FDI Limit Hike in Indian Insurance Industry: An Assessment

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Abstract
In the Union Budget 2014-15 on July 10, 2014, Finance Minister has proposed to increase the foreign direct investment (FDI) limit in the insurance sector, up to 49% from 26% with full Indian management and control through the FIPB route. However, it is not clear about how foreign investment promotion board (FIPB) will consider the proposal for approval of the extra 23% foreign investment in a company. In our view, this may happen in two scenarios: first, dis-investment of the Indian promoter’s stake to 51% from 74%; or Second, by keeping the Indian promoter’s stake at present level (in amount), but enhance the foreign investments, so that the new ratio of domestic and foreign insurer stake would be at 51:49.

In this paper, we have estimated the amount of capital may flows into the sector through foreign investments. We feel the first scenario may not an ideal and Government may favour the second scenario, i.e., to issue of fresh shares for extra foreign investments, rather than sale of shares by domestic promoters. In this scenario, the estimated results indicates that the insurance companies may receive around ‘14,719 crore ($2.5 billion, assuming $1 is ‘60) of additional foreign investment due to increase in FDI limit. However, if Government would allow to the domestic promoters to divest their stake (first scenario) in the insurance companies, it is estimated that a maximum of 7,000-7,500 crore additional investments may flows to the industry, through foreign investments.

In both the scenario, it is acknowledged that the move may provide huge capital support to the insurers through foreign investments, which would lead to product innovation, better customer service mechanism and higher insurance penetration in the country. The increasing FDI in insurance may also help to meet the infrastructural needs of the economy, which is estimated at $1.2 trillion in the 12th Plan. Additionally, to boost financial savings, Government also raised the 80C investment cap to ‘1.5 lakh from ‘1 lakh, which may help the insurers to tap the new business, which is declining in the last 2-years.

Keywords: Capital, Foreign Direct Investments and Insurance Penetration

Introduction
To promote competition and efficiency in Indian insurance industry, Government of India has liberalized the sector in 2000, by allowing private players to participate, with foreign investment up to 26% in equity capital. During the period 2000-01 to 2012-13, the life insurance business registered a CAGR growth of 22% in total premium & 25% in new business premium collections and non-life segment grew by 16% and now strives to tap the huge potential opportunities. This impressive growth has driven by entry of new players with significant growth aspirations and capital commitments, which is noticeable in terms of products, policies and premiums. This policy liberalization has transformed the Indian insurance sector to a competitive market from a monopoly structure. However, in compared to the developed countries like US, UK, France and South Africa, the Indian insurance industry is still under-developed both in terms of penetration and density.

In the recent period, the insurers are facing a sluggish period, which brings to fore the big challenge of profitability. Most of the private players have accumulated losses, not due to inefficiency but due to the nature of this business. For further expansion, the insurer needs capital which is a challenging task for the domestic promoters to infuse. In this circumstance, the need of the hour is to support the insurance business in India, with proper regulations, which will help to achieve the national agenda of ‘financial inclusion’ in the country.

Insurance in Union Budget 2014-15
In the Union Budget 2014-15 on July 10, 2014, Finance Minister has proposed to increase the foreign direct investment (FDI) limit in the insurance sector, up to 49% from 26% with full Indian management and control through the FIPB route. Additionally, to boost financial savings, Government also raised the 80C investment cap to ‘1.5 lakh from ‘1 lakh.

The move to provide funds for the capital intensive industry needs to be acknowledged, with a hope of huge capital inflows, which would lead to product innovation, better customer service mechanism and higher insurance penetration in the country. But there could be a dampener in the form of voting rights, which is limited to 26%. Additionally, the increase in 80C deduction limit to ‘1.5 lakh, may help the insurers to tap the new business,
which has been declining. With tax sops let's hope it's a beginning of 'acche din (better days)' for the life insurance industry, as this may encourage people to invest in long term savings instruments like life insurance.

