GROWTH PROSPECTS OF INSURANCE SECTOR WITH SPECIAL EMPHASIS ON ULIP

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ABSTRACT:

The increasing level of terror attacks, fast paced modern lifestyle and natural calamities has created a high level of uncertainty and apprehensions about the future and what it holds for the individual. The chances of a fatality or an injury may not be particularly high but then no one can really afford to completely discount its impact. This has led to the growing need for insurance. With the opening up of insurance sector in the post liberalization era and increase in literacy rates, the awareness for insurance has increased. The marketing strategies and increased level of advertisement has helped the sector to grow in prominence.

Objectives of the study:

1) *To study the region- wise growth of the insurance sector.*
2) *To study the insurance penetration and density in India.*
3) *Current trends in insurance in India.*

Methodology:

The data will be collected from secondary sources, namely

1) *Internet*
2) *Books and magazines*
3) *Newspapers*

Expected findings:

1) *Penetration of insurance in India*
2) *Popularity of ULIPs and its depth.*

Key words:
Insurance penetration, life insurance, unit linked insurance plans.

INTRODUCTION

In India, insurance has a deep-rooted history. It finds mention in the writings of Manu (*Manusmrithi*), Yagnavalkya (*Dharmasastra)* and Kautilya (*Arthasastra)*. The writings talk in terms of pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine. This was probably a pre-cursor to modern day insurance. Ancient Indian history has preserved the earliest traces of insurance in the form of marine trade loans and carriers' contracts. Insurance in India has evolved over time heavily drawing from other countries, England in particular.

The Indian Life Assurance Companies Act, 1912 was the first statutory measure to regulate life insurance business. In 1928, the Indian Insurance Companies Act was enacted to enable the Government to collect statistical information about both life and non-life business transacted in India by Indian and foreign insurers including provident insurance societies. In 1938, with a view to protecting the interest of the insured public, the earlier legislation was consolidated and amended by the Insurance Act, 1938 with comprehensive provisions for effective control over the activities of insurers.

The Insurance Amendment Act, 1950 abolished 'Principal Agencies'. However, there were large number of insurance companies and the level of competition was high. There were also allegations of unfair trade practices. The Government of India, therefore, decided to nationalize insurance business.

An Ordinance was issued on 19th January, 1956 nationalizing the Life Insurance sector and Life Insurance Corporation of India came into existence in the same year. The LIC absorbed 154 Indian, 16 non-Indian insurance companies as also 75 provident societies—245 Indian and foreign insurance companies in all. The LIC had monopoly till the late 1990s when the Insurance sector was reopened to the private players. The process of **re-opening of the sector** had begun in the early 1990s. In 1993, the Government set up a committee under the chairmanship of Mr. R N Malhotra, former Governor of RBI, to propose recommendations for reforms in the insurance sector. The objective was to complement the reforms initiated in the financial sector. The committee submitted its report in 1994 wherein, among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies should be allowed to enter by floating Indian companies, preferably a joint venture with Indian partners.

Following the recommendations of the Malhotra Committee report, the Insurance Regulatory and Development Authority (IRDA) was constituted in 1999 as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000. The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial stability of the insurance market.

The IRDA opened up the market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26%. The Authority has the power to frame regulations ranging from registration of companies for carrying on insurance business to protection of policyholders' interests.

As on 1st June 2009 there are 21 general insurance companies including the ECGC and Agriculture Insurance Corporation of India and 21 life insurance companies are operating in the country.

INSURANCE PENETRATION AND DENSITY:

Insurance has a big potential in India, given a large population and untapped markets especially the rural areas. The life insurance business (measured in the context of first year premium) registered a growth of 23.88% in 2007-08 (94.96% achieved in 2006-07) the general insurance business (gross direct premium) has registered a growth of 11.72% in 2007-08 (3.52% achieved in 2006-07). This has resulted in increasing insurance penetration in the country.

