CUTS International

For the Hon'ble Chairman, Select Committee of Rajya Sabha

Memorandum on

Insurance Amendment Bill, 2008

1. Background

1.1 Insurance is a powerful and progressive sub-sector of the financial sector providing social security. India's life insurance sector is biggest in the world. There are total 52 companies in the sector of which 24 are in life insurance and 28 in non-life.[i] Insurance sector has a positive contribution to the economy of the country, the most significant being that insurance is driving the infrastructure sector by increasing investment each year.[ii] With the growth in the financial industry as a whole, there has emerged a need to promote innovation and remove inefficiencies within the sector. This in turn would facilitate competition as well as orderly growth of the sector.[iii]

1.2 From perspective of the players the challenges posed by the sector are: cost, taxation, compensation, governance and regulatory issues and customer service. While on the market and consumer side concerns involve: mis-selling, lack of competitiveness, premium costs and lack of consumer protection in the sector.[iv] Therefore, insurance as a sector has not just reached a large section of the society owing to low penetration, and has also not contributed much to the GDP for want of capital. It was largely felt that the insurance sector is a one-sided sector, wherein the consumers do not have much of a say and that they are left at the mercy of the firms dictating terms to them. The problem of consumer protection is rampant in the sector. Also due to lack of capital the proliferation and optimum utilisation of the benefits of insurance has not been able to achieve.

1.3 To deal with above issues the government introduced the Insurance Bill in 2008 to amend Insurance Act, 1938, General Insurance Business (Nationalisation) Act, 1972 and Insurance Regulatory and Development Authority (IRDA) Act, 1999. The Bill also proposed to increase the Foreign Direct Investment (FDI) in joint venture cap to 49 per cent. In July 2014, the cabinet approved some amendments in the Bill, providing for a composite cap of foreign investment (including FDI, Foreign Portfolio Investment (FPI) etc.) with full Indian management and control. With the amendments so made, it is expected that the insurance sector will witness additional equity worth Rs 25,000 crore. This amount can be utilised to increase competition and realise full potential of the sector. With in-flux of capital in the sector, a boost would also be felt in the infrastructure sector and consequently on the economic growth of the country. Nonetheless, there is no denying the fact that the sector has witnessed a complete circle from being an open competition market to complete nationalisation to a liberalised market.

2. Consumer Issues

2.1 Though India has the highest number of life insurance policies in the world and the total investible fund with LIC is almost 8 per cent of the GDP, yet three-fourth of the India's insurable population has no insurance. Hence, the insurance sector has an untapped market. A well developed and consumer friendly insurance sector is needed for economic development of the country. Some of the most pertinent issues festering insurance sector are low level of penetration, lack of consumer satisfaction and widespread issue of mis-selling.[v]

2.2 Prior to the enforcement of this Act, the onus was on the insured to prove any form of mis-selling or misrepresentation made to him by the insurer. But the present bill has shifted such onus from the buyer to the seller. The Bill has empowered the consumers immensely by turning the principle of "*caveat emptor*" into "*caveat venditor*".

2.3 Insurance sector records the highest number of mis-sellings, which is primarily due to poor advice given by agents either unintentionally or for *mala fide* intentions. The faulty manner of dispute settlement is obvious from the fact that though the IRDA submits its jurisdiction to the Consumer Dispute Redressal Forums under the Consumer Protection Act, 1986, the consumer has to approach the insurer first and later to the IRDA Grievance Cell.[vi]

3. Competition and Amendments

3.1 Lack of competition is a persistent problem in the insurance sector. Though the government opened the doors for private and foreign players in the insurance sector, yet the monopolistic situation of Life Insurance Corporation of India (LIC) is still prevalent. This is owing to the sovereign protection extended to the LIC.[vii] Another issue is with respect to the re-insurance business that was in dire need of competition. Presently, there is only one player in reinsurance business, i.e., General Insurance Corporation. Reinsurance requires a hefty amount of capital to enable the company to provide reinsurance services. In such a scenario, not a single joint venture is present that would provide for the reinsurance services. With in-flux of foreign companies into the sector, huge in-flow of capital too will take place.[viii]

3.2 The Bill gives way to enhance competition in the sector by allowing higher FDI cap of 49 per cent with Indian control. Need for more number of players, scope of higher capital infusion and higher growth of the market are the factors that would attract players to the sector.

