specifically taken up rural insurance as a target. To promote rural insurance, it followed a segmented approach to the market. First, it targeted the rural wealthy with regular individual policies. Second, it offered group policies to people who could not afford individual policies. For the very poor, it offered government subsidized policies.

In India, even in 2004, more than half of the population live in rural areas and contribute a quarter of the GDP. Thus, the policymakers felt that it was essential to bring life insurance business to the rural population.

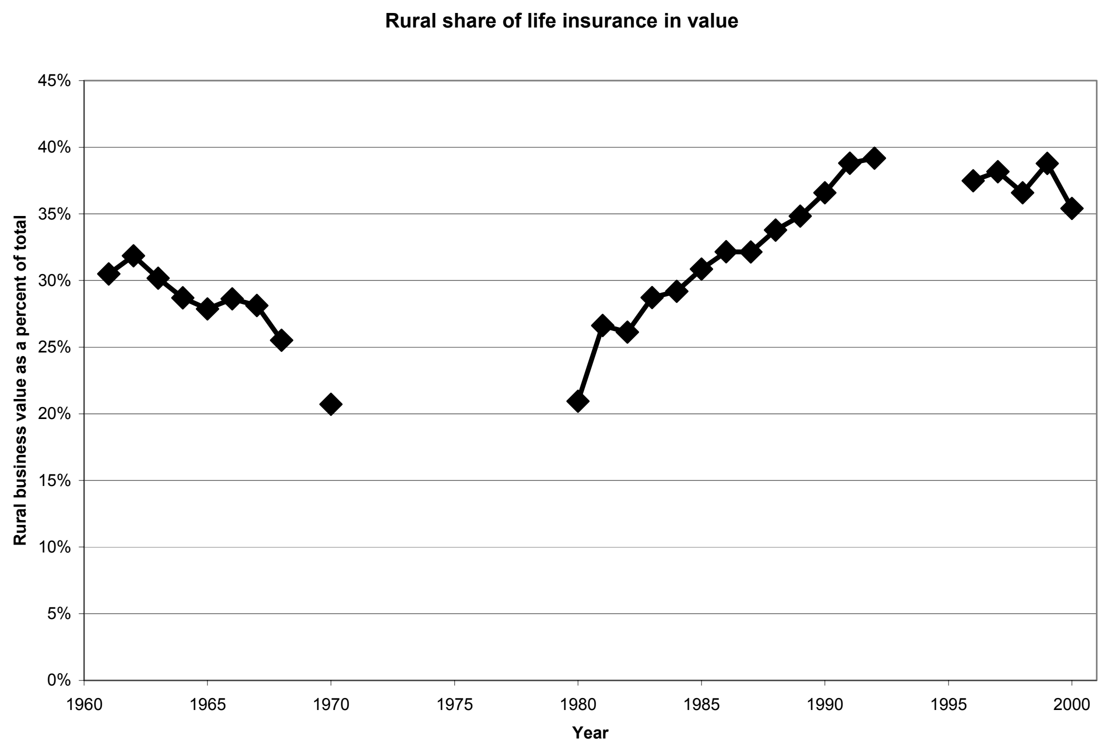
Did the policymakers succeed in bringing insurance in the rural sector? Exactly to whom in the rural sector did they manage to bring life insurance? We will examine these two questions in what follows.

The “success” of the rural expansion can be measured in a number of different dimensions. Here we are not talking about success necessarily in the sense of commercial success of higher profits. The Finance Minister was talking about social objective of bringing insurance cover for the “neglected” rural areas. After all, if profits were to be made by the private sector in rural insurance, they would not have neglected rural areas. Therefore, below we will measure success in terms of penetration of life insurance in rural areas.

(1) We first examine the penetration of life insurance in terms of headcounts. The earliest figure we have is for 1961. Around 36% of all the individual life policies sold were in the rural sector. This proportion fell to 29% by 1970. Then from 1980, the proportion had started to climb. It climbed steadily for a decade. Between 1995 and 1999 it climbed even faster with fully 57% of all policies sold were in the rural sector. This increase between 1980 and 1999 is remarkable for two reasons. First, the proportion of people living in rural areas has been falling steadily since 1950. Second, the fall in the proportion had not only halted since 1980 but it had been reversed. Thus, there is no question that the Life Insurance Corporation, through deliberate policy change managed to penetrate the rural market since 1980 in a way they could not earlier. Of course, the headcount gives us only the part of the story.

(2) Another way of examining the rural insurance business is in terms of the value of the insurance policies sold. This is depicted in Figure 1. In passing we note that during no period under study did the value of individual life insurance sold in the rural areas as a proportion of the total value of all individual life insurance policies sold in India breach 40%. During the late 1990s, even though the *headcount* of rural individual life policies sold kept climbing as a proportion of all individual life policies sold, the *value* of those policies did not. This implies that there were more policies sold with a smaller average value. This would imply that the profitability of each policy sold in the rural area in the late 1990s fell.

Figure 1: Rural share of life insurance business – value



Source: Life Insurance Corporation Annual Reports, various years.

(3) Finally we examine the value of the average individual life policy sold in the rural areas as a percent of the average of all the individual life policies sold nationwide. In 1961, this proportion was 84%. It fell almost steadily to 74% by 1970. Then it climbed back to 84% in 1990. It has hovered around that figure since then. If we examine the per capita income in the rural areas and contrast that with the per capita income in the urban areas, we find that for almost all states there is a 50% difference. Specifically, if the average rural income is 100, for most states, the urban average income is 150. Therefore, the individual life insurance policies in the rural areas are not being bought by the *average* rural households but by the *relatively wealthy* rural households.

Thus, the observations (2) and (3) above raise an uncomfortable question. Has the expansion of the Life Insurance Corporation in the rural areas served the rural rich at the high cost of reduced profitability of the company? Obviously this was not the intention when the Finance Minister spoke of serving the neglected rural areas in his speech at the eve of nationalizing life insurance in 1956.

Prelude to nationalization of general insurance: Birth of the Tariff Advisory Committee. The first collective measures to regulate rates and terms and conditions go back to 1896 with the formation of Bombay Association of Fire Insurance agents. By 1950, there was a set of regulation of rates, accepted by most insurers. The Insurance Act of 1938 was amended in 1950 to set up a Tariff Committee under the control of the General Insurance Council of the Insurance Association of India. Main lines of general insurance came under the Tariff Committee (they included Marine, Fire and Miscellaneous which included auto). Over the next eighteen years, Tariff Committee prevailed as the "rate maker". It was obligatory for all insurers.

In 1968, the Insurance Act of 1938 was amended further. A Tariff Advisory Committee replaced the Tariff Committee. The Tariff Advisory Committee became a statutory body. Section 64UC(2) of the Act stated: "In fixing, amending or modifying any rates, advantages, terms or conditions relating to any risk, the (Tariff) Advisory Committee shall try to ensure, as far as possible, that there is no unfair discrimination between risks of essentially the same hazard, and also that consideration is given to past and prospective loss experience: provided that the (Tariff) Advisory Committee may, at its discretion, make suitable allowances for the degree of credibility to be assigned to the past experience including allowances for random fluctuations and may also, at its discretion, make suitable allowance for future hazards of conflagration or catastrophe or both."

The introduction of the Tariff Advisory Committee was seen as an independent, impartial, scientifically driven body for ratemaking in general insurance. After the nationalization of general insurance in 1972 (see below), the Tariff Advisory Committee became the handmaiden of the nationalized companies. For example, the Chairman of the General Insurance Corporation, the holding company of four nationalized subsidiary, also became the Chairman of the Tariff Advisory Committee. All members of the Tariff Advisory Committee were nominated by the General Insurance Corporation. It came under heavy criticism from the Malhotra Committee. The Report stated that "the data supplied (by the nationalized companies) was often incomplete and outdated and, over the years, the system has almost broken down" (Malhotra, Chapter V, Section 5.25, p. 41).

The rates implemented by the Tariff Advisory Committee did not necessarily reflect the "market price." For example, after the amendments of the Motor Vehicles Act of 1939 (in 1982 and again in 1988), Third Party Liability became unlimited. It became clear that premium rates had to be revised upward to reflect this change in law. However, political pressure from transporters prevented this rise in premium (Malhotra, 1994, Chapter V, Section 5.26, p. 41).

Back in 1994, the Malhotra Committee recommended a delinking of the Tariff Advisory Committee from the General Insurance Corporation. It also recommended a gradual phasing out of the Tariff Advisory Committee with the exception of a few areas. However, it did not set a timetable. A recent report of a special committee set up by the Insurance Regulatory and Development Authority suggests an abolition of the Tariff Advisory Committee by April 1, 2006 (see, Report of the Expert Committee, Insurance Regulatory and Development Authority, December 2003).