Insurance penetration or premium volume as a ratio of GDP was less than 1% till 1990-91 in India. During the 1990s, it was between 1% and 2%. In 2005 it had increased to 2.53%. The impetus for this growth has come from both the public and private insurers. This further increased to 4% in 2007. The level of penetration particularly in life insurance tends to rise as income levels increase. India with its huge middle class households has exhibited growth potential for the insurance industry. Saturation of markets in many developed economies has made the Indian market even more attractive for global insurance majors. The insurance market in India has witnessed dynamic changes including entry of a number of global insurers in both life and non-life segment.

Table 1

Insurance penetration of select countries for 5 years

Countries	2007	2006	2005	2004	2003
United States	4.2	4	4.14	4.22	4.38
United Kingdom	12.6	13.1	8.9	8.92	8.62
WORLD	4.4	4.5	4.34	4.55	4.59
India	4	4.1	2.53	2.53	2.26
China	1.8	1.7	1.78	2.21	2.3

Source: www.swissre

Note: Data relates to calendar year

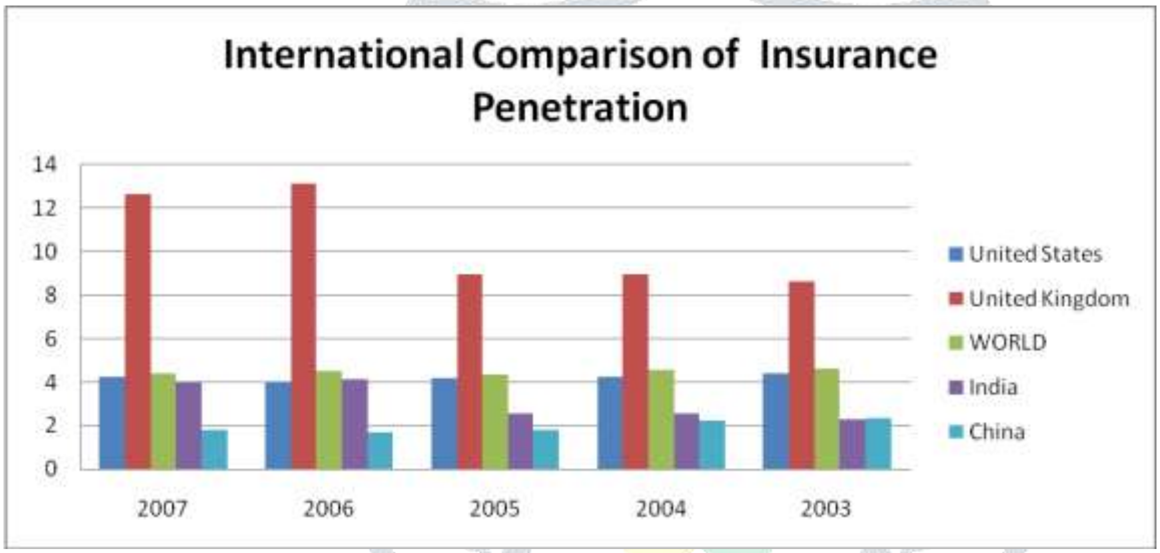

Figure 1: International comparison of Insurance Penetration

Insurance density is measured as ratio of premium (in US Dollars) to total population. Thus, it shows the per capita premium.

Table 2

Insurance density of select countries for 5 years

Countries	2007	2006	2005	2004	2003
United States	1922	1789.5	1753.2	1692.5	1657.5
United Kingdom	5730.5	5139.6	3287.1	3190.4	2617.1
WORLD	358.1	330.6	299.5	291.5	267.1
India	40.4	33.2	18.3	15.7	12.9
China	44.2	34.1	30.5	27.3	25.1

