# NATIONALISED INSURANCE

## POLICIES & STRATEGIES FOR THE '90S

By

R. K. DARUWALLA

1988

*Published by*

THE A. D. SHROFF MEMORIAL TRUST

235 Dr. D. N. ROAD,
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# THE A. D. SHROFF MEMORIAL TRUST

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## OBJECTIVES

(i) Publication of one or more books in English, Hindi, and regional languages annually on some of the great builders of Indian economy aimed primarily at educating the younger generation in high standards of building the national economy as practised by those great entrepreneurs and placing the example of their lives for emulation by India's youth.

(ii) Organising one or more memorial lectures annually on subjects which were of interest to the late Mr. A. D. Shroff, namely, banking, insurance, and industrial finance, the subjects to be chosen in rotation, and the lectures to be delivered by persons eminent in these fields.

(iii) Awarding annual scholarship or scholarships to outstanding student or students in the field of management.

(iv) Instituting a prize to be known as The A. D. Shroff Memorial Prize for the student standing first in Banking at the Sydenham College of Commerce, Bombay.

(v) Doing all such acts, matters and things as are incidental or conducive to the attainment of the above aims or objects or any one or more of them; and

(vi) Without prejudice to the above charitable objects or any of them, the TRUSTEES shall have the power to spend, utilise and apply the net income and profits of the TRUST FUND for the TRUST FUND for the charitable object of education or such other objects of general public utility not involving the carrying on of any activity for profit as the Trustees may think proper, it being the intention of the SETTLOR that the income and/or corpus of the Trust Fund shall be utilised for all or any of the aforesaid charitable objects without any distinction as to caste, creed, or religion.

# INTRODUCTION

The A. D. Shroff Memorial Trust arranges every year a public lecture on Insurance, Banking and Industrial Finance, by turn, since the late A. D. Shroff accomplished a great deal in these three areas during his lifetime.

The Trust was fortunate to have Mr. R. K. Daruwalla, former Chairman of General Insurance Corporation of India, to deliver a lecture on "Nationalised Insurance — Policies and Strategies for the 90s" on 28th April 1988 in Bombay. It was a very perceptive lecture containing frank and honest expression of Mr. Daruwalla's valuable views on various aspects. With his experience of over 45 years in the insurance industry, he gave several practical suggestions to make nationalised insurance more meaningful to a large number of people and more conducive to national economic development.

The text of Mr. Daruwalla's lecture is published as a booklet for the benefit of the public. It is hoped that the booklet will be useful to policymakers, high-ranking officials in insurance industry and to students of economic development.

N. A. Palkhivala,

Chairman,

The A. D. Shroff Memorial Trust.

Bombay

Dated : 10th June 1988

## A. D. SHROFF
## (1899-1965)

A. D. Shroff's achievements in the field of business, industry and finance were many and varied. A large number of enterprises owe their origin and development to him. As an economist, his predictions have proved right over the years. Through the Forum of Free Enterprise, which he founded in 1956, as a non-political, educative organisation, he sought to educate the public on economic affairs. It was his firm conviction that a well-informed citizenry is the foundation of an enduring democracy.

George Woods, former President of the World Bank, paid the following tributes to A. D. Shroff:

> "In every age and in every society men must express anew their faith in the infinite possibilities of the human individual when he has freedom to develop his creative talents. For this is in large part how the message of freedom is passed from generation to generation. A. D. Shroff spoke eloquently in a great tradition, and thanks to him we can be sure that other great men of India will continue to speak this message in the unknown context of our future problems."

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By

R. K. DARUWALLA*

I am thankful to the Board of Trustees of the A. D. Shroff Memorial Trust and especially its Chairman, the eminent Jurist, Mr. N. A. Palkhivala, for having invited me to deliver this year's public lecture related to Insurance. I cannot claim to have been associated with the late Mr. A. D. Shroff, but having been with the New India Assurance Co. Ltd., from 1943, I must say, I have known him and felt the impact of his presence as Chairman of the Company. It cannot be denied that the late Mr. A. D. Shroff played an important part in the development of the insurance industry in India and in this I must couple the name of Mr. B. K. Shah.

Life insurance business in India was nationalised in 1956 followed by nationalisation of general insurance business in 1971. Over this period, both the Life Insurance Corporation of India (LIC) and the General Insurance Corporation of India (GIC) have made

* Based on the annual public lecture under the auspices of The A. D. Shroff Memorial Trust delivered by Mr. R. K. Daruwalla in Bombay on 28th April 1988. The author is a former Chairman of the General Insurance Corporation of India.

rapid progress in their respective insurance fields. Both of them have a very important role to play in the national economy. They both are a very essential adjunct in the life of the nation, its finance, trade and commerce and it is necessary to see that they play this vital role effectively and efficiently. The 80s will soon come to a close. It is now time for the Government, the LIC and the GIC to plan for the 90s with a view to entering the 21st Century. The planning should consider what policies and strategies should be adopted so that nationalised insurance enures to the benefit of the nation — the common man who needs various types of insurance cover, the businessman who needs cover for his business activity, the wage earner who needs protection against loss of retirement benefit due to the failure of business activity, the farmer who needs protection from the ravages of nature and so on.