In India, the Tariff Advisory Committee set a floor price, that is, a minimum price is set and all insurance companies have to charge at least that minimum price. They could charge more (with the approval of the Tariff Advisory Committee). It should be emphasized that tariffication or setting a floor price is not unique to India alone. Neither is the practice only followed by developing countries. The Malhotra Committee Report noted that two large countries like Japan and Germany had similar floor prices in place.

However, the rates were periodically reviewed and adjusted according to the market experience (Malhotra, 1994, Chapter V, Section 5.17, p. 39). In Japan, tariffs were abolished coinciding with the liberalization of insurance in 1998. In Malaysia, motor and fire insurance are still subject to tariff regulations. In Indonesia, tariff regime was introduced in 1983. It continued till 1996. In India, detariffication (the removal of tariffs) was introduced in 1994 in the marine *hull* business only – the segment of the market dominated by foreign companies. Due to political pressure, it refrained from removing tariffs in the entire cargo insurance segment (Srinivasan, 2003).

Any move away from the tariffed regime is not always popular. What usually follows is rising premiums in some lines. For example, in India, with detariffication, motor insurance prices will rise. This will probably be pinned as a folly of privatization. Of course, such premium adjustment has nothing to do with privatization per se. Government-owned insurers could take a loss in the motor insurance business (as they did during the 1990s) and cover the deficit from other lines of business. But, privately run insurance companies would seek to generate profit from every line of business. As a result, motor insurance premiums will rise to cover losses. Similarly, rating systems based on age and experience of the drivers would be slowly introduced. It will be a slow and long process as they require individual specific past information that can be gathered cost effectively only with computerization of vehicle accident information and other risks.

Reinsurance. A reinsurer in India was defined clearly for the first time in the Insurance Act of 1938 (endnote 5). Indian currency has not been convertible since independence. Thus, to retain the maximum possible premium within India and thereby "preserving" foreign currency became a priority for reinsurance business. India did not have a floating exchange rate until the 1990s. Therefore, hard currencies (like the US dollar) were considered valuable resources. Thus, the policy was to pay minimum possible premiums in hard currencies. To achieve this goal, the insurance companies in India formed the India Reinsurance Corporation in 1956. This was a *voluntary agreement* at the time. In 1961, the Government created the Indian Guarantee and General Insurance Company. By amendment to Section 101A of the Insurance Act, the Government *required* all companies to give *statutory cession* of 10% each to the India Reinsurance Corporation and to the Indian Guarantee and General Insurance Company. This requirement has been echoed in the Act passed in 2000 (endnote 5). The only reinsurance company allowed to operate in India is the General Insurance Corporation.

Nationalization of general insurance. General insurance was finally nationalized in 1972 (with effect from January 1, 1973). There were 107 general insurance companies operating at the time. They were mainly large city oriented companies catering to the organized sector (trade and industry). They were of different sizes, operating at different levels of sophistication. They were assigned to four different subsidiaries (roughly of equal size) of the General Insurance Corporation. The General Insurance Corporation was incorporated as a holding company in November 1972 and it commenced business on January 1, 1973. It had four subsidiaries were: (1) the National Insurance Company, (2) the New India Assurance Company, (3) the Oriental Insurance Company, and (4) the United India Insurance Company with head offices in Calcutta (now Kolkata), Bombay (now Mumbai), New Delhi, and Madras (now Chennai) respectively. Collectively these subsidiaries are known as the NOUN for their initials.

There were several goals of setting up this structure. First, the subsidiary companies were expected to "set up standards of conduct and sound practices in the general insurance business and rendering efficient customer service." (General Insurance Business (Nationalisation) Act, 1972). Second, the General Insurance Corporation was to help with "controlling their expenses". Third, it was to help with the investment of funds. Fourth, it was to bring in general insurance in the rural areas of the country. Fifth, the General Insurance Corporation was also designated the National Reinsurer. By law, all domestic insurers were to cede 20% of the gross direct premium in India to the General Insurance Corporation under the Section 101A of the Insurance Act of 1938. The idea was to retain as much risk as possible domestically. This was in turn motivated by the desire to minimize the expenditure on foreign exchange. Sixth, all the four subsidiaries were supposed to compete with one another.

With the hindsight of thirty years of experience, we can examine the degree of success of each goal above. It was noted by the Malhotra Committee that the "behavior of the general insurance employees were not customer friendly" (Malhotra, 1994, Chapter II, Section 2.22, p. 15). Thus, the goal of "efficient customer service" remained elusive. Cost cutting seemed to have worked between 1973 and 1980. The cost of operation (as a percent of premium income fell from around 30% in 1973 to around 24% in 1980 (Malhotra, 1994, Appendix IX, p. 131). Thereafter, there had not been a huge change in cost of operation. For investment funds, it was again noted that funds of the General Insurance Corporation had very low rates of return (more on that, see below) "…general insurance companies have been far too conservative in managing their equity portfolios" (Malhotra, 1994, Chapter VI, Section 6.9, p. 47). For rural expansion, the subsidiaries introduced a number of schemes such as crop insurance, cattle insurance and the like. They also tried to stimulate rural business by raising the commissions of the rural agents. Unfortunately, the companies did not make much headway in any direction for expanding rural business. With respect to reinsurance, the General Insurance Corporation did retain a large amount of reinsurance domestically in some areas of general insurance (such as motor insurance). Finally, the competition among the subsidiaries of the General Insurance Corporation remained elusive. Effectively they acted like a cartel – carving up the market into their own regional territories and acting like monopolies.

Investment Regimes: Before and After Nationalization. The Insurance Act of 1938 required that the life insurance companies should hold 55% of their assets in government securities or other approved securities (Section 27A of the Insurance Act). In the 1940s, many insurance companies were part of financial conglomerates. With a 45% balance to play with, some insurance companies used these funds for their other enterprises or even for speculation. A committee headed by Cowasji Jehangir was set up in 1948 to examine these practices. The committee recommended the following amendments to the Insurance Act. Life insurance companies should invest 25% of their assets in government securities. Another 25% should go into government securities or other approved securities. Another 35% should go into approved investment that might include stocks and bonds of publicly traded companies. But, they should be blue chip companies. Only 15% could be invested in other areas if the Board of Directors of the insurance company approved them.

In 1958, Section 27A of the Insurance Act was modified to stipulate the following investment regime:

(a) Central Government market securities of not less than 20%

(b) Loans to National Housing Bank including (a) above should be no less than 25%

(c) In State Government securities including (b) above should be no less than 50%

(d) In socially oriented sectors including public sector, cooperative sector, house building by policyholders, own-your-own-home schemes including (c) above should be no less than 75%.

How did the investment regime actually operate on the ground? The figures as presented by the Life Insurance Corporation are reproduced in Table 4. Broadly, the first item of "Loans to State and Central Government and their Corporations and Boards" has steadily fallen from 42% to around 18% in twenty years. In their place, in the category of "Central Government, State Government, and Local Government Securities," the proportion of the portfolio has gone up steadily from 57% in 1980 to 80% in 2000. In fact, the Life Insurance Corporation (along with the State Bank of India) has become one of the two largest owners of government bonds in India.

Table 4: Investment Portfolio of the Life Insurance Corporation 1980-2000

Year	Loans to Government	Government bonds	Special Central Government	Unapproved	Foreign	Total
1980-81	41.7%	55.0%	1.6%	1.1%	0.6%	100.0%
1981-82	41.1%	54.1%	3.2%	1.0%	0.5%	100.0%
1982-83	40.3%	54.2%	4.0%	1.0%	0.5%	100.0%
1983-84	39.1%	54.5%	4.9%	1.1%	0.5%	100.0%
1984-85	37.7%	55.1%	5.7%	1.1%	0.5%	100.0%
1985-86	36.5%	55.6%	6.3%	1.1%	0.5%	100.0%
1986-87	35.0%	56.8%	6.6%	1.0%	0.6%	100.0%
1987-88	34.1%	57.8%	6.7%	0.8%	0.6%	100.0%
1988-89	33.2%	58.5%	6.7%	1.0%	0.6%	100.0%
1989-90	33.1%	58.8%	6.4%	1.2%	0.5%	100.0%
1990-91	33.6%	59.2%	5.6%	1.1%	0.5%	100.0%
1991-92	4.9%	85.5%	6.9%	1.9%	0.8%	100.0%
1992-93	34.1%	60.1%	4.2%	1.1%	0.5%	100.0%
1993-94	31.4%	63.4%	3.6%	1.1%	0.5%	100.0%
1994-95	28.7%	66.4%	3.3%	1.1%	0.6%	100.0%
1995-96	26.5%	69.0%	2.9%	1.2%	0.5%	100.0%
1996-97	24.8%	71.2%	2.6%	0.9%	0.5%	100.0%
1997-98	23.1%	73.3%	2.4%	0.8%	0.4%	100.0%
1998-99	21.7%	75.4%	1.8%	0.8%	0.3%	100.0%
1999-00	19.8%	77.9%	1.4%	0.6%	0.3%	100.0%
2000-01	18.3%	79.8%	1.1%	0.5%	0.3%	100.0%

Source: Life Insurance Corporation Annual Reports, various years.