Source: www.swissre.com

Note: Data relates to calendar year

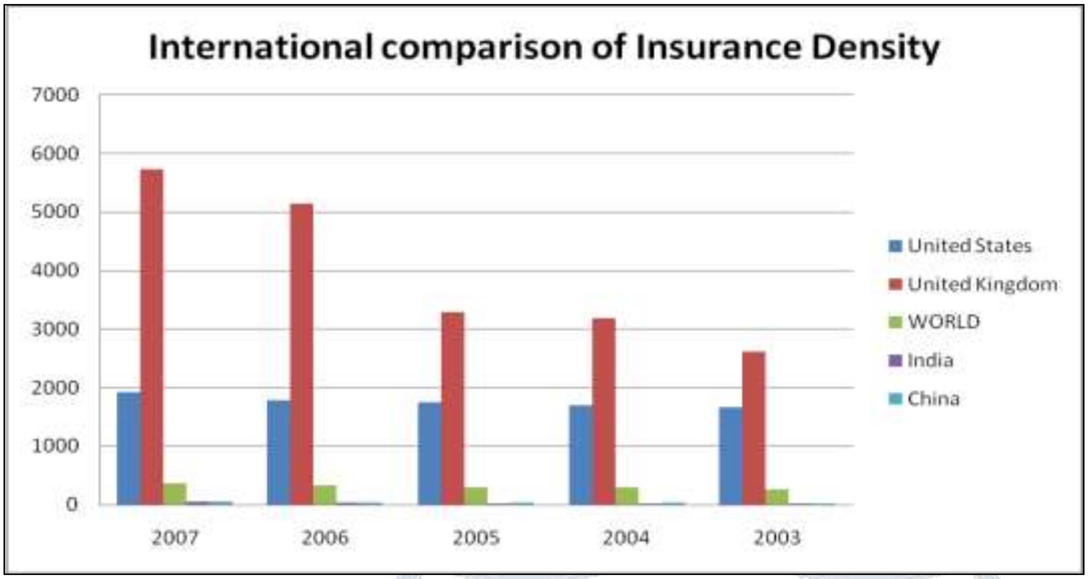

Figure 2: International comparison of insurance density

The premium density has increased rapidly from 12.9 in 2003 to 40.4 in 2007 indicating increase of 213% over 2003 figures. Even though this shows a healthy percentage, as compared to the world averages it is very less. This shows the potential for life insurance companies to do business in India and capture a wider market share.

GROWTH OF INSURANCE – WORLD:

The **insurance sector is a colossal one** and is growing at a speedy rate of 15-20%. Together with banking services, insurance services add about 7% to the country's GDP. A well-developed and evolved insurance sector is a boon for economic development as it provides long- term funds for infrastructure development at the same time strengthening the risk taking ability of the country.

Table 3

Global premium growth rates

Year	Real premium growth rates for life insurance	Year	Real premium growth rates for life insurance
1980	2.5%	1995	4.9%
1981	4.3%	1996	3.7%
1982	5.4%	1997	8%
1983	3.4%	1998	5.5%
1984	12%	1999	7.8%
1985	13.5%	2000	9.6%
1986	21.7%	2001	-1.4%
1987	12.4%	2002	2.9%

1988	13%	2003	-0.2%
1989	4.7%	2004	3.3%
1990	1.3%	2005	4.5%
1991	2.9%	2006	4.3%
1992	5.8%	2007	5.1%
1993	6.4%	2008	-3.5%
1994	4.2%		