3.3 From a consumer perspective, nonetheless, more players would mean better products, more innovation in the sector. lower prices and greater choice.

4. Foreign Direct Investment (FDI)

4.1 It is already pointed out that the insurance sector needs a significant amount of change in terms of competition and consumer protection as well as insurance penetration. That said, it is imperative to understand as to how the set object could be fulfilled. The issues festering the insurance sector can be eradicated in two ways. F*irstly*, by increasing capital in the market and *secondly* by enhancing competition. Both these means can be realised by allowing more foreign participation in the sector.

4.2 FDI cap in insurance sector has been increased from 26 per cent to 49 per cent, the Bill however, provides that the control of the joint venture shall remain with the Indian partner.

4.3 India's share in the global insurance market is less than one per cent and insurance sector can enormously be benefitted with in-flux of FDI. However, according to the Bill, insurance companies need to form joint ventures with Indian partners and that the control of the JV would remain with the Indian partners. That being said, this clause could prevent Indian private insurers to appoint CEOs of foreign origin.[ix]

4.4 FDI not only ushers capital and competition into a sector, it also brings with it management best practices, product innovation, international linkages and technical know-how that can significantly aid and improve the sector as a whole. Since Indian insurance sector is not as modernised and advanced as developed countries, therefore, scope to learn and develop is prominent. Therefore, a rise in FDI cap is one of the most prudent aspects of the Bill.

5. Concerns

5.1 Though the Bill attempts to answer and resolve most of the issues that plague the insurance sector, however, being an integral part of the economy, it is important that concerns of the various sections of the economy be considered.

5.2 The very nature of insurance sector dictates that, a large pool of money is entrusted to the insurers who pay the claims (as they come) from this pool of assets. Moreover, the interest on the pool of money is earned by extending a part of it to various businesses. Therefore, through insurance not just the claims of the assured or insured is taken care of but the needs of the businesses are also catered to.

5.3 That being said, one of the major concerns is that, increasing FDI cap in insurance would mean transferring huge capital to foreign businesses. This would result in entrusting foreign insurance companies with large sums of public money, the control of circulation of which would be entirely at the discretion of the foreign insurance companies.

5.4 Another aspect that is quite often cited is the present condition of the insurance sector. Insurance domain, as prevalent in India, is at a very nascent stage. Lacunae such as consumer/investor protection, market distortions prevail in the country. Though the Bill lucidly provides for shifting of responsibility to the seller, however, the consumer protection regime under the Bill must be further strengthened and must be enforced in a phase-wise manner so that on one hand the consumer remains protected and on the other the insurance sector prospers.

6. CUTS critique

6.1 From the consumer perspective the Bill has modified the perception towards insurance sector making it more dynamic and pro-consumer in nature. The aspect that touches consumer interest first is the fact that the shift of onus from buyer to seller is expected to change the perception towards insurance in general and in turn is expected to create more faith in the sector by the investor. The cumulative effect of such a behaviour change would result in *firstly*¸ more influx of capital into the insurance sector. *Secondly,* this would result in greater insurance penetration.

6.2 The amendment made to the Bill in 2014, ensuring that the control of the JV remains in Indian hands is no doubt a positive move; however, speculation remains as to the manner in which the foreign businesses would perceive the same. The sector as such is dubious as to the enforcement of this clause, the concerns of which are narrated above. It is doubtful as to how many investors would be attracted to the present scheme wherein the investment of the foreign businesses would be harnessed while control of the business would remain in Indian hands. The primary purpose of raising FDI cap is to ensure the influx of capital, which the foreign businesses would do provided that they get the incentive in form of controlling such business. Not allowing such prospect would discourage investors to invest their money into the insurance sector.

