REVIVAL OF THE INDIAN LIFE INSURANCE SECTOR – HOW AND WHEN?

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Introduction / executive summary

Despite the phenomenal growth achieved by the Indian life insurance industry over the past decade, certain regulatory actions as well as external events in the past few years have prompted many to raise several questions about the future performance of the industry.

Will the industry revive? How and when?

This paper considers various practical steps that can be taken by the Insurance Regulatory and Development Authority ("IRDA") and the Government, in order to help revive the industry. The paper also discusses some changes that may be necessary in the business practices adopted by companies, as well as in the macro-economic environment in India for the life insurance industry to go back on a sustainable growth path again.

Background

The Indian life insurance industry was opened for private sector participation in year 2000. Over the past decade, the industry has achieved a phenomenal growth in almost all areas.

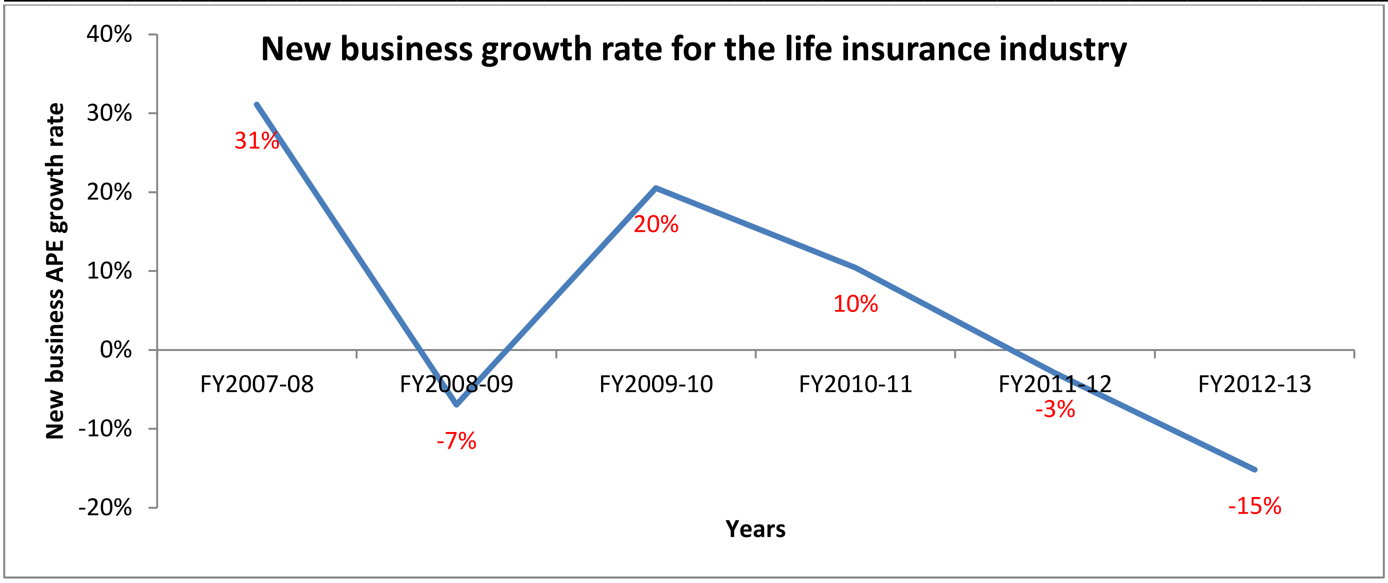
	FY2000-01	**FY2011-12**
Number of companies	5	24
Number of individual agents	1,15,709	23,58,885
Number of branches	Approx. 2,000 Estimated	11,167
New Business APE(1) (in Rs. Crore)	14,107(2)	67,770
Funds under management(3) (in Rs. Crore)	142,910	15,34,499

Source: IRDA annual reports / company published accounts / estimates

Notes:

1. *APE refers to annual premium equivalent and is derived as 100% of annualized regular premium plus 10% of single premium*
2. *The split between regular and single premium business was not available for this year and hence the amounts shown include 100% of single premium from new business*
3. *Funds under management is taken as the total of the shareholders' and policyholders' investments as shown in the balance sheet.*

However, regulatory actions as well as certain external events in the past few years have adversely impacted the growth of the industry in recent times.