Source: www.swissre.com

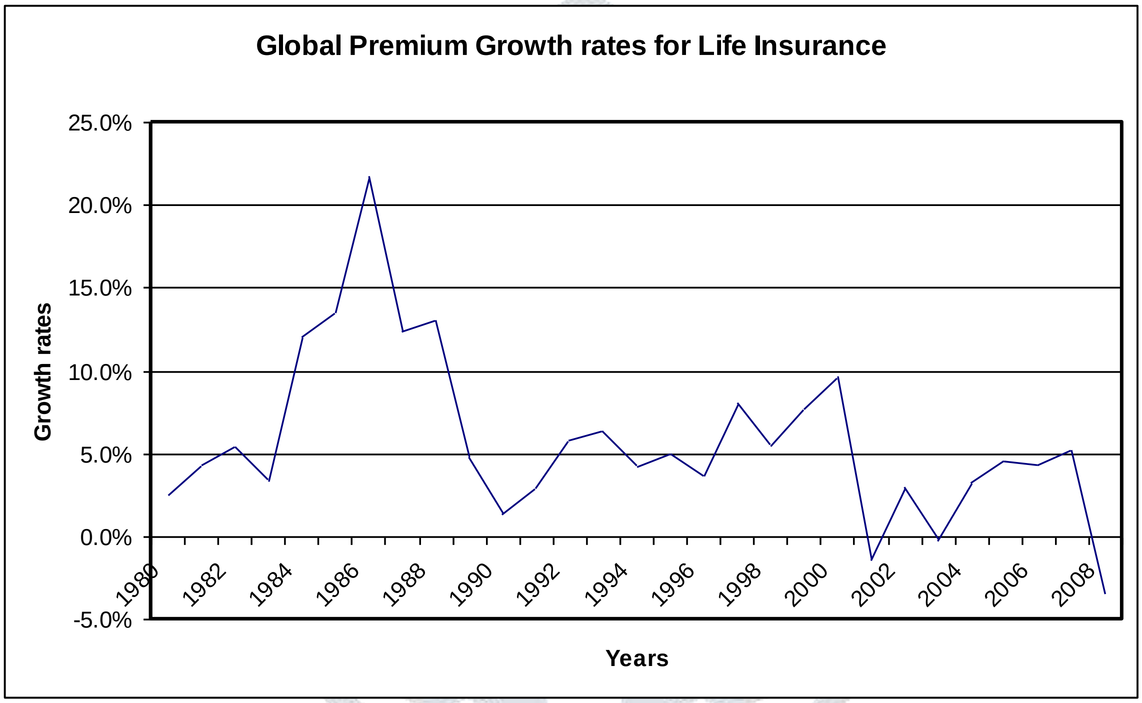

Figure 3: Global premium growth rates

Table 4

Region wise real growth rate – life insurance

Region	Growth rate 2007	Annual average growth rate 1997-2006	Growth rate 2008	Annual average growth rate 1998-2007
World	5.3%	4.3%	-3.5%	4.1%
Industrialized countries	4.6%	3.8%	-5.3%	3.6%
North America	5.3%	3.8%	-3.4%	3.6%
Western Europe	5.5%	6.9%	-11.6%	6.9%
Japan & newly industrialized Asian economies	1.8%	0.3%	5.2%	-0.8%
Oceania	7.9	1.6	7.6%	0.6%
Emerging markets	13.1	13.5	14.6%	13.2%
South and East Asia	16.8	19.3	19%	18.8%
Latin America and Caribbean	11.4	10.4	7%	9.8%
Central & Eastern Europe	17	7.6	18.7%	8.9%
Africa	3.4	7.5	5.5%	6.4%
Middle East & Central Asia	8.7	5.8	9.3%	6%

Source: www.swissre.com

The global recession has affected the insurance industry and there was a negative growth rate as can be observed from the statistics relating to year 2008. It greatly affected the industrialized nations where the life insurance business showed a negative growth rate of 5.3%. In North America it reduced by 3.4% and in Western Europe by 11.6%.

However, in South and East Asia the recession in fact consolidated the insurance industry where the business registered a growth of 19% in 2008 as compared to 16.8% in 2007. Similarly, the emerging markets have shown a growth rate of 13.1% in 2007 which increased further to 14.6% in 2008.