6.3 Another significant aspect relates to mechanism of appeal within the Bill. Though the Bill emphasises upon consumer protection and elevating onus from buyer to seller, however, the Bill does not address to the change in mechanism of redressal. One of the primary concern with respect to this issue is regarding lack of credible redressal mechanism within the insurance sector. There is no denial in the fact that the consumer courts are overburdened and also do not have the infrastructure to support the complexities of the insurance grievances, especially pertaining to quantum and administration. Moreover it is surprising that the Bill does not build upon the need of alternative dispute resolution instruments such as arbitration, conciliation and mediation. In absence of which the burden over the forums and other redressal mechanisms would remain.[x]

6.4 Nonetheless, there is no doubt that the Bill is a step forward towards creating wider options and better choices for the consumers by increasing the ambit of insurance sector in first place and also by ensuring that the consumers are adequately and systematically protected.

7. Conclusion

7.1 India as a country does not provide much towards the social security, resultantly, insurance as an instrument stands as a potent alternative. However, the issue with the sector is that there is lack of insurance penetration owing to primary lack of insurance products and sectoral – players. Coupled with this is the speculation among consumers and prospective consumers, owing to weak consumer protection regime.

7.2 The Bill is a good piece of legislation, since it has measured the problems and accordingly has provided for solutions. The Bill is formed by weighing in a balanced manner the issues, challenges and the solutions leading to a sound insurance sector. Expectations from the Bill are soaring and many, but if the enforcement of the same is made in phase-wise manner then the intended effect and anticipated behaviour change would be more prominent.

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[i] Study by India Brand Equity foundation, information derived from http://www.ibef.org/industry/insurance-sector-india.aspx last accessed on 9 September, 2014

[ii] Earnest &Young and CII Report entitled "*Indian Insurance Sector: Stepping into the next decade of growth*", information derived from http://www.ey.com/Publication/vwLUAssets/Insurance_sector_in_India/$FILE/Indian_insurance_sector.pdf last accessed on 18 September, 2014

[iii] Earnest & Young, Note entitled, "*India's Insurance Industry: issues and Challenges*" information derived from http://www.ey.com/IN/en/Industries/Financial-Services/Insurance/Indias-insurance-industry-issues-and-challenges last accessed on 10 September, 2014

[iv] Ibid

[v] Information derived from http://shodhganga.inflibnet.ac.in/bitstream/10603/4464/15/15_chapter%206.pdf last accessed on 15 September, 2014

[vi] Ashwin Harishchandran, "*Consumer Protection in Financial Sector*", Compendium of Papers towards One Day Seminar on Equipping Consumer Dispute Redressal Agencies for the present and the future, Centre for Consumer Protection Law and Policy, NUALS. Information derived from http://www.nuals.ac.in/web/pdf/CCPLaP%20-%20Compendium%20of%20Papers%201.pdf last accessed on 30 September, 2014

[vii] Shilpa Thakur, "*Competition in Life Insurance Sector in India*", research paper submitted to Competition Commission of India. Information derived from http://cci.gov.in/images/media/ResearchReports/IntRepShilpa280311.pdf last accessed on 29 September, 2014

[viii] Financial Times (20 January, 2014), "*Global reinsurance firms gearing up to enter India".* Information derived from http://indianexpress.com/article/business/business-others/global-reinsurance-firms-gearing-up-to-enter-india/ last accessed on 30 September, 2014.

[ix] The Economic Times (29 September, 2014), "*US Insurers vexed over control clause in Insurance Bill*", information derived from http://articles.economictimes.indiatimes.com/2014-09-29/news/54437354_1_insurance-bill-insurance-sector-insurance-regulatory last accessed on 29 September, 2014.

[x] Govind Johri, "*A Critical Look at Grievance Redressal Mechanism in Indian Insurance Industry*", National Insurance Academy, Pune, information derived from http://www.niapune.com/pdfs/Research/grievance%20redressal.pdf last accessed on September 30, 2014