Source: IRDA annual reports / estimates

This has prompted many to raise several questions about the future performance of the industry. Will the industry revive? How and when?

It is acknowledged that it might be difficult for the Insurance Regulatory and Development Authority ("IRDA") to roll back many of the regulations it has issued over the past few years. Nevertheless, this paper considers various practical steps that can be taken by the IRDA and the Government, in order to help revive the industry. The paper also discusses some changes that may be necessary in the business practices adopted by companies, as well as in the macro-economic environment in India for the life insurance industry to go back on a sustainable growth path again.

An article, written by the author of this paper, was published in the January 2011 edition of the "Asia Insurance Review" highlighting some of the key changes that are required for a sustainable growth of the life insurance industry in India. It is interesting to note that to a large extent, the measures and steps suggested in January 2011 article remain relevant even today. This paper takes stock of all these recommendations and also suggests a few more for a sustainable growth of the life insurance industry in the future.

Macro-economic environment

Whilst assessing the reasons for the under-performance of the industry over the past few years, it is very tempting to point fingers only at the fast changing regulations. However, one must not forget that starting with the global economic meltdown in 2008-09, the world economies have still not fully recovered. Many countries in Europe, American and Asia are still experiencing very low or no growth at all.

Consequently, the macro-economic scene in India has also been impacted adversely. Over the past few years, the GDP growth rate has slipped to around 5% from over 9% in FY2006-07 and the consumer price index (CPI) has been consistently at a high level, often in double digits. The equity markets have also been very volatile.

In such trying times, it is not surprising that the life insurance industry has suffered due to constraints on further capital investments by the shareholders; cost cutting measures taken by the insurers to protect their solvency positions; and due to the nervous sentiments prevailing amongst the potential customers / investors at large.

For the life insurance industry to go back on a sustainable growth path, it is very much necessary for the macro-economic factors to start looking positive again. In particular, the following changes may be necessary in the macro-economic environment:

- **REVIVAL OF THE POSITIVE SENTIMENTS ABOUT THE INDIAN ECONOMY**: The level of investments in the Indian economy has to increase. The overall GDP growth rate should go back to the levels of 8% - 9% seen earlier. This will ensure that the overall mood in the economy, as well as amongst the retail investor, would improve.
- **STABLE PERFORMANCE OF EQUITY MARKETS**: With the significant volatility witnessed on stock markets, the retail investors have stayed away from investing into unit-linked products ("ULIPs"). Thus, despite having one of the best financial products in the market (especially after the September 2013 regulations by the IRDA placing constraints on various charges on ULIPs), the ULIPs have failed to create attraction amongst the potential investors. A stable equity market performance would certainly help win the investor confidence and help put ULIPs back on the new business performance charts of life insurance companies.
- **SOFTER INTEREST RATE REGIME:** The steps taken by the Reserve Bank of India ("RBI") in the past several years to curb high inflation have resulted into high interest rate environment. This has also pushed up the interest rates on fixed deposits offered by the banks (8% - 9%). In pricing the traditional products, life insurers typically adopt a longer term view on interest rates, which has resulted into more conservative pricing interest rates than those prevailing now. At the same time, IRDA now also restricts the maximum illustration interest rate to 4% and 8% gross. Due to these factors, the traditional life insurance products offer rather unattractive returns to the customers, in comparison to the other financial products available. A softening of the short term interest rate regime may help ease the resistance shown by the consumers against buying life insurance policies.

Business practices adopted

It is important for the life insurance companies themselves to change the way they have been carrying out their businesses in the past. It may no longer be possible for the insurance companies to focus only on top-line performance, and ignore all other parameters that can measure their overall performance in efficiency, productivity, profitability, customer satisfaction and the quality of business sold.