Table 5

Life insurance premium collected by top 10 countries in emerging markets in 2007

Countries	Premium volume (USD Million)	Share of emerging markets
China	58,673	26.4%
India	51,322	23.0%
South Africa	34,430	15.5%
Brazil	18,533	8.3%
Poland	7,950	3.6%
Mexico	7,653	3.4%
Malaysia	5,573	2.5%
Indonesia	4,728	2.1%
Thailand	4,521	2.0%
Chile	3,792	1.7%
Top 10 countries	197,177	88.6%
Others	25,488	11.4%

Source: National Insurance authorities, Swiss Re Economic Research and Consulting

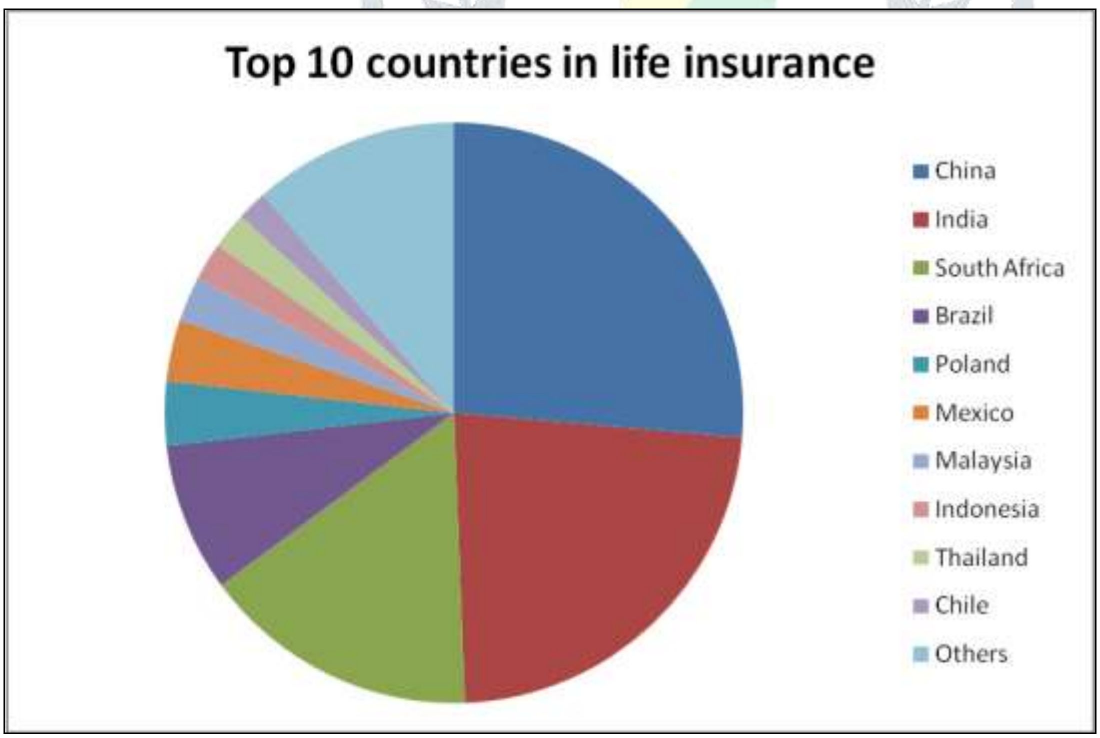

Figure 4: Share of Emerging markets in life insurance business

Around 50% of the business is generated in India and China. A huge population and a very low insurance penetration have attracted some of the major life insurance companies to set up ventures in these countries.

The Indian economy is the 12th largest in USD exchange terms as per World Bank. The GDP was pegged at 1217490 million US dollars. The crossing of Indian GDP over a trillion dollar mark in 2007 puts India in the elite group of 12 countries with trillion dollar economy. The tremendous growth rate has coincided with better macroeconomic stability. India has made remarkable progress in information technology, high end services and knowledge process services.

High GDP has led to increase the income levels and standard of living and consequently the savings of the household sector.

Table 7

Financial savings of the household sector for 4 years

	Percent of total financial savings			
	2004-05	2005-06	2006-07	2007-08
Currency	8.5	8.7	8.6	8.9
Deposits	37.2	47.1	55.7	47
Shares and Debentures	1.1	4.9	6.3	5.1
Claims on Government:	24.5	14.6	5.2	14.6
a) Investment in government securities	4.9	2.4	0.2	2.4
b) Investment in small savings	19.6	12.2	4.9	12.2
Insurance funds	15.7	14	15	14
Provident and pension funds	13	10.5	9.2	10.5
Total	100	100	100	100

Source: Reserve Bank of India Annual Reports from 2004-05 to 2007-08

Note: Components may not add up to the total due to rounding off.

