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J. B. BODA GROUP

MEDIAN

Issue 75 September 2013

Dear Readers,

Indian Rupee has depreciated in the past few days. In order to check high volatility in local currency value, Central Banks world over intervene in markets through buying or selling of foreign currencies, as required. Nevertheless, there is a silver lining. India’s long term growth remains intact due to demographics, rising middle class, urbanisation, increasing savings and investments. India with its strong fundamentals and resilience will continue to grow economically.

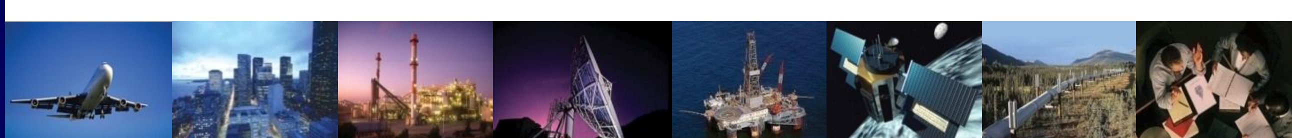
While globalisation will continue apace, hand-on-engagement with international business and industry circles by global insurance & reinsurance industry will be critical to success. Requisite global as well as local regulatory / statutory reforms are needed to be ushered in with the objective of improving global market efficiency, transparency and preventing unfair trade practices. The demand for insurances is increasing as a result of enhanced uncertainty. In these turbulent times, risk protection becomes predominant and contributes proactively in serving client fraternity to meet their insurance requirements.

We are happy to bring out this **75th Issue** of **MEDIAN** as a **Special Issue** dedicated to the **Insurance Industry in India**. The contents provide a landscape of Indian Insurance Industry traversing through its period milestones from the beginning to the present. Incidentally, the Group has witnessed three distinct eras of Indian Insurance Industry i.e. free & open market prior to nationalisation of industry in 1974, post-nationalisation and again market liberalisation from 1999 onwards.

Having set the reinsurance business footprints in Mumbai, India in 1943, today J. B. BODA has mainly become the architects as an international professional Reinsurance Intermediary of the Third World mainly from the Caribbean to Africa; in the Gulf, the Sub-continent of India and Asia.

This Issue augurs well during the 70th Anniversary of the J. B. BODA Group this year – First on Protection and Serving with Commitment.

We are pleased to inform you that, during the Brokers’ Meet arranged by GIC Re on Tuesday, 20th August 2013 at Taj Mahal Hotel – Mumbai, J. B. BODA Reinsurance Brokers Pvt. Ltd. were awarded for “The Best Usage of the Ethru Platform”.



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The Award was presented by Mr. A. K. Roy – Chairman – Cum – Managing Director of GIC Re to our Group Chairman Mr. Atul D. Boda during the above Meet.

The theme of this Special Issue is not to bombard you with figures, graphs and statistics of Insurance Industry in India. Plenty of it is available in public domain. The idea is to trigger a spark to ignite few candid thoughts on the industry's ongoing degeneration.

Get going to read, introspect and ponder………

With best regards,

Sanjiv Shanbhag
Senior Executive Director
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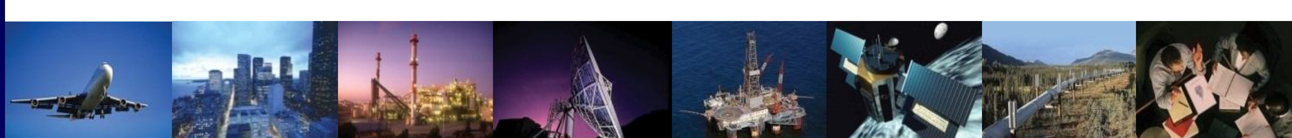

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Insurance Industry in India – at Crossroads