For General Insurance, Section 27B of the Insurance Act of 1938 was amended in 1976. The guideline for investment was set as follows.

(a) Central Government Securities 25%

(b) State Government and public sector bonds 10%

(c) Loans to State Governments, various housing schemes 35%.

The remaining 30% investment could be in market sector in the form of equity, long term loans, debentures and other forms of private sector investment.

We examine the actual level of investment by the General Insurance Corporation in Table 5. Investment in Central Government Securities hovered around 20% between 1980 and 2000. Investment in State Government Securities stayed much closer to the target of 10% throughout the period. Soft loans to housing rose from 8% in 1980 to a high of 29% in 1990, only to fall again to a low of 14% of the portfolio at the final stage. The Malhotra Committee (1994) recommended that the mandated investment of funds in Government Securities of the general insurance companies should be reduced to 40 per cent (Malhotra, 1994, VI, p. 50). In April 1995, the Government relaxed the investment policies of General Insurance Corporation and its subsidiaries. Therefore, in the last half of the 1990s, we see a jump in the other approved investment by the General Insurance Corporation to the 55%-60% range.

Table 5: Investment Portfolio of the General Insurance Corporation 1980-2000

	Central Government bonds	State bonds	Soft loans	Market investment	Other loans	Total
1980	21%	9%	8%	34%	27%	100%
1981	21%	10%	11%	30%	28%	100%
1982	25%	10%	15%	29%	20%	100%
1983	23%	10%	20%	30%	17%	100%
1984	24%	11%	22%	35%	8%	100%
1985	24%	10%	25%	34%	7%	100%
1986	23%	10%	28%	34%	6%	100%
1987	23%	10%	28%	34%	5%	100%
1988-89*	21%	11%	29%	33%	7%	100%
1989-90	19%	11%	29%	34%	8%	100%
1990-91	18%	11%	28%	31%	12%	100%
1991-92	17%	10%	26%	33%	14%	100%
1992-93	17%	10%	26%	36%	11%	100%
1993-94	17%	10%	27%	35%	11%	100%
1994-95	17%	10%	29%	35%	9%	100%
1995-96	17%	5%	23%	42%	13%	100%
1996-97	18%	6%	20%	42%	15%	100%
1997-98	18%	7%	18%	40%	17%	100%
1998-99	18%	8%	16%	42%	16%	100%
1999-00	19%	9%	14%	43%	14%	100%
2000-01	21%	11%	14%	44%	10%	100%

Notes: Data up to 1987 are as at end-December and for the remaining years data are as at end-March. * denotes figures for 15 months (January 1, 1988 – March 31, 1989).
Source: General Insurance Corporation, Annual Reports, various years.

Life Insurance Business during the Nationalized Era. Indian life insurance was nationalized in 1956. All life companies were merged together to form one single company: the Life Insurance Corporation. By 2000, Life Insurance Corporation had 100 divisional offices in seven zones with 2048 branches. There were over 680,000 active agents across India with a total of 117,000 employees in the Life Insurance Corporation employed directly.

There are two problems with this type of examination of the industry. First, the population of India has grown from 413 million in 1957 to over 1,000 million in 2000. Therefore, we would expect growth in life policies sold by the growth of the population alone. Second, if we measure growth in life insurance in nominal amount, for a country like India, where the annual inflation rate has averaged 7.8% a year between 1957 and 2002, we would expected a growth in the sale of life insurance by the sheer force of inflation. Therefore, in our discussion, we will not indulge in such descriptions.

The largest segment of the life insurance market in India has been individual life insurance. The types of the policies sold were mainly whole life, endowment and "money back" policies. Money back policies return a fraction of the nominal value of the premium paid by the policyholder at the termination of the contract. Until recently, term life policies were not available in the Indian market. The number of *new* policies sold each year went from about 0.95 million a year in 1957 to around 22.49 million in 2001. The *total* number of policies in force went from 5.42 million in 1957 to 125.79 million in 2001. Thus, on both counts there has been a 25-fold increase in the number of policies sold. Of course, during the same period, the population has grown from 413 million in 1957 to over 1,033 million in 2001. On a per capita basis, there were 0.0023 new policies per capita in 1957 compared with 0.0218 new policies in 2001. Total policies per capita went from 0.0131 in 1957 to 0.1218 in 2001. Thus, whether we examine the new policies sold or the total number of policies in force, there has been a tenfold increase during that period. Therefore, if we examine the headcount of policies as an indication of penetration, there has been a substantial rise. A part of this rise is directly attributable to a deliberate policy of rural expansion of the Life Insurance Corporation.

In Table 6, we lay out the details of different components of life insurance business during the nationalized era. Between 1985 and 2001, total life business has grown from below 18 billion rupees to over 500 billion rupees. During that period, the price index has grown fourfold. Thus, if there were no change in life insurance bought in real terms, it would have accounted for 78 billon rupees worth of business. Note that even in 2001, individual life business accounts for 92% of all life insurance market.

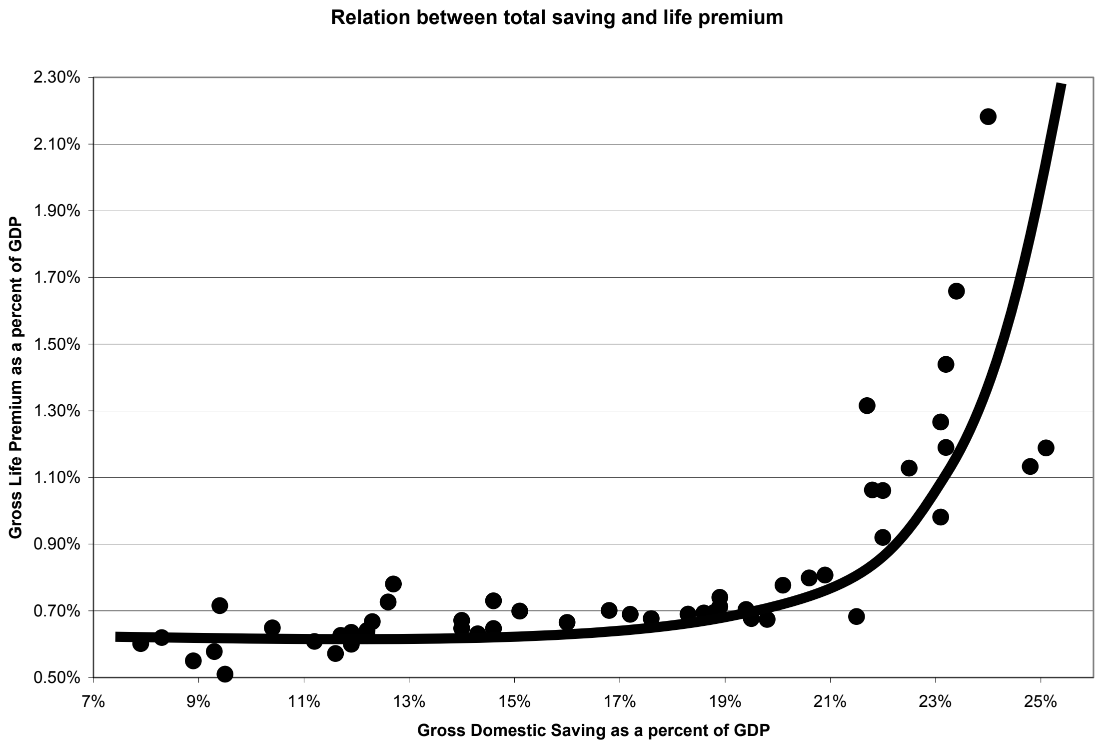
Table 6: Life Insurance in India, 1985-2004, in millions of US dollars