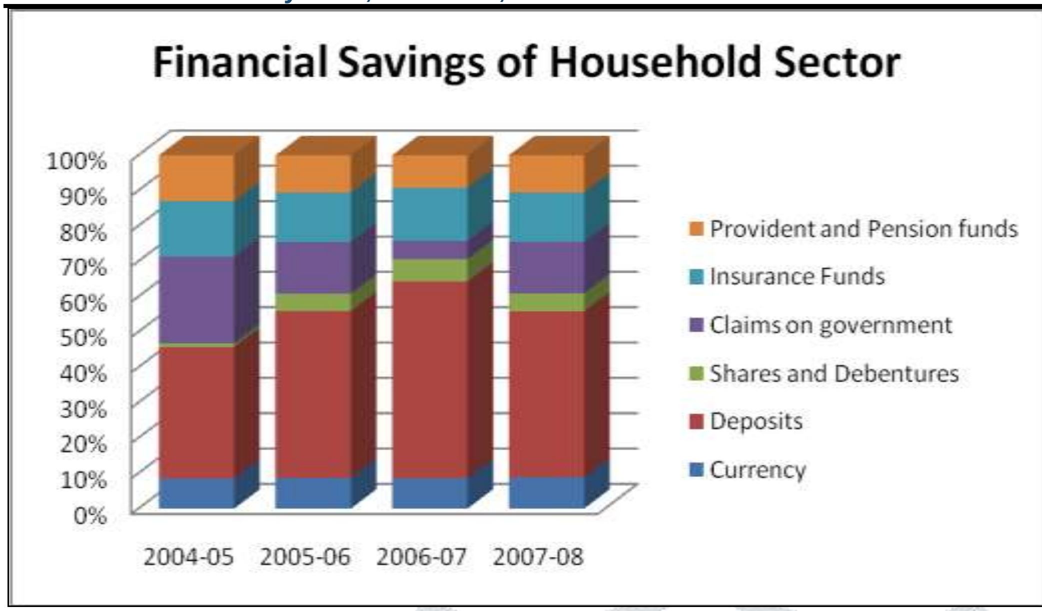

Figure 6: Financial savings of household sector

The household sector investment portfolio includes deposits, shares and debentures, government investments, insurance sector, provident and pension funds and the balance was retained as currency.

The savings of the household sector in financial assets was 10.2% in 2004-05 and 11.4% in physical assets. The corresponding figures for 2005-06 were 11.7% and 10.7%. In 2006-07 the share of financial assets came down to 11.3% while that of savings in physical assets went up to 12.5%. This level of physical assets was maintained in 2007-08.

It can be observed that households have shown an increasing preference for deposits in 2005-06 as its share has increased to 47.1% from 37.2% in 2004-05. This share went up further in 2006-07 to 55.7%

According to preliminary estimates released by RBI on household financial savings for 2007-08, insurance funds constituted 17.5% of the total gross financial savings of the households in 2007-08. This has resulted in an increase in the share of insurance funds in the total household savings. A similar increase was observed in mutual funds also. The above shift in the preferences towards insurance sector was mainly on account of the households preferring to invest in ULIPs. This was on account of bullish stock market as the returns of ULIPs depend on it. A similar observation can be made about the investments in mutual funds. It may be noted that during 2007-08, the BSE Sensex has given abnormal returns and the gains were across all the sectors.

GROWTH OF UNIT LINKED INSURANCE PLAN IN INDIA:

After opening up of insurance sector, ULIPs have become increasingly popular. ULIPs were so successful that insurance companies led the financial services industry in channelizing retail investments into equity.