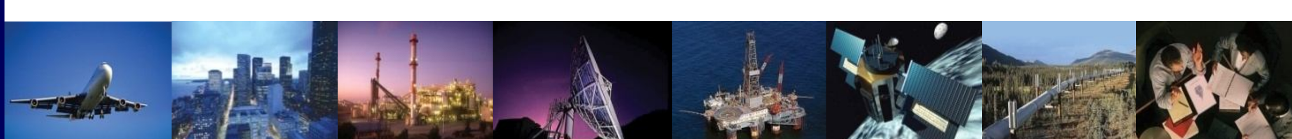
India an emerging market

In sixty six years since India attained independence in 1947, India has consolidated a vibrant democracy, improved literacy and health conditions, achieved global competitiveness in information technology, business process outsourcing, telecommunications and pharmaceuticals, an acknowledged nuclear power and one of the world's most dynamic economies, ranked fourth largest in purchasing power parity terms globally. India has always been an incredible country, which straddles many centuries simultaneously. But in the last 25 years, there has been an enormous churn, brought about by fiscal growth, globalization and technology. India entered the era of economic liberalization and coalition governments in the 1990s with an unprecedented degree of confidence and maturity.

India is regarded as one of the emerging markets that present opportunities for insurers. In thirteen years since Indian insurance industry was opened in August 2001, it has grown at a compounded annual rate of 15 %. Some Indian general insurers now provide cover to the global assets of India Inc. through their international insurance programmes. Forecasts indicate that by 2017, India's overall insurance market will increase nearly double its current volume.

While the insurance penetration increased substantially through the past decade, it declined in FY 2009-10 (April-March) and FY 2010-11 (April-March). New business premium collected by the life insurance industry also declined in FY 2011-12 (April-March) and FY 2012-13 (April-March). Additionally due to regulatory changes, the sale of ULIPs has gone down and insurers are also burdened by high operating costs. The insurance penetration in India fell from 5.1 % in FY 2009-10 (April-March) to 4.1 % in FY 2010-11 (April-March) and 3.9 % in FY 2011-12 (April-March). The first year premium collected by life insurers declined for the second consecutive year.

The non-life sector has grown steadily in FY 2012-13 (April-March), but the industry is still burdened by underwriting losses which amounted to approximately INR 30 billion (USD 429 million) for FY 2011-12 (April-March). Health Insurance has grown substantially with INR 153 billion (USD 2.19 billion) in 2012-13 (April-March) in premium collected. However, the segment is plagued by high claims ratio.



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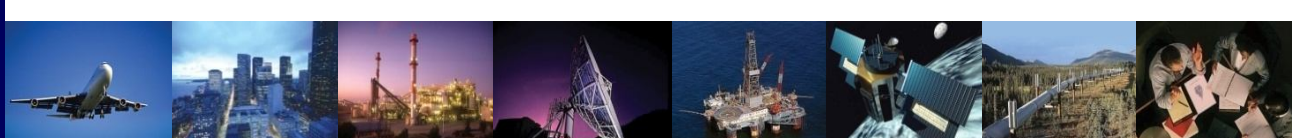
Life Insurance Industry

Life insurance industry registered an impressive 29% CAGR between FY 2001 – FY 2011. The industry growth rate has been negative in FY 2011-12 (April-March) and FY 2012-13 (April-March) due to regulations necessitating insurers to revamp their business models and move towards more cost efficient operations. The private sector has achieved a robust CAGR of more than 50 % since its inception in FY 2001 and a market share that increased from nothing to around 40 % over a decade to again fall back to 30 % of the total Life Insurance market. LIC however continues to have a stronghold over the market with its legacy of an extensive distribution network and trusted brand image.

On the products front, the market has shifted from a predominantly traditional portfolio in the early years of liberalization to a larger mix of Unit Linked Plans (ULIP) post 2006. ULIP plans were more prevalent amongst private insurers with several insurers operating at almost 90% ULIP mix. The ULIP regulations of 2010 changed this scenario by restricting the margins on ULIP plans through cap on charges and thereby requiring insurers to revert to a higher mix of traditional products in their portfolio.