Year	Total	Individual	Individual pension	Group	Group superannuation
1985	1439.00	1305.60	0.61	133.40	36.64
1986	1655.73	1497.10	1.25	158.63	39.17
1987	2056.14	1815.95	10.01	240.19	49.58
1988	2459.19	2212.68	99.02	246.52	64.73
1989	2759.06	2483.13	131.33	275.92	62.91
1990	3189.71	2878.51	147.06	311.19	63.70
1991	3049.37	2749.45	131.26	299.92	65.79
1992	2822.35	2564.42	26.69	257.93	65.62
1993	3096.56	2817.43	18.40	279.12	75.13
1994	3654.18	3324.75	16.40	329.43	92.69
1995	4354.21	3743.76	13.46	610.45	341.76
1996	4583.93	4124.49	41.28	459.43	173.72
1997	5299.35	4731.80	39.57	567.54	253.84
1998	5535.60	4946.75	54.57	588.85	240.12
1999	6436.30	5811.79	121.93	631.62	255.69
2000	7810.76	6529.91	64.32	701.47	286.18
2001	10649.33	9771.61	611.52	877.71	430.00
2002	12216.81	10268.03	593.23	913.71	441.84
2003	14938.63	12534.63	789.79	1079.23	534.98
2004	17496.40	14662.19	981.96	1230.37	621.88

Notes: (1) These are figures for direct premiums in force for domestic risks. (2) Figures for all years are actual figures except for 2004. (3) 2004 figures are estimates based on the actual results of the first nine months of the year. (4) All figures were converted into US dollars by using the average market exchange rate of the year.
Source: Swiss Reinsurance Company database

In recent years, life insurance saving has played a bigger role in national saving. In Figure 2, we have plotted total national saving against life insurance premium (both as percentages of the contemporaneous GDP) for fifty two years. It clearly shows a nonlinear relationship between these two variables. Specifically, at relatively lower levels of saving rate (that correspond to lower level of income), a rise in saving rate does not lead to a rise in life insurance premium expressed as a fraction of GDP. Beyond a threshold, in the case of India, the threshold value of saving rate seems to be around 20%, the life premium as a percent of GDP starts to grow rapidly. India has reached that turning point.

Figure 2: Relationship between national saving and life insurance premium, 1950-2001



Source: Calculated based on data from the Central Statistical Organization database.

Note: The figure is plotted with Gross Domestic Saving as a percent of GDP in the horizontal axis and Gross Life Premium as a percent of GDP on the vertical axis. Thus, there are fifty-two data points each pair representing data for a given year.

A similar story emerges when we examine the saving through insurance companies as a component of financial saving. This is revealed in Table 7. Over a period of ten years between 1991 and 2000, the amount of financial saving as a percent of GDP has varied from around 11% to 14.4%. Two components of this financial saving, life insurance saving and pension saving have increased steadily over the years.

Table 7: Components of Financial Saving as a Percent of GDP

Year	1991	1992	1995	1999	2000
Financial Saving	11.0%	11.0%	14.4%	12.5%	12.1%
Currency	1.2%	1.3%	1.6%	1.2%	1.1%
Bank deposits	3.7%	3.2%	6.5%	5.2%	4.5%
Stocks	1.6%	2.6%	1.7%	0.4%	0.8%
Claims on government	1.5%	0.8%	1.3%	1.6%	1.5%
Insurance funds	1.0%	1.1%	1.1%	1.3%	1.5%
Pension funds	2.1%	2.0%	2.1%	2.6%	2.8%

Note: Each financial year ends March 31

Source: Central Statistical Organization database.

General Insurance Business during the Nationalized Era. After the nationalization of general insurance in 1972, the government set up one holding company the General Insurance Corporation of India. Under the holding company, there were four subsidiaries. Information about general insurance premium earned is shown in Table 8. Between 1985 and 2001, the business of general insurance grew tenfold to 122 billion rupees. Thus, general insurance business in India is approximately one fourth the size of life insurance business. In 1988, fire insurance (in terms of premium earned) accounted for about a quarter of all business. The percentage has remained the same over the next fourteen years. Marine insurance has shrunk in relative importance. It went from nearly 20% of general insurance to under 10% by 2001. The biggest component called "miscellaneous" has grown be occupy 68% of general insurance market. This classification is unfortunate. This method of categorizing lines of business can be traced back to the Insurance Act of 1938 (see Appendix 1). It stipulated whatever cannot be classed as life insurance or fire insurance or marine insurance is put into this category called "miscellaneous." Thus, the biggest component of general insurance – motor insurance – is lumped with a range of other general insurance such as aviation, engineering and crop insurance. In terms of premium, motor insurance accounts for around 54% of premium income. The Tariff Advisory Committee has been unwilling to revise motor premium upward (due to political pressure) to be consistent with higher losses experienced. As a result, the losses have mounted in motor insurance. A crude measure (of profitability) of claims as a percent of premium earned hovered between 120% and 140% during 1996 and 2001 for motor insurance business. Therefore, this line of business was not profitable for these state-run enterprises. As a result, overall profitability of four subsidiaries of the General Insurance Corporation has masked the losses incurred in motor insurance.

Table 8: General Insurance in India, 1985-2004, in millions of US dollars

Year	Total	Fire	Marine	Misc.	Net claims incurred	Profit/Loss before tax	Assets/Liabilities, book value
1979	508.58						
1980	637.52						
1981	718.89						
1982	802.74						
1983	886.14						
1984	911.01						
1985	976.48						
1986	1129.37						
1987	1276.66						
1988	1689.86	418.63	323.09	890.86	1205.47	243.53	3394.75
1989	1405.55	363.23	258.24	732.63	927.02	229.12	3442.44
1990	1665.52	390.68	291.25	930.65	1085.25	275.30	3819.73
1991	1542.67	369.44	279.08	818.27	1014.09	294.45	3637.74
1992	1445.42	350.85	273.86	741.76	1008.24	276.78	3548.54
1993	1523.30	371.97	266.03	805.69	974.82	345.67	3657.56
1994	1679.26	421.38	263.43	918.89	1366.52	160.08	4425.58
1995	1967.12	486.61	296.51	1105.98	1365.52	256.45	5089.42
1996	2069.25	506.70	278.91	1214.22	1437.51	307.49	5282.34
1997	2223.15	549.13	290.02	1384.05	1546.49	446.41	5931.26
1998	2214.10	527.76	247.78	1438.56	1561.97	354.69	5937.43
1999	2314.44	558.75	237.49	1518.20	1758.78	267.24	6473.50
2000	2410.90	492.19	227.22	1691.50	1985.70	163.21	6894.47
2001	2609.08	618.66	225.60	1764.80	1686.05	95.54	7182.36
2002	2879.83	682.87	249.01	1947.94	1861.02	105.45	7927.70
2003	3484.58	826.26	301.30	2356.99	2251.83	127.59	9592.47
2004	4118.68	976.62	356.12	2785.90	2661.60	150.81	11338.04

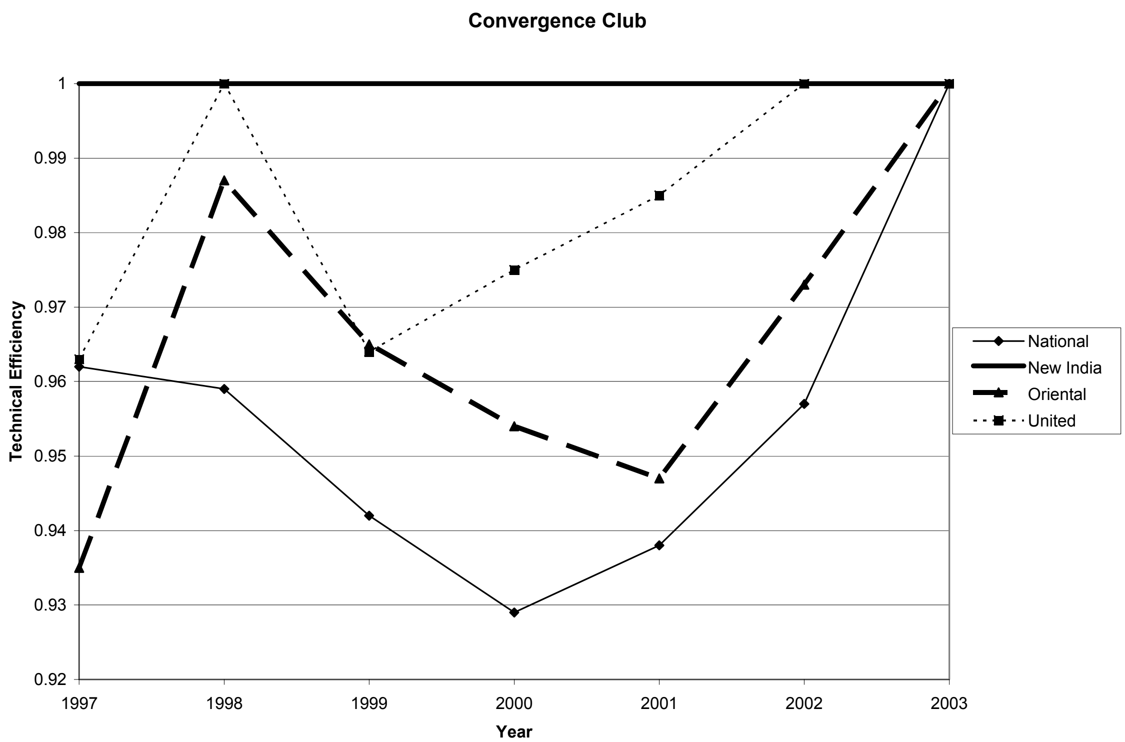
Notes: (1) Figures for all years are actual figures except for 2004. (2) 2004 figures are estimates based on the actual results of the first nine months of the year. (3) All figures were converted into US dollars by using the average market exchange rate of the year.
Source: Swiss Reinsurance Company database

How Public Insurers Reacted During the Final Countdown. During the final years of the General Insurance Corporation as a holding company, there were a number of suggestions as to what to do with the structure of the industry. The Malhotra Committee Report strongly recommended that the General Insurance Corporation should cease to be the holding company and concentrate on reinsurance business only. The four subsidiaries should become independent companies. The report also noted that the subsidiaries were overstaffed (Malhotra, 1994, Chapter XII, p. 88-89).