The insurance companies may need to take steps to restructure their businesses and adopt practices that would foster a sustainable growth in the future. Some of these steps may include:

- **ENGAGE WITH THE PROMOTERS TO EXPLAIN THE NUANCES OF THE INDUSTRY**: A lot of the behavior in the industry in the past may be attributed to the directions received right from the top – i.e. from the promoter level. It is, therefore, essential to ensure that the promoters have a good understanding of how the life insurance business works. A mandatory offsite session for the promoters / Board members to 'educate' them about the nuances of the life insurance business may be a good first step.

- **ALIGN INTERESTS OF DIFFERENT STAKEHOLDERS:** In the past, a lack of alignment of interests of different stakeholders has resulted into certain stakeholders gaining undue advantage at the cost of the other stakeholders. In an ideal scenario, protection of the policyholders' interest should have been the core focus of the industry and the other stakeholders' interests should have been aligned to those of the policyholders. The industry may need to focus in achieving this going forward. This alignment of interests can be achieved through various measures such as by promoters / shareholders carrying out a review of their individual interests and whether they are aligned to those of the policyholders; by insurance companies offering compensation to distributors that is better aligned to the interests of the policyholders; by employees being offered remuneration / incentives that are linked to fulfilling the quantitative as well as qualitative aspects of customer satisfaction etc.
- **ALIGN COST STRUCTURES WITH PRODUCTIVITY AND EFFICIENCY**: After 13 years of being in business, and after several failed attempts to bridge the gap between the loaded expense levels and the actual expenses of companies, almost all the life insurance companies continue to experience significant levels of expense overruns. A drastic measure may be required to re-align the cost structures in the industry. These may include, for example, cutting the salary levels for senior management (indeed, the salary levels in the life insurance industry are believed to be out of line against that from the other financial services industries in India); enhancing the proportion of performance linked incentives in the salary structures; offering variable remuneration to the front-line sales executives; offering variable cost structures to life insurance branch management etc.
- **SIGNIFICANTLY ENHANCE THE USE OF TECHNOLOGY**: This is stating the obvious. Using technology in almost all areas of life insurance business management would go a long way in putting the industry back on a sustainable growth path. Unfortunately, life insurance industry has been lagging behind the use of technology as compared to other industries in India such as banking, asset management etc. Usage of the technology shouldn't be confined only to the sales function or to other function / service areas in isolation. The entire gamut of management of life insurance business from "sales" to "after sales" to "customer servicing" to "accounting" to "investment management" to "MIS reporting" to "claims" should be automated as much as possible by using technology. This will not only help cut down the cost, but would also lower the human intervention and thereby improving the overall quality of the business and the level of customer satisfaction.
- **REVAMP THE SALES PROCESS:** A number of problems faced by the industry today are due to the bad sales practices adopted by the distributors in the past. It is again stating the obvious - we really need to 'clean up' the sales process. Right from having the right distributor, with appropriate level of training; to providing him with the right IT tools to aid in the sales process; to monitoring his sales activities through periodic / spot checks and audits; to taking prompt action against erring distributors - all of this would go a long way in ensuring that the industry henceforth sells good quality business.
- **SEGMENTATION OF THE OPPORUNITY:** If there is one thing that the insurance industry didn't do effectively at all in the past, that would be segmenting the market and offering the right product to a given market segment. In order to understand their potential market much better, the insurance companies may need to carry out a detailed exercise to analyse the demographics, needs, income / saving patterns, family circumstances etc. of their potential market. They may then need to allow only the 'right' distribution channel to reach out to a given target customer segment. Insurance companies shouldn't allow all distributors to sell all types of products to any and all of

the customer segments. A proper mapping of "customer needs – distribution channel – suitable sales process – products" is the need of the hour. Only this would enable them to achieve a high quality sale going forward.