The life insurance industry has witnessed a decline in premium in the last two years with the change in regulatory environment. It is presently dealing with several pressing issues such as low productivity of distribution channels, high attrition in sales force, high distribution costs particularly for the agency channel and sub-optimal persistency ratios on account of increased mis-selling. All these factors have contributed to an increased pressure on profit margins and compelled insurers to turn to efficiency improvement and cost optimization measures to achieve desired return of capital.

Cumulative Losses stand at close to INR 125 billion (USD 1.79 billion) in FY 2011-12 (April – March) for the industry and a total capital infusion of over INR 350 billion (USD 5 billion) made primarily to fund operating losses.



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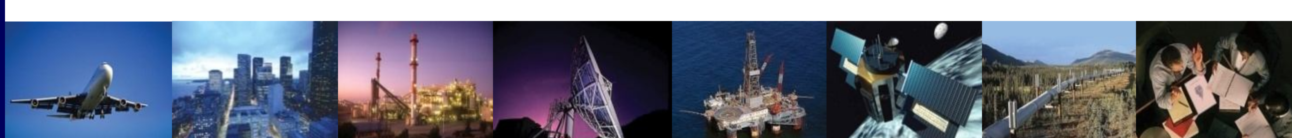
Non – Life Insurance Industry

Important Milestones in business

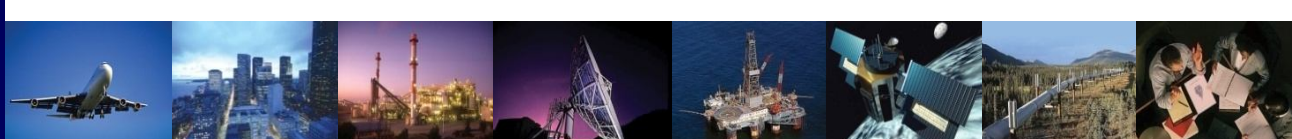
Indian insurance saga has three clear time zones. Pre-nationalization (Life business was nationalized in 1956 and Non-Life in 1972); Post-nationalization upto 1999; and since 1999, the privatisation of the market.

1850	The first general insurance company, Triton Insurance co. Ltd. established in Kolkata.
1907	The Indian Mercantile Insurance Ltd. set up, the first company at Kolkata to transact all classes of general insurance business.
1938	Insurance Act came into force.
1956	Life business was nationalized.
1957	Framing of a code of conduct by the General Insurance Council to ensure fair conduct and ethical business practices.
1968	i. The Insurance Act amended to regulate investments and set minimum solvency margins. ii. The Tariff Advisory Committee set up.
1972	The General Insurance Business (Nationalization) Act, 1972 introduced to nationalize the general insurance business in India.
1973	i. 107 insurers amalgamated and grouped into four companies viz. National Insurance Co. Ltd., The New India Assurance Co. Ltd., The Oriental Insurance Co. Ltd. and United India Insurance Co. Ltd. - as fully owned subsidiaries of General Insurance Corporation of India. ii. GIC was incorporated as a holding company.
1991	i. Beginning of economic liberalization. ii. SWIFT (Single Window International Facultative & Treaty) Division – GIC on behalf of Indian market writing International Inward business, except reciprocal exchange, which continued with respective companies.
1993	Malhotra Committee set up to complement the reforms initiated in the financial sector.
1994	i. Malhotra Committee submits Report ii. Detarrification of aviation, liability, personal accident, health and marine cargo insurance products.