I thought that I would put down my thoughts on this subject so as to create a public debate. Let me mention that some of the issues I have touched upon have been raised in the past. I must admit that I have left many posers unanswered. Perhaps the industry and the Government are better placed to find solutions. Before I go to the specifics for the two branches of the insurance industry, I thought I would place before you some thoughts I came across of what is expected of the ideal insurance industry.

The insurance industry has to be a service oriented industry selling protection and in the case of life savings too. It must explore every avenue to fulfil its primary aim of selling protection and savings.

The manner of providing protection has to be diverse and meet the different needs of the buyers. The industry must cater to the needs of every class, occupation and geographical region in the country. Further, protection must be offered in such a way as to be convenient and economical. Where needed to meet customer requirements, the covers should be tailor-made.

In the drafting of various types of policies, clauses and conditions, the concept of maximum consumer protection must be kept uppermost in mind. The clauses should be in simple language and easily understood by the public.

Outdated underwriting norms, prejudices and procedures should not govern the industry and administrative procedures should be consumer responsive. Efficient and speedy service to clients should not suffer at the hands of audit or vigilance. In servicing and settling claims, the human or personal touch must ever prevail. I am sure that LIC and GIC will take this challenge and see that Indian insurance industry does measure upto these ideal norms.

# I

# GENERAL INSURANCE

The General Insurance Corporation of India (GIC) was set up in 1972 as the holding company of the four nationalised insurance companies which started operation from 1st January, 1973. These four subsidiaries of GIC operate all over the country competing with one another and underwriting various classes of general insurance business including reinsurance, except for aviation insurance of the two national airlines and crop loan insurance which business is handled by the GIC. The purpose of setting up the four companies was to inject an element of competition — competition in the matter of service to the clients and innovative approach to new insurance covers.

It is not the purpose of this paper to consider the merits/demerits of nationalisation but I do wish to make a mention of one aspect. If I were asked to single out the most outstanding gain of nationalisation of general insurance, I would say it was the consolidation of business and its people. This has helped the GIC to obtain very favourable terms and conditions on their reinsurances placed abroad, to underwrite very large risks with comparative ease and retain much higher amount of risk on their business, made them financially very sound and above all it has made the insurance and reinsurance companies and brokers the world over to recognise the potential of the general insurance industry in India.

Pardon my mentioning something which this august gathering must already be knowing. The term general insurance encompasses all types of insurance business other than life insurance and annuity business and, believe me, when I say that there are scores of classes of insurance business on the general side each with its own peculiarities and specialisation. Therefore, when we talk about general insurance, we are talking about a multitude of classes of insurance business, each class needing its own specialisation and expertise.

**Organisational Structure**

In 1973, the first year of nationalisation of general insurance, the gross direct premium of the industry in India was Rs. 184 crores. Over the last fourteen years, the industry has made great progress and the premium income for 1987 is placed at around Rs. 1535 crores. The investment income of the industry has risen from Rs. 20 crores in 1973 to Rs. 289 crores in 1986, and the profits before tax from Rs. 35 crores to Rs. 318 crores. The industry now employs close to 60,000 employees and has got an organisation network of nearly 3000 offices.

Over the last two decades, there have been tremendous technological changes all over the world and new large sophisticated risks have come up. India is no exception and we have seen large petrochemical complexes, nuclear risks, offshore oil installations, satelite risks and the like coming up in the country. The industry was required to provide on the one hand covers for these sophisticated and highly complex new risks and on the other, there was a demand for issue of various types of covers for non-traditional type of business like cattle insurance, poultry insurance, bore-well insurance and a host of other types of covers which have a rural bias.

The position today is that while the business is growing fast, the companies have to cater to the needs of a very vast clientele with differing needs.

The potential for general insurance business in the country is very great. Rapid industrial development is taking place, exports are increasing at a very fast rate, construction activity is booming, mass insurance covers for the rural sector of the economy is on the rise and the awareness of the public to the need for personal insurance in the urban areas is increasing. Also the industry has to lend its support to Government by introducing social security schemes for the benefit of the weaker sections of the society. I will not be surprised if by the middle of the next decade, general insurance industry will be writing a gross direct premium in India of nearly Rs. 4000 crores.

It is in this light I would like the GIC to examine whether the existing policy of allowing the four subsidiaries to write all classes of business serving all segments of the society is the best policy for the next decade and for the 21st Century, especially as when this policy was laid down general insurance was mostly selling only traditional covers to trade and industry. I would like them to consider whether this pattern is in the best interest of development of business; whether in would be in the best interest of the different groups and classes of the insuring public so that they are well served and at the cheapest cost; and finally, whether it is in the best interest of the industry itself and whether it will be possible to build up high degree of technical skills and expertise for each class of business which is so essential for this industry.

A word on the organisation structure of each company. This consists of the Head Office, Regional offices, Divisional offices and Branches. The development of business is through development staff who are on monthly remuneration basis as well as through agents on a commission basis.