It was not the final word. A study conducted by the consulting company PriceWaterhouseCoopers commissioned by the General Insurance Corporation in 2000 recommended just the opposite. It argued that in the face of impending competition from the private companies, the subsidiaries should be merged to form one single company to better fight the competition. While these discussions were going on, the four subsidiaries undertook restructuring. The results of this restructuring can be seen if we monitor the efficiency level of the companies over 1997-2003.

To assess the change in efficiency of these four companies, we calculated the technical efficiency of each company. The relative efficiency measure of Farrell (1957) has been formulated in a mathematical programming framework – usually called data envelopment analysis (DEA). We took the number of employees (labor), the number of offices (physical capital) and the commission paid as three inputs. We took two alternative measures of outputs: premiums and claims (see, Cummins et al., 1997, for a discussion on this issue). The results are similar for both outputs. It shows that after some initial change, the relative efficiency level converged among the public sector general insurance companies by 2003 (see Figure 3). New India Insurance has consistently stayed as the company with the highest technical efficiency (equal to 1 *for every single year*). It is well known in the literature that DEA is biased upward in small samples. Thus, the absolute level of efficiency should not be taken at face value. The point here is that there has been a convergence among the public sector companies in terms of efficiency.

Figure 3: Convergence of efficiency among the four public sector general insurers (1997-2003)



Source: Calculated by the author.

The management of these companies negotiated a "voluntary retirement scheme" to reduce the level of staffing. In February 2004, this was implemented. Of the total 80,000 employees in the four companies, the voluntary retirement scheme option was restricted exclusively to 68,000 employees. Around 12,000 Development Officers were kept out of the voluntary retirement scheme scheme. Of the total staff, 8,500 opted for the voluntary retirement scheme from the four companies. Of the total 13,500 officers in the four companies, 34 per cent opted for the voluntary retirement scheme as against only 11 per cent of the 36,000 clerical staff. This outcome came as a surprise to the management. They were hoping to eliminate more clerical jobs through the voluntary retirement scheme. The powerful union of clerical workers has strongly opposed a similar plan for the Life Insurance Corporation (Swain, 2004).

Introduction of the New Legal Structure

After the report of the Malhotra Committee came out, changes in the insurance industry appeared imminent. Unfortunately, instability of the Central Government in power slowed down the process. The dramatic climax came in 1999. On March 16, 1999, the Indian Cabinet approved an Insurance Regulatory Authority (IRA) Bill designed to liberalize the insurance sector. The government fell in April 1999 just on the eve of the passage of the Bill. The deregulation was put on hold once again.

An election was held in late 1999. A new government came to power. On December 7, 1999, the new government passed the Insurance Regulatory and Development Authority Act. This Act repealed the monopoly conferred to the Life Insurance Corporation in 1956 and to the General Insurance Corporation in 1972. The authority created by the Act is now called the Insurance Regulatory and Development Authority.

New licenses are being given to private companies. The Insurance Regulatory and Development Authority has separated out life, non-life and reinsurance insurance businesses. Therefore, a company has to have separate licenses for each line of business. Each license has its own capital requirements (around USD24 million for life or non-life and USD48 million for reinsurance).

Features of the Insurance Regulatory and Development Act. The Insurance Regulatory and Development Act of 1999 was set out as follows. "To provide for the establishment of an Authority to protect the interests of holders of insurance policies, to regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto and further to amdend the Insurance Act, 1938, the Life Insurance Corporation Act, 1956 and the General Insurance Business (Nationalisation) Act, 1972."

The Act effectively reinstituted the Insurance Act of 1938 with (marginal) modifications. Whatever was not explicitly mentioned in the 1999 Act referred back to the 1938 Act.

(1) It specified the creation and functioning of an Insurance Advisory Committee that sets out rules and regulation.

(2) It stipulates the role of the "Appointed Actuary". He/she has to be a Fellow of the Actuarial Society of India. For life insurers the Appointed Actuary has to be an internal company employee, but he or she may be an external consultant if the company happens to be a non-life insurance company. The Appointed Actuary would be responsible for reporting to the Insurance Regulatory and Development Authority a detailed account of the company.

(3) Under the "Actuarial Report and Abstract", pricing of products have to be given in detail. It also requires details of the basic assumptions for valuation. There are prescribed forms that have to be filled out by the Appointed Actuary including specific formulas for calculating solvency ratios.

(4) It stipulates the requirements for an agent. For example, insurance agents should have at least a high school diploma along with training of 100 hours from a recognized institution.

(5) Under "Assets, Liabilities, and Solvency Margin of Insurers", the Insurance Regulatory and Development Authority has set up strict guidelines on asset and liability management of the insurance companies along with solvency margin requirements. Initial margins are set high (compared with developed countries). The margins vary with the lines of business.

Life insurers have to observe the solvency ratio, defined as the ratio of the amount of available solvency margin to the amount of required solvency margin: (a) the required solvency margin is based on mathematical reserves and sum at risk, and the assets of the policyholders' fund; (b) the available solvency margin is the excess of the value of assets over the value of life insurance liabilities and other liabilities of policyholders' and shareholders' funds.

For general insurers, this is the higher of RSM-1 or RSM-2, where RSM-1 is based on 20% of the higher of (i) gross premiums multiplied by a factor A, or (ii) net premiums; RSM-2 is based on 30% of the higher of (i) gross net incurred claims multiplied by a factor B, or (ii) net incurred claims (The factors A and B are listed in Appendix 2).

(6) It sets the reinsurance requirement for (general) insurance business. For all general insurance, a *compulsory cession* of 20% regardless of line of business to the General Insurance Corporation, the designated national reinsurer was stipulated.

(7) Under the "Registration of Indian Insurance Companies", it sets out details of registration of an insurance company along with renewal requirements. For renewal, it stipulates a fee of one-fifth of one percent of total gross premium written direct by an insurer in India during the financial year preceding the year. It seeks to give detailed background for each of the following key personnel: Chief Executive, Chief Marketing Officer, Appointed Actuary, Chief Investment Officer, Chief of Internal Audit and Chief Finance Officer. Details of sales force, activities in rural business and projected values of each line of business are also required.

(8) Under "Insurance Advertisements and Disclosure", details of insurance advertisement in physical and electronic media has to be detailed with the Insurance Regulatory and Development Authority. The advertisements have to comply with the regulation prescribed in section 41 of the Insurance Act, 1938. The Act of 1938 says, "No person shall allow or offer to allow, either directly or indirectly, as an inducement to any person to take out or renew or continue an insurance in respect of any kind of risk relating to lives or property in India, any rebate of the whole or part of the commission payable or any rebate of the premium shown on the policy, nor shall any person taking out or renewing or continuing a policy accept any rebate, except such rebate as may be allowed in accordance with the published prospectus or tables of the insurer."

(9) All insurers are required to provide some coverage for the rural sector. It is called the "Obligations of Insurers to Rural Social Sectors" (endnote 6).

Current State of Play and Future Prospects

Starting in early 2000, the Insurance Regulatory and Development Authority started granting charters to private life and general insurance companies. We have listed in Appendix 3 the list of all companies with charters as of December 31, 2003.

By the end of 2003, there were thirteen life insurance companies had charters to operate, one public (the old monopoly) and twelve private companies. *All* of the private companies had foreign partners in life business. Almost all general insurance companies also have foreign partners. One such charter was very special. The State Bank of India (SBI) announced a joint venture partnership with Cardif SA of France (the insurance arm of BNP Paribas Bank). Since the SBI is a bank, the Reserve Bank of India (RBI) needed to clear the participation of the SBI because banks are allowed to enter other businesses on a "case by case" basis. Thus, the SBI became the test case.

