Chapter 1

Growth of insurance industry

1.1 Introduction

The beginnings of the insurance industry in India date back to the nineteenth century when the first life insurance company was established at Kolkata in 1818. Subsequently, the first general insurance company commenced operations at Kolkata in 1850. Over the years the industry expanded, with numerous entities operating in both life and general insurance segments. The insurance business is normally classified into two segments viz. life and non-life. General insurance is part of the non-life segment and refers to fire, marine and miscellaneous insurance. The term "miscellaneous insurance" includes engineering, motor vehicle insurance, health insurance, etc. Significant milestones in the development of the insurance sector are described in Box 1.1.

Box 1.1

Insurance in India: Milestones

- 1938- Enactment of the Insurance Act, 1938, replaced earlier legislation and consolidated the law relating to both life and general insurance.
- 1956- Nationalization of the life insurance business by enactment of the Life Insurance Corporation Act, 1956.
- 1968- Amendment of the Insurance Act, 1938 providing for, the establishment of the Tariff Advisory Committee (TAC) to fix, control and regulate premium rates and conditions of policies.
- 1971- The Central Government took over the management of general insurance companies under the General Insurance (Emergency provisions) Act, 1971.
- 1972- Enactment of the General Insurance Business (Nationalization) Act, 1972, paving the way for the formation of the General Insurance Corporation of India (GIC) along with its four subsidiaries viz. the United India Insurance Company (UIIC), the New India Assurance Company Limited (NIAC), the National Insurance Company Limited (NIC) and the Oriental Insurance Company Limited (OIC). These companies were given the exclusive privilege of carrying on general insurance business in India.
- 1994- The Committee, headed by Shri R.N. Malhotra, submitted its report on the structure of the insurance industry making significant recommendations like allowing domestic and foreign operators entry into the sector and setting up an independent insurance regulatory authority.

- 1999- The Insurance Regulatory and Development Authority (IRDA) Act, 1999 was enacted with the objectives of protecting the interests of holders of insurance policies and to regulate, promote and ensure the orderly growth of the insurance industry. The IRDA Act also amended the Life Insurance Corporation Act, 1956 and the General Insurance Business (Nationalization) Act, 1972, withdrawing the exclusive privilege of the LIC and GIC and its subsidiaries of carrying on life and general insurance business.
- 2002- The General Insurance Business (Nationalization) Act, 1972 was amended. Consequently, the four subsidiary companies of GIC became independent companies wholly owned by the Government of India. The role of GIC was restricted to the business of reinsurance.

1.2 Legislative and regulatory framework

The Insurance Act, (the Act) 1938, which came into effect from 1 July 1939, was the cornerstone of the legislative framework underpinning the insurance industry in India. The Act consolidated and amended the law relating to the insurance business, both life and general insurance and increased the supervision of all entities engaged in the insurance business. The Act established the control of the Central Government over the conduct of insurance business in India and created the office of the Controller of Insurance.

The Act contains provisions for regulating the following aspects of the functioning of insurance companies:

- Investments,
- Managerial Expenses,
- Registration, licensing and remuneration of agents and other intermediaries,
- Solvency margins,
- Receipt of premium and inception of risk,
- Reinsurance, and
- Annual accounts and audit.

The Act was amended in 1968 to establish greater control on assets and investments as also to regulate tariffs, through the medium of the TAC which was established to regulate the rates, the advantages, terms and conditions that could be offered by insurers in respect of general insurance business.

Marine (Cargo) and Marine (Hull) tariff was deregulated from 1 April 1994 and 1 April 2005, respectively. However, a significant development in the insurance industry was the removal of tariffs with effect from 1 January 2007. Subsequently, tariffs have been entirely deregulated with effect from 1 January 2008 with the exception of Motor Third Party premium. The current de-regulated scenario would lead to considerable change in the insurance markets.

With the enactment of the IRDA Act, 1999 and the changing environment of the insurance industry, the IRDA now performs the functions earlier vested with the Controller of Insurance. In pursuance of its primary objectives of regulating, promoting and ensuring the orderly growth of the insurance industry as also protecting the interest of policy holders, the IRDA issued various Regulations relating to specific aspects of the insurance business. The details of Regulations issued are contained in Annexure I.