**Impact on Equity Capital of the Insurers**

The FDI cap hike may help the insurance industry in two ways; (i) may help the insurer to access capital more easily, and (ii) could act as a trigger for listing of insurance players. However, it is not clear about how FIPB will consider the proposal for approval of the extra 23% (49% minus 26%) investment in the company. In our view, this may happen in two scenarios: first, disinvestment of the Indian promoter’s stake to 51% from 74%; or Second, by keeping the Indian promoter’s stake at present level (in amount), but enhance the foreign investments, so that the new ratio of domestic and foreign insurer stake would be at 51:49. In this paper, we have estimated the amount of capital may flows into the sector through foreign investments.

<table>
<thead>
<tr>
<th>Table 1: Estimated Additional Capital Flows to the Sector due to FDI Limit Hike</th>
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<tbody>
<tr>
<td><strong>Private Insurers</strong></td>
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<tr>
<td>-----------------------</td>
</tr>
<tr>
<td>Life</td>
</tr>
<tr>
<td>Non-Life</td>
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<td>Specialised</td>
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<td>Total Equity Capital</td>
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*Source: IRDA & Computed; * assuming $1= `60

In our view, Government may favour the second scenario, i.e., to issue of fresh shares for extra foreign investments, rather than sale of shares by domestic promoters. In this scenario, we estimated that the insurance companies may receive around 14,719 crore ($2.5 billion, assuming $1 is `60) of additional foreign investment due to increase in FDI limit. However, if Government would allow to the domestic promoters to divest their stake (first scenario) in the insurance companies, it is estimated that a maximum of 7,000-7,500 crore additional investments may flows to the industry, through foreign investments. However, the objective of FDI limit hike may not achieved, as the capital base will remain same and the insurers are not able to expand their foot print to achieve the national agenda of financial inclusion.

**Benefits to the Stakeholders**

Insurers need capital to maintain a healthy base, offer a wider bouquet of products, and protect consumer interests against insolvency. Increased capital inflow will enable insurers to offer products that are capital-guzzling but work in the customer’s interest without taking a toll on their bottom lines. It will also give domestic players access to state of the art technology to upgrade their distribution systems towards deeper product expertise and better underwriting skills. Additionally, it also opens up doors for two non-life insurers, namely L&T General Insurance and Reliance General Insurance, and three life insurers, namely ING life, Sahara India Life and Shriram Life, to sell stakes to overseas companies, which owns 100% by the Indian promoters.

It will also incentivise insurance intermediaries such as brokers and web aggregators through higher commissions. The increased capital inflow is also likely to give a fillip to relatively new private life insurance companies that have seen a decline in new business premium over last two years.

The insurance industry not only protects human life but is also a key resource for raising funds for the country’s infrastructure. According to the 12th Plan, India needs to spend about $1.2 trillion on infrastructure build-up and expansion, and there’s almost a $300 billion gap in funding. Increasing FDI in insurance is one way of meeting this requirement.

The budget moves may help the banking fraternity in two ways; firstly, the big banks like SBI, ICICI Bank, may reap higher revenues (non-interest income) due to their wide distribution network, as international companies may pay a premium to exploit their franchise. Secondly, if the first scenario of disinvestment (refer section III) is considered, then public sector banks (PSBs) may be benefited to sale their stake in insurance business to meet the capital requirement under Basel III. However, it is not advisable to PSBs to sale their stake in insurance, as banking business in the current scenario is under stressed, with higher non-performing assets and low interest income.

**Concluding Remarks**

The Indian insurance industry has always been an attractive market for global insurers to expand their business in the country, mainly due to demography profile and untapped business opportunities. However, the FDI limit for insurance in India is among the lowest globally. China, Indonesia and Malaysia have an FDI limit of 50%, 80% and 51% respectively. Japan, South Korea, Vietnam, Hong Kong and Taiwan allow 100% FDI. In this context, the Union Budget moves to increase the FDI limit in insurance is a welcome move, which aims...
that the global investors to bring in the much required foreign capital to meet the industry needs. This may help the insurer to expand their footprint to support Government’s objective of financial inclusion, through insurance inclusion in the country. However, there is a need that the Government should simplify the KYC norms and demat accounts to a single unit across all financial products, which will benefit the insurance inclusion in the country. It is also feasible to provide a separate cap of `50,000 for life and health insurance, under 80C deductions, which will help all the stakeholders.

Hope budget moves would be positive for all the stakeholders!!!

References