In 2007-08 life companies pumped Rs. 55000 crore into equity, overtaking foreign institutional investors who made net investments of Rs. 53403 crore.[1]

Table 8

Bifurcation of life insurance business into unit-linked and non-linked business

	Unit-linked business (%)			Non-linked business (%)		
	2005-06	2006-07	2007-08	2005-06	2006-07	2007-08
Private	82.3	88.75	90.33	17.7	11.25	9.67
LIC	29.76	46.31	62.31	70.24	53.69	37.69
Industry	41.77	56.91	70.3	58.23	43.09	29.7

Source: IRDA Annual Report 2007-08

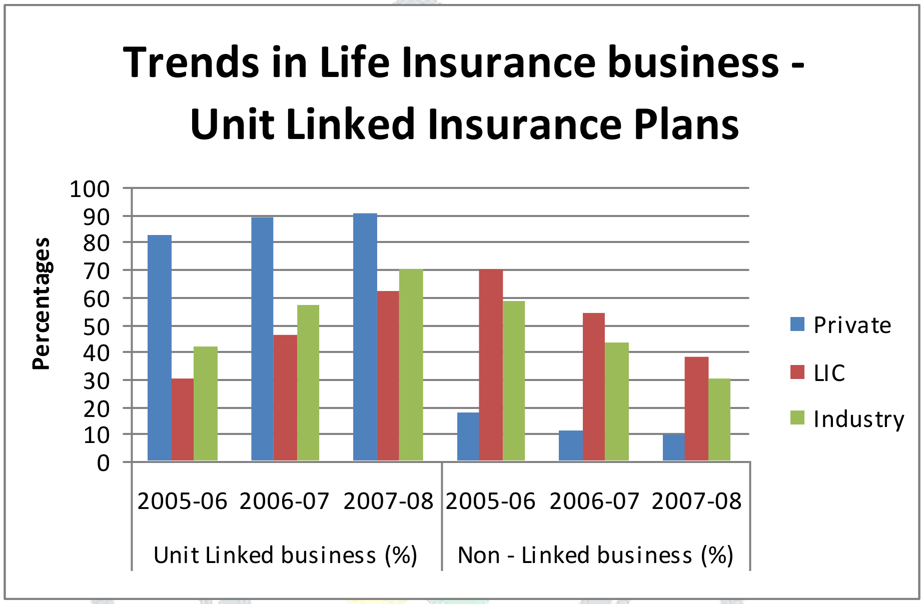

Figure 7: Bifurcation of life insurance business into unit-linked and non-linked business

The private life insurers have played a major role in increasing the popularity of linked plans. Of the total business, 82.3% was contributed by ULIPs and rest by way of traditional plans. They consolidated their position in 2006-07 by increasing it further to 88.75% and 90.33% in 2007-08.

LIC which predominantly sold the traditional plans had only 29.76% of its overall business coming from ULIP. However with the growing popularity they also introduced new policies which helped them to increase the share of linked business to 62.31% in 2007-08.

[1] ET Bureau, 'ULIPs to be more transparent', in The Economic Times, 12 September 2008, viewed on 26 December 2009, <http://economictimes.indiatimes.com/personal-finance/Insurance-news/ulips-to-be-more-transparent/articlesshow/3473248.cms>

Thus for the industry as a whole the linked business accounted for around 70% of total business in 2007-08.

UNIT LINKED INSURANCE PLAN IN PRESENT SCENARIO:

The benchmark 30-share BSE index has rallied 104% from its low of 8160 in March 2009 to 16632 in November 2009.[2] The improving economic environment has increased the inflow in stock market. This will affect the insurance sector which is expected to get around Rs. 40000 Crores by way of renewal premium on various ULIPs over the coming months.