The latest group to receive an outright charter for operating a life insurance company is the Sahara Group (on March 5, 2004). Sahara's entry is notable for two reasons. First, Sahara would be the only company to enter the Indian *life* insurance market without any foreign partner. It thus becomes the only purely domestic company to be granted a license to operate in the insurance sector. Second, it operates the largest Non-Bank Financial Company in India. It would become the first Non-Bank Financial Company to operate in the life insurance sector.

There are thirteen general insurance companies operating in India by the end of 2003. Four are the public sector companies – the erstwhile subsidiaries of the General Insurance Corporation that operated as nationalized companies. The rest are private sector companies.

In India, life business in 2002 amounted to 12.2 billion US dollars and that of non-life amounted to 3.3 billion US dollars. Thus, life business is almost four times as large as the non-life business. The rate of annual growth in the year 2001-2002 was 43% in life insurance and 13.6% in non-life. The total premium underwritten by the Life Insurance Corporation of India was around 11 billion US dollars in the fiscal year 2001-2002. Income of Life Insurance Corporation during the same period was 16 billion US dollars. There were twelve companies in the private sector with foreign company participation up to the permissible limit of 26% of equity share capital. Over a period of ten years (1991-2001), the Life Insurance Corporation has averaged a real growth rate of 12%.

During the same period, 2001-2002, the gross direct premium income of the four public sector companies, the subsidiaries of the General Insurance Corporation of India, was 2.9 billion US dollars. The real growth rate over a period of ten years (1991-2001) has been 5% annual. The general insurance business includes motor vehicle insurance, marine insurance, fire insurance, personal accident insurance, health insurance, aviation insurance, rural insurance and others. At present, the General Insurance Corporation is the only reinsurer. Foreign capital of around 140 million US dollars has been so far invested in the new life insurance companies in India.

Distribution channels. The Life Insurance Corporation has traditionally sold life business using tied agents (in-house sales forces are not a traditional feature of the Indian life market). All life insurers have tied agents working on a commission basis only, and the majority of private-sector insurers have followed this approach in distributing life products. Nevertheless, as banks are now able to sell insurance products, bancassurance has made a major impact in life sales. Almost all private sector insurers have formed alliances with banks, with a few of the insurers using bancassurance as their *major* source of new business. For example, in 2003, SBI Life and Aviva Life sold more than half of their policies through banks. Private insurers are selling more than 30% of their policies through the banking channel (in 2004). In India, banks are being used only as a channel of *distribution* because current law prohibits bank employees from accepting commission for selling insurance policies.

Reinsurance. In reinsurance business, Insurance Regulatory and Development Authority (General Insurance - Reinsurance) Regulations, 2000, stipulated the following:

"The Reinsurance Program shall continue to be guided by the following objectives to: (a) maximize retention within the country; (b) develop adequate capacity; (c) secure the best possible protection for the reinsurance costs incurred; (d) simplify the administration of business."

For life reinsurance, the Government has allowed private reinsurance companies to operate in exactly the same way it has allowed private life insurance companies. A foreign reinsurer is allowed to have up to 26% share in a life reinsurance company. However, until the end of 2003, there has been no taker of this offer. No private reinsurance company has stepped forward. The reason is easy to see. For most reinsurers, the main business is (still) general reinsurance. To get an idea, if we look at the OECD countries, we observe that around 95% of life insurance risk is retained domestically. For general insurance, however, the average risk retained is around 85% (OECD, 2003).

Market Share. In life insurance, we get an indication of where the market is heading by examining the new business written during eleven months of the fiscal year of 2003 (April 2003-February 2004). The distribution of premium is given in Table 9. The Life Insurance Corporation has slightly over 87% of the market share, leaving the rest for the twelve private companies. Among the private companies, ICICI-Prudential has the biggest market share at 4.43%, followed by Birla Sun Life at 1.90%. Tata AIG and HDFC Standard Chartered are the only two other companies with more than 1% market share.

Table 9: Market share for premiums: life market (March 2003-February 2004)

Company	Market share (%)
Public Sector	*87.22*
Life Insurance Corporation of India	87.22
Private Sector	*12.78*
Allianz Bajaj Life Insurance Company Limited	0.87
ING Vyasa Life Insurance Company Limited	0.35
AMP Sanmar Assurance Company Limited	0.16
SBI Life Insurance Company Limited	0.89
TATA AIG Life Insurance Company Limited	1.10
HDFC Standard Life Insurance Co. Limited	1.15
ICICI Prudential Life Insurance Co. Limited	4.43
Aviva	0.46
Birla Sun-Life Insurance Company Limited	1.90
OM Kotak Mahindra Life Insurance Co. Ltd.	0.53
Max New York Life Insurance Co. Limited	0.81
MetLife Insurance Company Limited	0.14

Source: IRDA Journal, April 2004, p. 38-39.

The market share for each company for general insurance companies is given in Table 10. Public sector companies have close to 86% of the premium and the rest is with the private sector companies. Once again, ICICI-Lombard has the biggest market share among the private companies. Bajaj-Allianz comes next with 2.95% of the market share. Tata-AIG has a market share of 2.25% and IFFCO-Tokio has 1.97%. The rest of the market is shared by others.

Table 10: Gross Premium Underwritten by General Insurance Companies (April 2003-February 2004)

Company	Market share (%)
Public Sector	*85.79*
National Insurance Company Limited	21.39
New India Assurance Company Limited	24.22
Oriental Insurance Company Limited	18.13
United India Insurance Company Limited	19.38
Private Sector	*14.21*
Bajaj Allianz General Insurance Co. Limited	2.95
ICICI Lombard General Insurance Co. Ltd.	3.16
IFFCO-Tokio General Insurance Co. Ltd.	1.97
Reliance General Insurance Co. Limited	1.07
Royal Sundaram Alliance Insurance Co. Ltd.	1.58
TATA AIG General Insurance Co. Limited	2.25
Cholamandalam General Insurance Co. Ltd.	0.57
Export Credit Guarantee Corporation	2.66
HDFC Chubb General Insurance Co. Ltd.	0.66

Source: IRDA Journal, April 2004, p. 40.

Investment Regimes. Investment regimes in insurance in India have always had quantitative restrictions. Current legal requirements are explained in Table 11 for life business and in Table 12 for general insurance business. At least half of the investment has to be either directly in government securities (bonds) or for infrastructure investments (which also take the form of government bonds). These investment options are "safe" as they are fully backed by the government. Of course, it also means they earn the lowest rate of return in the Indian market. The government (both at the federal and state levels) has used insurance business as a way of raising capital. Unfortunately, much of it has been spent on consumption expenditure leading to substantial increase in government debt.

Table 11: Investment Regulation of Life Business

	Type of Investment	Percentage
I	Government Securities	25%,
II	Government Securities or other approved securities (including (I) above)	Not less than 50%,
III	Approved Investments as specified in **Schedule I**	
	Infrastructure and Social Sector Explanation: For the purpose of this requirement, Infrastructure and Social Sector shall have the meaning as given in regulation 2(h) of Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations, 2000 and as defined in the Insurance Regulatory and Development Authority (Obligations of Insurers to Rural and Social Sector) Regulations, 2000 respectively	Not less than 15%
	Others to be governed by Exposure/ Prudential Norms specified in Regulation 5	Not exceeding 20%
IV	Other than in Approved Investments to be governed by Exposure/ Prudential Norms specified in Regulation 5	Not exceeding 15%

Source: Gazette of India Extraordinary Part III Section 4. Insurance Regulatory and Development Authority (Investment) Regulations, 2000

Table 12: Investment Regulation of General Insurance Business

	Type of Investment	Percentage
I	Central Government Securities **being not less than**	20%
II	State Government securities and other Guaranteed securities including (i) above **being not less than**	30%
III	Housing and Loans to State Government for Housing and Fire Fighting equipment, **being not less than**	5%
IV	Investments in Approved Investments as specified in **Schedule II**	
a)	*Infrastructure and Social Sector* Explanation: For the purpose of this requirement, Infrastructure and Social Sector shall have the meaning as given in regulation 2(h) of Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations, 2000 and as defined in the Insurance Regulatory and Development Authority (Obligations of Insurers to Rural and Social Sector) Regulations, 2000 respectively	Not less than 10%
b)	Others to be governed by Exposure/ Prudential Norms specified in Regulation 5	Not exceeding 30%
V	Other than in Approved Investments to be governed by Exposure/ Prudential Norms specified in Regulation 5	Not exceeding 25%

Source: Gazette of India Extraordinary Part III Section 4. Insurance Regulatory and Development Authority (Investment) Regulations, 2000

Are there any differences in the investment regime of the public and the private sector? Recent figures for investment regimes across different companies both in the life insurance sector and the general insurance sector show the following (Rao, 2003).