- **ARRANGE CUSTOMER CENTRIC PROGRAMMES:** A lot needs to be done to improve the level of customer experience in the life insurance industry. Several steps may be taken - initiating customer awareness programmes / seminars; offering regular health check-up facilities not just as value added services, but also as a risk management tool and as an opportunity to enhance up-sell opportunities; offering customer loyalty programmes along the lines of those offered by credit card companies; arranging "family days" of fun and entertainment for customers and their families etc.
- **ENHANCING THE LEVEL OF PUBLIC RELATION ACTIVITIES:** Unfortunately, in the past few years, the life insurance industry has suffered due to the negative media coverage attracted by the industry. It is important for the industry to take steps to correct the negative perceptions. A massive public relations ("PR") engagement initiative is necessary at all levels – IRDA, insurance companies, the Life Insurance Council and indeed at the level of the individual employees of life insurance companies. The industry may need to project the significant achievements through real life examples such as the large number of claims processed, how timely insurance payments have helped needy families, how a systematic saving / investment in insurance policies has helped families achieve their goals etc.
- **GO RURAL:** It is not sufficient to confine the life insurance penetration at the metro, urban or semi-urban areas. The need of the hour is to expand the reach of the business to all corners of the country. In doing so, the insurance companies should not look at this just as a regulatory requirement to be fulfilled. Instead, it should be looked at as an investment into creation of future business opportunities. Initiatives such as 'adopting' villages and providing basic infrastructure facilities, arranging regular health check-ups, providing education on the need to be insured etc. will help develop goodwill and a market for the insurance industry in these areas.

Legislations / regulations

The various changes that may be required in the regulations / legislations to help the industry get back on a sustainable growth path are set out in this section.

Perhaps, it may not be possible for IRDA to reverse many of the regulations issued over the past few years. In fact, many of the regulations are issued in the right direction and with the right focus (i.e. customer protection) in mind. However, even within these constraints, there are a number or changes that are still possible and necessary for a customer centric growth of the industry.

Some of the changes suggested in this section are required to be carried out by Government agencies / departments other than the IRDA. It may not be easy / straightforward to bring about the various changes listed below. Some of the suggestions may also seem rather radical. Nevertheless, the changes suggested are believed to be in the best interest of the potential customers / policyholders and consequently the life insurance industry as a whole.

The following steps may be taken for an orderly and sustainable growth of the life insurance industry in the future:

- **ALLOW FLEXIBILITY IN ARRANGING DISTRIBUTOR COMPENSATION**: This may be seen to be a bit controversial and going against the overall focus of the IRDA to protect customers. However, we are not suggesting to remove the maximum caps on distributor compensation altogether. What is being suggested is to allow flexibility to insurance companies to structure the distributor compensation within a company level maximum limit (such as that in Insurance Rule 17D) that may be placed. Thus, for example, on a given product, a highly productive distributor consistently writing high quality business may be allowed to be paid a compensation of say 100% of first year premium, whereas on the same product, another distributor may be paid only 10%. The flexibility may also allow companies to offer compensation linked to other parameters such as persistency, shareholder value addition, customer satisfaction etc. Provided there is full transparency on the level of distributor compensation offered, such flexibility may enable companies reward the right behavior and penalize the wrong behavior, yet maintaining the overall company level compensation within the stated limits.

- **MANDATORY TO BUY TERM INSURANCE PRODUCTS**: A common criticism of the insurance industry is that it 'pushes' the products that the consumers do not need. How about making it mandatory for the consumers to buy the products that they have a clear need for? This way, the consumers will 'demand' the product that they need (albeit because they need to fulfil the statutory requirement). This will also enhance the overall level of protection cover in India and fulfill an important social need of the country. To begin with, it may be made compulsory to buy protection products upon certain lifestyle events such as marriage, child birth etc. where a financial dependency gets created. It may perhaps also be made mandatory with the organized sector to begin with, or at the time of granting a loan to a borrower.