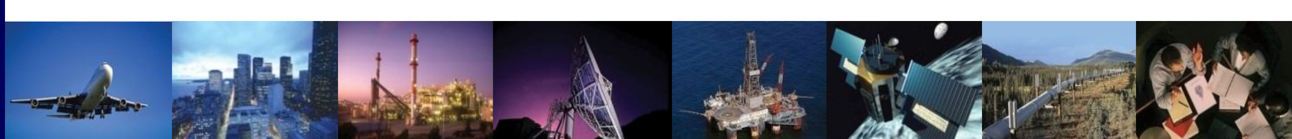
1996	i. Interim Insurance Regulatory Authority (IRA) set up. ii. Budget promises to grant statutory powers to IRA.
1997	Standing Committee Final Report tabled in Parliament
1998	i. Ninth Five – Year Plan Draft envisages role for private sector in insurance. ii. Budget provides for opening of insurance to private sector. iii. Tariff Advisory Committee (TAC) reconstituted with IRA Chairman as its head. iv. IRA Bill introduced in Parliament, referred to Standing Committee. v. Comprehensive Insurance Reforms Bill (CIRB) introduced in Parliament, referred to Standing Committee.
1999	Insurance Regulatory and Development Authority (IRDA) Bill passed in Parliament.
2000	i. IRDA incorporated as the statutory body to regulate entire insurance industry and to register insurance companies. ii. Private sector insurance companies are allowed foreign collaboration with equity participation upto 26%. iii. General Insurance Corporation (GIC) made India's national reinsurer (GIC Re). iv. The subsidiaries of GIC were delinked to become independent companies.
2002	Parliament passed the Bill of de-linking the four subsidiaries from GIC.
2005	De-tarrification of marine hull insurance.
2007	De-tarrification of all general insurance products except of the auto third-party liability segment.

The non-life insurance sector has grown significantly, since the insurance sector opened in 1999-2000. Increasing disposable income, a growing middle-class segment, increased awareness about insurance, increasing investments and spending on infrastructure has opened doors for both domestic and foreign insurers. Furthermore, several reforms and policy measures, especially during the last decade, have enabled conductive environment for the insurance companies to flourish.



Traditionally, the non-life insurance has been dominated by motor insurance (due to mandatory third-party liability). It constituted 43% of the total non-life insurance premium in FY 2012-13 (April-March), followed by health and fire at 22% and 10%, respectively. Health Insurance is the latest emerging product segment in the non-life sector. A few specialized health insurers have begun to strengthen their foothold in the Indian market, which has contributed to an increase in share of premiums from 18% in FY 2007-08 (April-March) to 22% in FY 2012-13 (April-March). Since the establishment of these specialised insurers, their market share has increased from 0% in FY 2006-07 (April-March) to 11% in FY 2012-13 (April-March). Fire Insurance has lost ground to some extent, with its market share declining from 13% in FY 2007-08 (April-March) to 10% in FY 2012-13 (April-March) , whereas marine, engineering and liability continues to remain almost at the same level, at 4%, 4% and 2%, respectively in FY 2012-13 (April-March).

Since 2002, the sector has witnessed a double-digit growth in almost all the years, and this is expected to continue for the next 5-10 years. Non-life insurance premiums grew at a cumulative average growth rate (CAGR) of 19.6% from FY 2000-01 (April-March) to FY 2012-13 (April-March). However, the growth has been largely in line with the country's GDP and has seen a limited increase in penetration levels. The penetration of the non-life segment increased marginally from 0.4% in FY 2002-03 (April-March) to 0.8% in FY 2011-12 (April-March). Prior to 2010 the industry observed a stagnation in growth from 2007-2010. This slow-down in growth can be attributed to price de-tariffication guidelines and hence increased competition of existing players, new entrants in the market, high claims ratios and the Motor Third Party Pool.



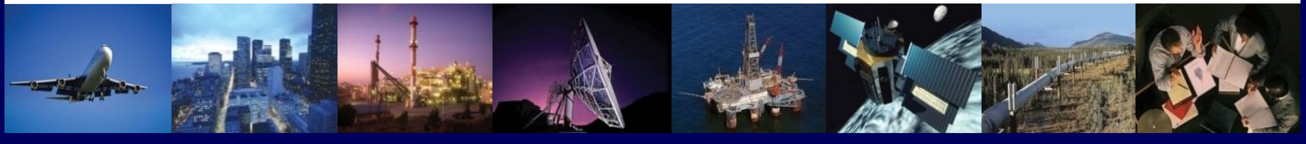
Post Detariff Scenario

The liberalization of insurance market in India gained momentum with the enactment of the Insurance Regulatory and Development Authority (IRDA) Act in 1999. 75% of the non-life insurance industry, which consists of fire, engineering and motor covers, was subject to rates prescribed by the Tariff Advisory Committee upto December 2006, irrespective of nature / quality of the risk. Partial detariffing on pricing took place on 1st January 2007, when fire, engineering, motor own damage and workmen's compensation segments were freed for insurers to rate premiums. But the regulator restricted the discounts with effect from 13th March 2007 in order to minimize the dangers of an irrational price war. Full detariffing on pricing took place on 1st January 2008. This completed first phase of detariffing price freedom. Detariffing and fierce competition have forced all insurers to cut premiums drastically in general insurance industry. This has its adverse effect on premium income levels of nearly all insurers.