The Life Insurance Corporation has 64% invested in Government securities and other approved securities. For the private sector as a whole, the corresponding figure is 60%. It ranges from 54% (ICICI Prudential) to 70% (AMP Sanmar). Infrastructure investment for the Life Insurance Corporation was 14% and 16% for the private companies as a group. It ranges from a high of 20% for AMP Sanmar and Allianz Bajaj to a low of 0% for Aviva. Since Aviva started its operation relatively recently, the figure is somewhat unusual. In the "other approved" investment category, the Life Insurance Corporation has invested 22%. The average for the private sector in this category is 19%. In the unapproved category, the Life Insurance Corporation has no investment at all whereas in the private sector 5% of the total is in this category. OM Kotak leads this category with 13%. Most of the other companies have no investment in this area.

In the general insurance sector, public sector companies invested 35% in government securities whereas the private sector has 41% in that category. For the public sector companies, it ranges from a low of 29% by the Oriental Insurance Company to a high of 42% by the National Insurance Company. For the private sector it varies from a low of 35% by Tata AIG and 50% by IFFCO Tokio. The other big category is a catchall "other investments." In that category, the public sector has 49% whereas the private sector only has 39%.

Insurance in the Rural Sector in 2003. There are two types of obligations of all insurance companies. Rural sector and Social sector obligations (see endnote 6). The requirements are different for life and general business. The requirements also differ depending on the number of years in business. Data for the private life insurance companies show that on the average, 13% of private life insurance policies have been sold in the rural sector. Among the life insurers, there is a great variation. The new entrant – Aviva – virtually did not sell any whereas ING Vyasa sold almost 35% of their policies in the rural areas during the fiscal year 2002-2003. Surprisingly, very few of the agents of ING Vyasa are rural. Similarly MetLife sold 26% of their policies in the rural areas. Very few of their agents are rural (Insurance Regulatory and Development Authority Annual Report, 2002-2003, Appendix III). These companies sold a few large group policies to agribusiness. Through these, they qualified for being "rural" as the locations of these large businesses are in rural areas. For private general insurance companies, 3.9% of all policies sold were rural. The highest proportions are for Bajaj-Allianz and IFFCO-Tokio with 5.87% and 5.42% respectively. These figures are surprising as these companies have very few rural agents. The average for public insurance companies is 6.4% (figures are for April 2002-March 2003).

Price Dispersion of Life Insurance Products. Life insurance products like Whole Life or Endowment or Money Back policies have two components: saving and security. Specifically, there is an element that pays even when a policyholder survives the duration the policy is in force. Therefore, the "price" or the premium obscures the protection element offered by such policies. Hence, it is somewhat difficult to compare such products. Many insurance products have additional benefits (called riders). For example, buying bags of fertilizer in villages might include one-year term life benefits. Thus, if a product also riders, it becomes even more difficult to value them because of the embedded options.

The simplest product to compare across sellers is term life. It only has one element. It pays the beneficiary in case the buyer dies within a specific time period. When the Life Insurance Corporation was a monopoly, there was nothing else to compare its term life policy with. Now, the buyer has an array of options. How do they compare? This question has been investigated by Rajagopalan (2004). The results are reported in Table 13. It compares policies of 5, 10, 15, 20 and 25 years for a 30 year old ordinary male for the Life Insurance Corporation, HDFC, ICICI Prudential, Tata-AIG, Allianz Bajaj, Birla Sunlife and Max New York with a sum assured of 100,000. The first striking observation is that ratio of the maximum and the minimum premium is 2.16 for five year term and 2.60 for the thirty year term. Therefore, the dispersion in price is strikingly high for very similar products. The degree of price dispersion might be expected to decline as the market matures. The second striking feature is that it is not the same company that quotes a consistently low price but the same company (Tata-AIG) quotes the consistently highest price. There is some problem with comparability here as Tata-AIG quotes are for a 35 year old rather than a 30 year old. The results are quite similar for a sum assured of 500,000.

Table 13: Comparison of Premiums as on Oct 31, 2002 for Pure Term Insurance for Ordinary Males

Comparison of Premiums as on Oct 31, 2002 for Pure Term Insurance for Ordinary Males

Insurer	**LIC**	**HDFC**	**ICICI Pru**	**Tata-AIG**	**Allianz Bajaj**	**Birla Sunlife**	**Max New York**		
Age	**30**	**30**	**30**	**35**	**30**	**30**	**30**		
Sum Assured (Rs)	**500000**	**500000**	**1000000**	**500000**	**500000**	**500000**	**500000**		
								Yearly Premium (Rs)	
Term (yrs)									
5	NA		2455	2575	1655	1875	1190		
10	1140		2504	2585	1805	1875	1225		
15	1285	1510	2553	3010	2050	1875	1265		
20	1528	1535	2680	3450	2440	1905	1375		
25	NA			4160		1980	1600		
30	NA	1790							
Sum Assured	**100000**	**100000**	**100000**	**100000**	**100000**	**100000**	**100000**	**Best Deal**	**Max/ Min (Ratio)**
				Yearly Premium (Rs / 100000 sum assured)					
Term (yrs)									
5			245.5	515	331	375	**238**	238	2.16
10	**228**		250.4	517	361	375	245	228	2.27
15	257	302	255.3	602	410	375	**253**	253	2.38
20	305.6	307	**268**	690	488	381	275	268	2.57
25				832		396	**320**	320	2.60
30		**358**						358	

Notes:
1.TATA-AIG quotes are for 35 yr male. Their quotes for a 30 yr old will be lower.
2. SBI Life and ING Vysya do not offer a pure level term plan
3. Could not get data from the websites of Om Kotak Mahindra and ANP Sanmar
4. The premia per Rs 100000 assured is likely to be higher for ICICI Prudential as they are based on the quotes for a sum assured of Rs. 1000000.

Source: R. Rajagopalan, Valuing the Term Insurance Products in the Indian Market, Paper presented at the Fifth Global Conference of the Actuaries, January 25, 2004, New Delhi.
Note: Rs stands for Rupees. For the year 2002 (the year for which the data was taken), the average value of one US dollar was approximately 49 Rupees.

Future Prospects: Market Size. At the end of 2002, the size of the Indian market (in terms of premium volume) was slightly bigger than that of Sweden and 20% smaller than that of Ireland (Sigma, 2003). So, why would foreign insurance companies be interested in the India market? The answer, of course, is that the growth *potential* of the Indian market is much higher over the coming decades.

Although many commentators have written about India's growth potential, actual estimates of where the Indian GDP will be over the next decades have come only very recently. One is by Wilson and Purushothaman (2003) and the other is by Rodrik and Subramanian (2004). There are two critical ingredients in our approach. First, we need to understand the factors contributing to economic growth in India. Second, we need to understand how the economic growth will influence saving rate in general and saving in the form of insurance in particular.

<u>Growth accounting</u> Wilson and Purushothaman (2003) posit a model to posit a long term economic growth rate of 6% per annum. However, their model is virtually driven by demographics. Rodrik and Subramanian (2004), on the other hand, show that India has had sustained growth in labor productivity, with a very low variation. In addition, the proportion of people who are economically dependent on others in the labor force (called dependency ratio) will decline from 0.68 in 2000 to 0.48 in 2025. This alone will increase the saving rate from current 25% of GDP to 39% of GDP. Just these factors of productivity growth and favorable demographics alone will produce an aggregate growth rate of around 7% a year. There is also evidence that the total factor productivity in India is below 60% to 70% below where it should be. Institutional reforms (a stable democratic polity, reasonable rule of law and protection of property rights) needed for the so-called second round of economic growth are already in place. Institutional quality not only helps economic growth, it also makes economic systems reasonably resistant to economic shocks. Moreover, improvement in labor quality due to higher level of educational attainment will also contribute to economic growth. Conservatively, these factors will contribute 1% of additional growth rate to GDP. Overall, therefore, a conservative estimate shows that the GDP growth rate can be 8% per year on a sustained basis.

<u>Insurance sector and economic growth</u> It is well-known that growth in income is positively related to demand for insurance. What is the exact relationship? This question has to be answered empirically for each country. For India, there is a clear nonlinear relationship between total saving and life insurance saving. It can be shown that the relationship is contemporaneous. In other words, there seems to be very little backward and forward linkages: past overall saving does not seem to influence future saving in the form of life insurance and vice versa.

From this, we can project forward the demand for life insurance in real terms using the economic growth estimate described above. This method gives us an estimate of 140 billion US dollars in today's dollars for life insurance in India in 2020. Similar technique also gives us an estimate of general insurance demand in 2020 of 60 billion US dollars in today's dollars. Assuming a retention rate of 95% in the life insurance market and a retention rate of 85% in the general insurance market (OECD, 2003) we arrive at a reinsurance market of 16 billion US dollars in today's dollars for 2020.