- **REVAMP THE PENSION PRODUCT REFGULATIONS**: Based on the experience thus far, it is evident that despite the best of intentions of the IRDA, the new regulations have failed to click with the insurance industry and the IRDA may need to analyse the reasons for the same. Although a significant potential exists here to address an important social need in India – i.e. to promote long-term savings and retirement provisions - the new IRDA regulations on pension products may need to be revamped for the insurance industry to help realize these goals. The two most important aspects that may need to be revised include removal of the requirement to offer minimum guaranteed benefit / investment return, and allowing an open market option ("OMO") to be offered at the time of annuitisation.

- **RELAX RESTRICTIONS ON RIDER PREMIUMS**: It is acknowledged that riders offer a cost effective way to enhance the different types of protection benefits to customers. Unfortunately, due to restrictions on the rider premium (as a % of the base policy premium), the industry has never sold riders in large volumes. It may be desirable for IRDA to relax the restrictions on the rider premium in order to help promote protection business.

- **OFFER TAX INCENTIVES ON INSURANCE POLICIES**: This will act as an impetus to promote the growth of the industry. Steps such as offering tax exemption on life insurance premiums on an exclusive basis (as opposed to clubbing life insurance with other financial products); offering an enhanced limit of tax exemption on life insurance premiums; offering exclusive tax incentives for certain type of products such as term insurance so as to enhance the level of protection business in the country, will help 'create a demand' for the life insurance products.

- **TAKE STEPS TO PROMOTE ANNUITIES**: The Government should make deeper markets for long term zero coupon bonds available so as to enable insurance companies match the annuity liabilities. A certain fiscal incentive is also required for the consumers to provide for regular income protection through annuities.

- **INVESTMENT FLEXIBILITY**: The life insurance industry may be allowed to offer external funds (e.g. mutual funds) in life insurance products. This would result into the retail consumers benefitting from the distribution infrastructure established by the life insurers and the investment expertise of the mutual funds industry in a cost effective manner. If availed of this facility, the life insurance industry (especially the smaller companies) would benefit through low cost investment management and would concentrate more on the protection business. Life insurance companies may also be allowed to invest into derivative instruments so that they can appropriately hedge the investment risks offered in life insurance products. This may also enable newer type of products to emerge. The existing restrictions on investments of life insurance funds (i.e. the 'controlled funds') may also be relaxed to allow greater flexibility to invest into equities, overseas markets etc.
- **ALLOW PROVIDENT FUND MONIES TO BE INVESTED IN INSURANCE**: A large corpus of retirement provisions made under the provident funds currently suffers from low investment yields. If insurance companies are allowed to manage these funds and / or if a certain portion of these funds are allowed to be invested in insurance products offering higher potential investment returns, it may benefit the consumers at large. At a retail level, individuals may also be allowed to withdraw their provident fund monies and invest into other financial instruments such as the pension products offered by the life insurance companies providing potentially higher returns – a concept that has been popular in some other countries such as Singapore.
- **MAKING DISTRIBUTORS MORE ACCOUNTABLE:** One of the existing provisions in the Insurance Act, 1938 requires distributor compensation to be structured on a 'writing distributor' basis as opposed to a 'servicing distributor' basis. This clearly requires a change in order to ensure that compensation to the distributor is paid only if the distributor continues to provide after sale service to his / her client.
- **INCREASE FOREIGN DIRECT INVESTMENT ("FDI") LIMIT IN INSURANCE:** This has been cited a number of times in the past at different forums. The initiatives required to further enhance the insurance penetration in India would require significant capital support. According to some estimates, some US$6bn additional capital may be required for the insurance industry to achieve its rightful place in the Indian economy. It is, therefore, important for the Government to enhance the FDI limit in the sector without any further delay. At the least, such a move will add a sense of positivity in the life insurance industry.

Conclusions

There is no doubt that there is a significant need for providing life insurance coverage in India. There is also no doubt that with the right policies adopted, the life insurance industry will achieve a high growth in the long term.

In this paper, a number of initiatives have been highlighted, that can be taken to revive the life insurance industry in India. With such initiatives, the industry will certainly go back on a sustainable growth path and achieve the past glory it enjoyed.

A difficult question to answer though is 'when'? Let's leave it to the readers to form their own judgment on this!