1.3 Insurance industry in India

When the IRDA Act was enacted in 1999, there was only one life insurer viz. LIC and five public sector non-life insurers. In addition, there was one specialised institution - Export Credit Guarantee Corporation of India. However, by August 2007, there were sixteen life insurers and fifteen non-life insurers in operation (Box 1.2). This is indicative of the change that has swept the insurance sector in the past few years. (The GIC is now only involved in the reinsurance business as the national reinsurer or "National Re").

Box 1.2

Life insurers	Non-Life insurers
Bajaj Allianz Life Insurance Company Limited	Bajaj Allianz General Insurance Company Limited
Birla Sun Life Life Insurance Company Limited	ICICI Lombard General Insurance Company Limited
HDFC Standard Life Insurance Company Limited	IFFCO Tokio General Insurance Company Limited
ICICI Prudential Life Insurance Company Limited	National Insurance Company Limited
ING Vysya Life Insurance Company Limited	The New India Assurance Company Limited
Life Insurance Corporation of India	The Oriental Insurance Company Limited
Max New York Life Insurance Company Limited	Reliance General Insurance Company Limited
Met Life India Insurance Company Limited	Royal Sundaram Alliance Insurance Company Limited
Kotak Mahindra Old Mutual Life Insurance Limited	Tata AIG General Insurance Company Limited
SBI Life Insurance Company Limited	United India Insurance Company Limited
Tata AIG Life Insurance Company Limited	Cholamandalam MS General Insurance Company Limited
Reliance Life Insurance Company Limited	HDFC-Chubb General Insurance Company Limited
Aviva Life Insurance Company Limited	Export Credit Guarantee Corporation of India Limited
Sahara India Life Insurance Company Limited	Agriculture Insurance Company of India Limited
Shriram Life Insurance Company Limited	Star Health and Allied Insurance Company Limited
Bharti Axa Life Insurance Company Limited	

(IRDA website)

However, considerable potential for growth existed given the current levels of general insurance density and insurance penetration in India, in comparison to global levels. Insurance density is the percentage of premium to total population while insurance penetration is an expression of the ratio of total premium to Gross Domestic Product (GDP). The Table 1.1 indicates the comparative figures.

Table 1.1

Year-wise comparison – general insurance density and insurance penetration

Year	Insurance density		Insurance penetration	
	World	India	World	India
2003	202.5	3.5	3.48	0.62
2004	220.0	4.0	3.43	0.65
2005	219.0	4.4	3.18	0.61

(IRDA Annual Reports)

While there had been a steady growth in premium income for the four public sector insurers in the four years up to 2006-07 there was a decline in market share, with the entry of private insurers. This is illustrated in Table 1.2.

Table 1.2

Public Sector Insurers' premium growth and declining market share

(Rs. in crore)

Year	Total premium	PSU	Percentage to total premium	Private	Percentage to total premium
2003-04	15595	13337	85.52	2258	14.48
2004-05	17481	13973	79.93	3508	20.07
2005-06	20359	14997	73.66	5361	26.34
2006-07	25003	16286	65.13	8717	34.87

(Annual Report of IRDA/Report Card March 2007)

1.4 Performance of the Public Sector General Insurers

The overall performance of the four public sector general insurance companies were assessed using certain key indicators like the retention ratio, the incurred claims ratio, operating profits or losses in different business segments as also the costs of procuring business which is represented by commission payouts. These indicators are briefly discussed below.

The Insurance companies pass on or cede a part of the risk covered by them to reinsurers. For this protection, a pre-determined portion of the premium is ceded to the reinsurers. Similarly, companies accept part of the risk of other insurers for which they receive a pre-determined portion of the premiums of the ceding companies called "acceptances". The portion of the premium that relates to the accounting year is known as net earned premium. The retention ratio measures the premium retained by the insurer after cessions to reinsurers, to the gross premium, which includes acceptances. Table 1.3 gives details of gross premium received, net earned premium and the retention ratios.

Table 1.3: Public Sector Insurers' gross premium receipt and retention

(Rs. in crore)

	2002-03	**2003-04**	**2004-05**	**2005-06**	**2006-07**
Gross Premium including acceptances					
NIA	5083	5146	5418	6008	6405
NIC	2976	3469	3906	3636	3880
UIIC	3095	3164	3045	3217	3573
OIC	2990	3009	3196	3691	4128
GIC*	4515	4641	5122	4881	7404
Net Earned Premium					
NIA	3297	3589	3767	4121	4535
NIC	1966	2388	2664	2763	2768
UIIC	2109	2137	2163	2194	2373
OIC	1856	1972	2123	2356	2691
GIC*	3186	3992	4374	4459	5264
Retention Percentage (Net Premium divided by Gross Premium including acceptances)					
NIA	73	74	76	77	80
NIC	74	74	74	76	75
UIIC	70	70	73	71	72
OIC	66	70	72	69	72
GIC*	85	90	90	87	87