Presently, by and large, there are common policy wordings across insurers. However, insurers have the freedom to issue Add-on Covers/Endorsements to add/delete coverage features enabling customization. Insurers have also increased policy deductible/excess. In a free market scenario, a lower premium rate may go with a larger deductible/excess, leading to balance insurer's risk portfolio, in tune with international standards. This enhances reinsurer's comfort level as well.

Detariffing envisages to allow risk acceptance based on the specific competencies of individual insured, to set in motion a more matured and broad-based market. It is expected to lead to specialization resulting in better risk management and acceptance practices and to ensure that the market achieves global standards in underwriting and risk management.

Indian insurers are now opting for multi-channel partnerships to reach out to their prospective customers. Brokers, agents, corporate agents, bancassurance and e-insurance are playing an important role in marketing and selling insurance products. The future lies in tapping unserved and under-served market segments through innovative efforts and revamping the distribution channels. Around 80% of the population remains excluded in life insurance category and 90% out of non-life insurance category. 93% of workforce belongs to unorganized sector.



Insurance Sector Reform – Road Ahead

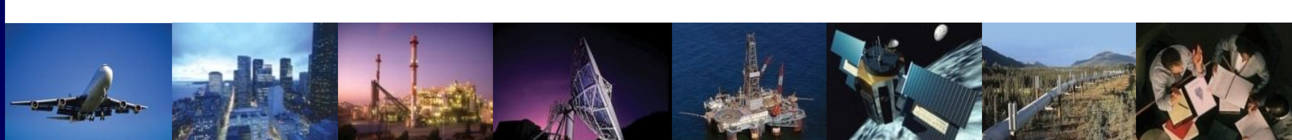
The share of financial savings channeled to the insurance industry is approximately 24% and given the backdrop of moderating economic growth, it might change a bit. The household savings in 2011 stood at INR 10,440 billion (USD 149 billion), with the share of currency increasing to 13.3% (9.8% in 2010), deposits remaining largely at the same level at 47.3% (47.2% in 2010); life insurance funds increasing to 24.2% (22.0% in 2010) and provident and pension funds slipping to 9.1% (11.5% in 2010). The insurance industry, by offering long term savings and protection products, can channelize a larger share of household savings and enhance the levels of financial protection currently deficient in Indian economy.

Insurance in India has evolved progressively and is now in a transitory phase, striving to meet the modern customers' expectations. India is maintaining conducive environment for sustainable growth. India story is one of hope and optimism. With low penetration rates for both life and non-life, potential is tremendous and opportunities are unlimited.

The growing insurance industry in India is one of the big achievements of Indian economic reforms programme. The insurance growth story is changing Indian economy in many ways. There has been an influx of foreign direct investment (FDI) and entry of international financial conglomerates, bringing in technological advancement into the sector. There has been significant employment generation and boost to financial markets. There is strong regulatory framework to protect interests of various stakeholders, by addressing core parameters of value issues like policy holder protection, solvency, basic conduct and best practices.

In the evolving market scenario, with the advent of many private players in the non-life space, constant revision of strategies is becoming the order of the day. Insurers are coming up with unique propositions and customer – centric initiatives to sustain themselves in fiercely competitive market and meet customers' demands.

In the long run, the insurance industry is still poised for a strong growth, as the domestic economy is expected to grow steadily, leading to rise in per capita and disposable income, while savings are expected to be stable. Insurers now look to reassess the business model from product, pricing, risk management, rural inroads, distribution, claims management and a realistic pace of growth. The industry stakeholders are working towards more favourable environment for stable growth, increasing the penetration of insurance to rural and underpenetrated areas and increasing the contribution to the economy.