The industry collected Rs. 12698 Crores as renewal premium on ULIPs during the quarter ending 30th June 2009 against Rs. 8793 Crores in corresponding period last year as per estimates of LIC of India.[3] The renewal premium of ULIPs has witnessed a jump when the overall sector witnessed a slowdown in growth in terms of new premium collection. The sale of new ULIP products had dipped by about 10% during the period. This implies that even though new consumers are still wary of putting in money in ULIPs fearing volatility in stock markets, old ULIP customers are putting in more money. The policy holders have also began switching their funds from debt-based unit linked plans to equity plans when markets crashed. ICICI Prudential Life Insurance Co, Birla Sun Life reported large number of requests to switch to equity schemes. Besides new policies opting for equity schemes have recorded a sharp increase as reported by Bajaj Allianz Life Insurance Company. [4]

As of now, the ULIPs are promoted by the agents highlighting the premium paying term as 3 or 5 years although the premium paying term may be 15/20/25 years. According to Mr. Gaurang Shah, Managing Director, Kotak Life, "It's easier to sell if the prospects feel he is not being forced into a long term contract. The concept of being locked in for a long term and compulsion of regular premium payment is not very popular with customers".[5]

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[2] Anand Rawani, 'Rs. 40,000 cr likely to flow into bourses from ULIP', in The Economic Times, 6 December 2009, viewed on 27 December 2009, <http://economictimes.indiatimes.com/Rs-40000-cr-likely-to-flow-into-bourses-from-ULIP/articleshow/5306478.cms>.

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[4] TNN, 'ULIP holders switch from debt to equity after market crash', in The Economic Times, 24 January 2008, viewed on 26 December 2009, <http://economictimes.indiatimes.com/Markets/Analysis/Ulip-holders-switch-from-debt-to-equity-after-market-crash/articleshow/2726318.cms>.

[5] Vidyalaxmi, 'Between the agent and the ULIP', in The Economic Times, 7 October 2009, viewed on 25 December 2009 <http://economictimes.indiatimes.com/Markets/Analysis/Between-the-agent-and-the-ULIP/articleshow/5095817.cms>.

Technically the agents are stating facts it is the information which they withhold that causes the most damage. For example, the policy holder pays the premium for only 3 years but the insurance cover continues. All applicable charges are deducted from units available in the fund. However, this leads to reduction in rate of return in the long run if the policy holder has not yet withdrawn the money.

The returns increase with regular investment because the charges in subsequent years are lower. The charges are averaged out once the policy holder pays the premium over the full tenure of the policy.

The anomaly in the charges of ULIP of various life insurance companies has led IRDA to issue a circular on December 21, 2005 regarding various aspects of ULIP. Almost all insurance companies have a number of ULIPs and under each product there are various charges which are recovered from the contribution or fund value. In order to enable the customers to have a clear understanding of the product and to comprehend various features of ULIPs, it was decided by IRDA to prescribe one cap on all charges put together.

Taking this objective into mind, IRDA has prescribed the cap on charges. This cap is expressed in terms of the difference between gross and net yield to the customer. The net yield is the gross yield adjusted for all charges. For insurance contracts which are of a tenor of less than or equal to 10 years duration the difference between gross and net yield shall not exceed 300 basis points of which FMC shall not exceed 150 basis points. For other contracts, i.e. those whose contract period is above 10 years, the difference between gross and net yield shall not exceed 225 basis points, of which the FMC shall not exceed 125 basis points.

The cap on charges came into effect from 1st October 2009. All the existing products that do not meet the requirements of this circular should be withdrawn or modified by 31st December 2009.

CONCLUSION:

Insurance today is accepted as a default choice by most of the investors. The large number of companies in the market has helped in increasing the penetration and providing cover to large number of people's lives. However, there is a huge disparity over the number of people covered in urban and rural areas. The need of the hour is to take it to the grass root level and make it as popular as bank deposits/fixed deposits.

Over the years ULIP has emerged as a most favoured form of insurance. Its popularity has arisen on account of the fact that it combines the twin objective of insurance and investment. The recent cap on charges for ULIP will help in bringing uniformity across the plans of various insurance companies. This will take the penetration of ULIPs to the next level.

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