**** represents premium on reinsurance accepted***

The net incurred claims represent the claims paid and payable that had not been ceded to reinsurers. The net incurred claims ratio indicates the extent to which the 'net premium' is to be applied to meet this obligation and is a measure of the risk retained by the insurer. This enables an assessment of profitability of underwriting operations and reinsurance arrangements. The Incurred Claims Ratio (ICR) of the five companies, over the five year period ending March 31 2007, is given in Table 1.4.

Table 1.4: Public Sector Insurers' incurred claims ratio

(Rs. in crore)

	2002-03	2003-04	2004-05	2005-06	2006-07
Net Incurred claims					
NIA	2699	2713	2905	3632	3644
NIC	1620	2110	2263	2830	2394
UIIC	1905	1842	1998	2043	2142
OIC	1466	1588	1908	2065	2359
GIC	2744	2895	3703	4573	3622
Net Incurred claims percentage to Net Earned premium					
NIA	82	75	77	88	80
NIC	82	88	85	102	86
UIIC	90	86	92	93	90
OIC	79	80	90	87	88
GIC	86	73	85	103	69

The cost of procuring business had registered a steady increase over the last five year ending 2006-07. Commission expenses of all four companies had risen, reflecting the current competitive nature of the insurance markets as indicated below:

Table 1.5: Public Sector Insurers' commission expenses

(Rs. in crore)

	2002-03	2003-04	2004-05	2005-06	2006-07
Commission					
NIA	418	453	529	611	607
NIC	199	245	273	296	315
UIIC	167	202	203	244	266
OIC	151	192	228	280	302
GIC	NIL	NIL	NIL	NIL	NIL

The operating results of the companies, in different business segments, are detailed in Table 1.6. It will be noted that the miscellaneous segment, which includes the Motor portfolio, continued to register negative or poor results. This was attributed to the high incidence of claims in the Motor Third Party business.

Table 1.6: Operating Profit/Loss (Net of income from investments)

(Rs. in crore)

Company/ Business segment	2002-03	2003-04	2004-05	2005-06	2006-07
NIA					
Fire	32	167	107	-155	17
Marine	45	52	4	-16	35
Misc.	-639	-907	-793	-1072	-708
Net operating profit	-562	-688	-682	-1243	-656
NIC					
Fire	133	147	98	-34	48
Marine	-2	74	0	-5	-38
Misc.	-432	-748	-633	-1050	-618
Net operating profit	-301	-527	-535	-1089	-608
UIIC					
Fire	139	150	111	27	-69
Marine	38	8	-15	-16	-53
Misc.	-619	-702	-841	-943	-648
Net operating profit	-442	-544	-745	-932	-770
OIC					
Fire	127	76	53	-26	81
Marine	8	18	-14	-18	-53
Misc.	-384	-556	-649	-634	-564
Net operating profit	-249	-462	-610	-678	-536
GIC					
Fire	110	276	61	-85	-182
Marine	-6	-6	-90	-60	-172
Misc.	-593	-289	-542	-1117	275
Net operating profit	-489	-19	-571	-1262	-79

Income from Investments is the critical source of revenue for all the companies and accounts for their overall profits, as evidenced from Tables 1.7 and 1.8.

Table 1.7: Income from investments and other income

(Rs. in crore)

Company	2002-03	2003-04	2004-05	2005-06	2006-07
NIA	805	1030	1128	1422	1557
NIC	419	508	505	606	627
UIIC	545	676	742	858	864
OIC	413	536	741	642	735
GIC	844	1033	1158	1225	1309

Table 1.8: Profit before tax

(Rs. in crore)

Company	2002-03	2003-04	2004-05	2005-06	2006-07
NIA	313	648	798	856	1614
NIC	139	73	141	-60	456
UIIC	214	393	318	453	520
OIC	176	454	472	334	630
GIC	343	1277	800	443	1790

1.5 Combined Ratio

The Insurance companies publish various performance indicators/ratios in their Annual Reports to facilitate appreciation of their overall performance. The Combined Ratio correlates expenses of management and claims paid out to the gross premium earned. The ratio reveals whether premium earned was adequate to meet expenses of management and claim payouts. The ratios as computed and reported by the Companies for the period 2002-2003 to 2006-2007 are detailed in Table 1.9:

Table 1.9: Details of Combined Ratios

(Figures in percentage)

Company	2002-03	2003-04	2004-05	2005-06	2006-07
NIA	75	82	80	87	81
NIC	81	99	98	115	107
UIIC	91	93	106	127	116
OIC	87	97	102	121	99

$$\textbf{Combined Ratio} = \frac{\textbf{Expenses of Management + Claims paid}}{\textbf{Gross Premium (Direct)}}$$

However, while computing expenses of management, commission paid is not included though it represents the cost of procurement of business. Sec. 40C of the Insurance Act, 1938, while prescribing limits on expenses of management, includes commission as part of expenses. Such inclusion of commission is also standard international practice. A more accurate picture would emerge if commission pay out is also taken into account while computing the combined ratio as given in Table 1.10.

Table 1.10: Details of Combined Ratios after considering commission paid

(Figures in percentage)

Company	2002-03	2003-04	2004-05	2005-06	2006-07
NIA	72	93	92	100	102
NIC	96	100	104	122	114
UIIC	98	101	117	134	122
OIC	97	99	97	109	94

$$\textbf{Combined Ratio} = \frac{\textbf{Expenses of Management + Claims paid + Commission}}{\textbf{Total Premium (including acceptances)}}$$

When the combined ratio exceeds 100 *per cent*, the implication is that the company had, during the year, not been able to raise adequate earnings to meet these expenses. It will be seen that NIC and UIIC consistently suffered operating losses for three years. The four PSU insurers had operated on low margins or at a loss during the five years.

The pre-tax profits have largely been generated by income from investments. The inadequate operating profits would indicate that either premia were inadequate or efforts to contain expenses of management need to be strengthened.

1.6 Scope and objectives of the performance audit

A performance audit was undertaken between March and August 2007, focusing on the operations and performance of the public sector insurance companies viz, NIA, UIIC, NIC and OIIC and the designated Indian reinsurer, the GIC.

The performance audit was limited to four specific aspects of the functioning of the public sector insurance companies viz Motor Third Party claims, reinsurance, claims settlement and grievance redressal procedures, and agency and brokerage commission. In respect of GIC, acceptances and reinsurance arrangements were examined as the company undertakes only reinsurance business. The audit focused on transactions for the period 2004-2005 to 2006-2007.

The broad objectives of the performance audit were to assess and examine the effectiveness of systems established by the companies for:

- reinsurance operations which ensured mitigation of losses and improve underwriting capacity;
- mitigation of losses in Motor Third Party claims;

- settlement of claims and grievance redressal, thereby enhancing customer satisfaction; and

- compliance with the procedures and regulations governing payments to intermediaries like brokers and agents.

While the broad objectives of the audit have been outlined above, specific audit objectives for each of the four areas reviewed and examined are discussed in the appropriate chapters.

Entry conferences were held with the senior management of all five companies in March, 2007, where the scope and objectives of the audit were explained to them. Ministry of finance had forwarded the replies of the Companies on 10 January 2008. Detailed discussions on the audit findings and recommendations were held with the Ministry of Finance and the senior management of the companies on 24 January 2008**.** The view point of the Ministry/Companies have been considered and included appropriately at the time of finalisation of this Report.

1.7 Audit methodology

The four general insurance companies have a national presence and widespread operations. Each company has several regional offices, which control divisional offices and branch offices. In order to ensure a representative sample, random sampling was adopted for selecting divisional offices, adopting the ICR as the criterion. Where divisional offices had branches, one branch was covered in this audit. In all, 32 regional offices, 160 divisional offices and 128 branch offices of the four companies were audited. Audit of reinsurance activities was conducted at the GIC and the Head Offices of the four general insurance companies. The details of the units audited are given in Annexure II.

1.8 Audit criteria

While conducting the audit, the criteria applied included the companies' own policies, guidelines and operating procedures. In addition, the operations of the companies were also examined with reference to the Regulations issued by the IRDA, governing specific aspects of the insurance business.

Cases and records, pertaining to the period under review, were selected using sampling techniques. The databases of the companies were directly queried, certain data extracted and analysed, as appropriate. The audit methodology and the sample size are detailed in Annexure III.

1.9 Acknowledgement

The assistance and cooperation extended to audit by the Management and staff at various levels of the five companies is acknowledged.