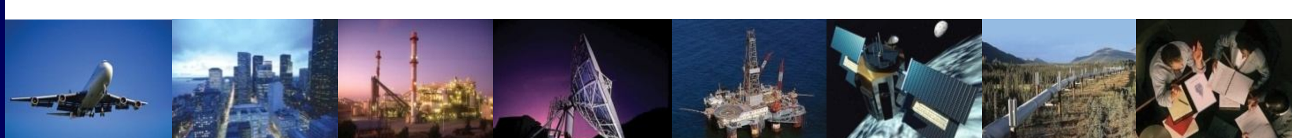
The insurance industry has brought about rapid financial convergence. The public confidence in the industry is positive and the industry on the whole is far more dynamic. Very soon, this success story would push the policy makers to liberalize the pension sector and other sub-sectors of the insurance industry, including raising the FDI limit to 49% from 26% and allowing lower capital for specialized players. Some of the fundamental factors which are attracting big players to Indian insurance industry are that India has :-

* 18% of world population
* 2 % of world GDP
* 63 % of Indian population is in age group of 15-64.
* Global investors can pump in equity capital into insurance ventures.
* Indian insurers will be allowed soon to disinvest so that JV partners will stand to gain by listing by diversifying their shares and choosing to step up their valuation accordingly at a later stage.

The insurance sector in India is now waiting for two major reforms – first, an increase in foreign direct investment (FDI) from 26% to 49% and second, freedom of product design. Foreign capital inflow and customized products are what the insurance sector needs.

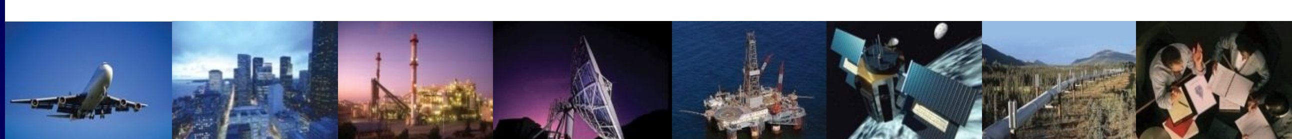
As private insurers increase their business, they have to increase their capital as well to meet the additional solvency margin requirement. This is needed more in the case of life insurers, as the industry has shown exponential growth since the opening of the sector, thereby creating a need for more capital. It is envisaged that these insurers have to dilute Indian partners' holdings by entering the capital market with an Initial Public Offering (IPO). It is imperative that these insurers have been looking at top line growth, which will facilitate better valuation, thereby enabling larger premium for their IPOs. Hence, it is fair and just to expect Indian partner to offload additional holdings to foreign partner at a premium. Insurance is a capital intensive business and an increase in foreign direct investment (FDI) will allow foreign partners of insurers in India to bring in more funds to help maintain growth. Insurers need additional capital infusion periodically to maintain required solvency margins – particularly in the scenario of slowdown. The FDI hike will also result in new international players entering Indian insurance market, which will benefit customers in terms of wider choice of products and service parameters.

Freedom in pricing of insurance, except automobile third party insurance, has been in effect since 1st January 2007. This has been a boon for customers, more so for large corporate clients, which take property insurance in a big way. This segment has attracted unprecedented



discounts in premium rates resulting in negative slide of premiums. This trend continues and customers have been enjoying further reduction in rates. In the absence of another alternative to compete in the market – other than pricing – the insurers are forced to reduce rates consistently. Hence, it is time that insurers are permitted to design products. In the process, brokers can play enhanced professional role expected of them to cater to different product features to suit the needs of different customer profiles. This change will provide insurers and brokers significant opportunities in product innovation, best service standards and deliveries, expansion to newer segments and also move towards risk based pricing. Insurers will have flexibility to restructure premiums based on merits of risks and also offer specialised products depending on market requirements. More importantly, customers with good risk profiles will enjoy lower premiums and optimum covers.