The projections above completely ignored two important elements of the insurance sector: pension and healthcare. Again, if we add conservative values (of 3% of GDP each) in each of these markets, another 240 billion US dollars will be added to our estimates above. Note that these are conservative estimates. Thus, excluding pension and health, we have a conservative projection of 180 billion US dollars in 2020. If we include health and pension, the estimate will balloon to 440 billion US dollars thus making it as large as the Japanese market in 2002.

Future Prospects: Market Share. How would the life insurance market be divided up between the incumbent Life Insurance Corporation and the newcomers? Models of market share have shown that in a fast growing market, the first few years are critical (see Guerrero and Sinha, 2004). In life insurance, the Life Insurance Corporation has two important elements in its favor. (1) The Life Insurance Corporation has a vast distribution network in the rural and semi-urban areas. This would be hard to duplicate. One potential way to duplicate it would be through bancassurance – selling insurance through banks. Some insurance companies have already embarked on this road. (2) Since the Life Insurance Corporation started with 100% of the market share, it will lose market share simply because of expansion of the market itself and less because of loss of existing customers. The Life Insurance Corporation is the *only* financial institution in the top 50 trusted brand names in India by a survey of the *Economic Times* newspaper (http://economictimes.indiatimes.com/articleshow/362862.cms). (3) As life insurance benefits accrue over time, it becomes more expensive to switch - because switching would mean a loss of accrued benefits. With the rapid expansion of life insurance, the market share of the Life Insurance Corporation could fall below the 50% mark in five years time.

For the general insurance business, private companies would have an easier access. Unlike life insurance, it is not expensive to switch insurers because most policies are of one year or less. The problem of tariffication makes competitive pricing difficult for the newcomers. In addition, reliable data on hazard rates are not available for many risks.

Conclusions

India is among the important emerging insurance markets in the world. Life insurance will grow very rapidly over the next decades in India. The major drivers include sound economic fundamentals, a rising middle-income class, an improving regulatory framework and rising risk awareness. The fundamental regulatory changes in the insurance sector in 1999 will be critical for future growth. Despite the restriction of 26% on foreign ownership, large foreign insurers have entered the Indian market. State-owned insurance companies still have dominant market positions. But, this would probably change over the next decade. In the life sector, new private insurers are bringing in new products to the market. They also have used innovative distribution channels to reach a broader range of the population. There is huge in the largely undeveloped private pension market. The same is true for the health insurance business. The Indian general insurance segment is still heavily regulated. Three quarters of premiums are generated under the tariff system. Reinsurance in India is mainly provided by the General Insurance Corporation of India, which receives 20% compulsory cessions from other general insurers. Finally, the rural sector has potential for both life and general insurance. To realize this potential, designing suitable products is important. Insurers will need to pay special attention to the characteristics of the rural labor force, like the prevalence of irregular income streams and preference for simple products.

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Endnotes

(1) The term *general insurance* is used in Britain and other Commonwealth countries. Elsewhere, the equivalent term is *property/casualty insurance* or *non-life insurance.*
(2) An excellent history of Indian Business can be found in Tripathi (2004). It gives detailed account of the rise of business houses in India during the colonial period.
(3) I am indebted to Professor Alan Heston of the University of Pennsylvania for drawing my attention to this document.
(4) Social sector investments mean loans to State Electricity Boards, housing, municipalities, water and sewerage boards, state Road Transport Corporations, roadways and railways. These account for about a fifth of the socially oriented investments portfolio, with the balance accounted by government and government guaranteed securities.
(5) Section 101A(8)(ii), Insurance Act, 1938: "Indian re-insurer" means an insurer specified in sub-clause (b) of clause (9) of section 2 (any body corporate carrying on the business of insurance, which is a body corporate incorporated under any law for the time being in force in India; or stands to any such body corporate in the relation of a subsidiary company within the meaning of the Indian Companies Act, 1913, as defined by sub section (2) of section 2 of that Act), who carries on exclusively re-insurance business and is approved in this behalf by the Central Government.
(6) The formal definition of rural sector used is as follows. "Rural sector" shall mean any place as per the latest census which has: (i) a population of not more than five thousand; (ii) a density of population of not more than four hundred per square kilometer; and (iii) at least seventy five percent of the male working population is engaged in agriculture. As for obligation to the rural sector, the specific minimum requirements for insurance companies are the following. In respect of a life insurer, (a) five percent in the first financial year; (b) seven percent in the second financial year; (c) ten percent in the third financial year; (d) twelve percent in the fourth financial year; (e) fifteen percent in the fifth year (of total policies written direct in that year). In respect of a general insurer, (a) two percent in the first financial year; (b) three percent in the second financial year; (c) five percent thereafter (of total gross premium income written direct in that year). In addition, each company is obligated to service the "social sector" as follows. The "social sector" is a sub-category of the rural sector. It consists of economically underprivileged groups within the rural areas such as the aboriginals. In respect of all insurers, (I) five thousand lives in the first financial year; (II) seven thousand five hundred lives in the second financial year; (III) ten thousand lives in the third financial year; (IV) fifteen thousand lives in the fourth financial year; (V) twenty thousand lives in the fifth year. "Social sector" includes unorganized sector, informal sector, economically vulnerable or backward classes and other categories of persons, both in rural and urban areas.

Appendix 1: Definitions of various lines of business in the Insurance Act of 1938

Section 2(11), Insurance Act, 1938: "Life Insurance Business" means the business of effecting contracts of insurance upon human life, including any contract whereby the payment of money is assured on death (except death by accident only) and the happening of any contingency dependent on human life, and any contract which is subject to payment of premiums for a term dependent on human life and shall be deemed to include
(a) the granting of disability and double or triple indemnity accident benefits, if so provided in the contract of insurance;
(b) the granting of annuities upon human life; and
(c) the granting of superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment or of the dependents of such persons.

Section 2(6-A), Insurance Act, 1938: "Fire Insurance business" means the business of effecting, otherwise than incidentally to some other class of insurance business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured in fire insurance policies.

Section 2(13-A), Insurance Act, 1938: "Marine Insurance Business" means the business of effecting contracts of insurance upon vessels of any description, including cargoes, freights and other interests which may be legally insured, in or in relation to such vessels, cargoes and freights, goods, wares, merchandise and property of whatever description insured for any transit by land or water, or both, and whether or not including warehouse risks or similar risks in addition or as incidental to such transit, and includes any other risks customarily included among the risks insured against in marine insurance policies.

Section 2(13-B), Insurance Act, 1938: "Miscellaneous insurance business" means the business of effecting contracts of insurance which is not principally or wholly of any kind or kinds included in Section 2 (6-A), 2 (11) and 2 (13-A) of the Insurance Act, 1938."

Appendix 2

The detailed factors are listed below for each major line of business:

Line of business	Factor A	Factor B
Fire	0.5	0.5
Marine: marine cargo	0.7	0.7
Marine: marine hull	0.5	0.5
Miscellaneous:		
Motor	0.85	0.85
Engineering	0.5	0.5
Aviation	0.9	0.9
Liability	0.85	0.85
Rural insurance	0.5	0.5
Other	0.7	0.07
Health	0.85	0.85

Appendix 3

List of Insurance/Reinsurance companies in India (December 31, 2003).

LIFE INSURERS

Public Sector: Life Insurance Corporation of India
Private Sector: Allianz Bajaj Life Insurance Company Limited, Birla Sun-Life Insurance Company Limited, HDFC Standard Life Insurance Co. Limited, ICICI Prudential Life Insurance Co. Limited, ING Vysya Life Insurance Company Limited, Max New York Life Insurance Co. Limited, MetLife Insurance Company Limited, Om Kotak Mahindra Life Insurance Co. Ltd., SBI Life Insurance Company Limited, TATA AIG Life Insurance Company Limited, AMP Sanmar Assurance Company Limited, Dabur CGU Life Insurance Co. Pvt. Limited

GENERAL INSURERS

Public Sector: National Insurance Company Limited, New India Assurance Company Limited, Oriental Insurance Company Limited, United India Insurance Company Limited

Private Sector: Bajaj Allianz General Insurance Co. Limited, ICICI Lombard General Insurance Co. Ltd., IFFCO-Tokio General Insurance Co. Ltd., Reliance General Insurance Co. Limited, Royal Sundaram Alliance Insurance Co. Ltd., TATA AIG General Insurance Co. Limited, Cholamandalam General Insurance Co. Ltd., Export Credit Guarantee Corporation, HDFC Chubb General Insurance Co. Ltd.

REINSURER

General Insurance Corporation of India