With intense competition, insurers will have to rationalize costs by using better operational efficiencies, better technology, effective risk management solutions, efficient resource management and speedy marketing, the benefits of which will be ultimately passed on to customers. The insurance industry grew strongly over the last decade, but has witnessed de-growth of new business premium in the last two fiscal years. Besides, the industry is also faced with challenges of high operating costs and underwriting losses. The key indicators in Life Insurance industry are fall in new business premium in last two fiscal years, share of agency channel decreasing and high operating costs. The key indicators in Non-life Insurance industry are low penetration levels, underwriting losses and high claims ratio in Health Insurance. There are major opportunities for insurers in Micro-Insurance, Health Insurance (penetration of only 3% of population) and Pension & Social Security Schemes (only 11% of workforce covered), where there is substantial untapped market potential. The way forward for the insurance industry in India is achieving product innovation, finding new means of selling and working towards a sustainable profitable growth momentum.



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Much has been talked and less has been walked. There are numerous challenges facing the insurance industry in India today. The immediate front-burner issue to be addressed is in respect of Non-life Insurance industry on the pricing front. The main reasons for underwriting losses are lack of risk-based technical pricing and inadequate pricing mechanism. At present the commercial pricing is greatly influenced by competitive pressures – not inherent risks. **De-tariffication has led to an ongoing fierce price war resulting in irrational decline in premium rates purportedly by 50% - 99% on erstwhile Tariffs in different insurances mainly on basis of client size with sheer focus on top-line sacrificing profitability and sustainability totally.**

On premium pricing front, the insuring fraternity in India is passing through a natural fear psychosis, which is in fact the own creation of Indian insurance industry. This is certainly a worst scenario for the industry. **The prime questions to which the insuring fraternity is finding logical answers are :-**

(i) In case the higher premiums charged in earlier non-liberalised insurance market in India were correct, thence how come Indian Insurers can afford to charge ridiculously lower premiums in liberalized insurance market?.. Apparently, this is a dicey position/situation.

(ii) In case the lower premiums being charged in subsequent liberalised insurance market in India are correct, this means Indian insurance industry has unfairly collected huge premiums earlier and has taken the insuring fraternity for a ride.

On product front, the development has been insignificant. The products currently available in Indian insurance market are age old, conventional and traditional, lacking the requisite punch and synergy. The niche and novel products, which are available in even medium/small insurance markets in even developing countries, are not available to insuring fraternity in India.

The open market scenario will be better appreciated and availed by the insuring fraternity only when Indian insurance market is fully liberalised in true sense of the term – on both Pricing and Product fronts.

Market watchers are upbeat about the future of insurance industry in India. Now is the time for all the stakeholders to adopt participative approach to take the industry to greater heights through profitable sustainable future growth.

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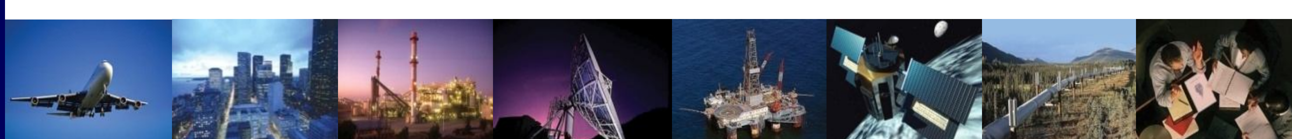

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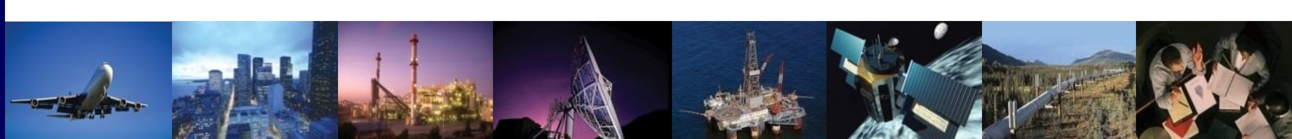

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