It is my humble submission that the present policy of allowing the four subsidiaries to develop and underwrite all classes of insurance business to meet the needs of the different segments of our society which constitute the clientele of the industry, would need a change if the challenges of tomorrow have to be effectively met. The different segments of the society which the industry has to service can be broadly classified as —

(a) Commercial and industrial

(b) Trading and small business

(c) Urban personal line covers

(d) Rural and agricultural, and

(e) Government — in respone to social evolution and handling high risk/catastrophy prone developments in science and technology.

These segments have their individual challenges in respect of perception of risk, designing of covers and their wordings, marketing strategy and the technique for providing the customer service, particularly in the areas of loss assessment, loss prevention and claims settlement.

The reasons which prompt me to say a change is necessary are:

(a) Different segments of the society and different classes of business need different organisation and development structure. Rural non-traditional business if it has to be cost efficient does not need a regional or divisional office. The development of this business could be more effective through agents rather than through development staff and agents.

(b) The system of development of business through development staff where no agents are involved may be appropriate for commercial and industrial business. But where personal lines are involved, where premiums are small, the intervention of the development staff and agent is perhaps costly. For such class of business a new strategy is desirable.

(c) Dealing in all classes of insurance at one place puts too much strain on various levels in the organisation. By restructing the companies on a different basis a part of this strain can certainly be removed.

(d) I am not sure whether the system helps to develop technical expertise of a higher order in respect of such classes of business where the volume of business is small.

(e) There is a tremendous potential for general insurance business. It should not happen that the mere increase in the volume of business of the companies leads to loss of control or inefficiency.

I am of the view that the Rural and Agricultural segment and the Urban Personal Lines segment of the society should be serviced through separate companies.

**Rural and Agricultural Segment**

The rural and agricultural segment of insurance business should be handled through a separate company. And when I am talking of rural insurance business, I am not only referring to the non-traditional business like agricultural pump sets, cattle and other animals insurance, poultry, fish, honey bee, silkworm, dwelling huts and the like, but also traditional business found in rural areas like pedal cycles, personel accident, householders and shopkeepers comprehensive and a host of such other risks.

The compulsions, the area of operations and the set up needed for this type of business is different from the other classes of business. These policies will have very small premiums. The development of this business will have to be on a different basis. Perhaps for a lot of this business the mass or group concept is more appropriate.

I mentioned earlier that competition was the motive which prompted the setting up of four companies at the time of nationalisation. One would say that in this class of business too competition should exist but in a limited form. There is no question of competition in premium rates as this will be suicidal. This class of business has to be sold. New types of covers introduced, new ideas in marketing the business should be initiated. One may, therefore, say that, to this extent, there can be competition. Competition in the shape of more than one company operating in any one area does not have to exist. Since competition will help, I suggest that the GIC form four subsidiaries to transact all types of rural business. Each of these subsidiaries should have a defined territory for operation.

The responsibility for developing these subsidiaries will be with the lead insurance company for that area.

This approach will help in the development of rural insurance business in a big way. It will be possible for the rural subsidiary to pay its full attention to the business which is available for development. What is important, it would reduce a lot of work load and responsibility from the Regional and Divisional offices of the existing companies thereby enabling them to develop their traditional business more effectively.

A question may well be asked whether this class of business which at present is small in size would justify the formation of four subsidiaries and whether from a financial angle, these companies would be viable. I have suggested four subsidiaries so that one can be attached to each of the existing companies. Also it is better to have a regional approach for such business.

I do admit that there is a danger in the matter of financial viability of these companies. It is not expected that this class of business should produce any large profits. Today the losses, if any, of this class of business get hidden in the profits of the other portfolio. It has to be noted that these companies do not have to deal with other companies outside India as the business is of a nature where reinsurance facilities are not needed. So it matters little if there is an underwriting loss. The GIC should consider that they are rendering a much needed economic and social service for rural India. To see that these companies remain financially viable the GIC should provide them with a large capital base so that they have substantial investment income to support their underwriting losses, if any.

Here I may like to draw a parallel. When the Government wanted to start feeder airline services they had two options. Either to ask Indian Airlines to take over this responsibility or to form another company. They opted for Vayudoot, a separate company. To my mind the compulsions for setting up a separate organisation are similar.

**Urban Personal Lines Segment**

Whenever a tragedy like large scale riots, a devastating fire, a cyclone, flood, a rail accident or an event like the Bhopal Gas leak strikes, it is very agonising to discover that thousands of unfortunate people and their possessions were uncovered and unprotected. When insurance is considered as an instrument of financial security, the need to see that personal insurance covers of various types are sold to the public should be in the forefront of the tasks and challenges of tomorrow facing the GIC.

Personal insurance are of various type like householders comprehensive covering fire, theft, etc. of household goods, jewellery and valuables cover, personal accident cover, hospitalisation and medical cover, television cover, baggage cover, third party liability cover, Janata personal accident and the like.

The risk exposure to the individuals and the families in the urban areas has been changing dramatically. To identify risk exposures and provide economic protection to this class of people on a realistic appreciation of their needs — capable of being serviced in simple, flexible and expeditious manner is undoubtedly a formidable challenge.

For the GIC to meet this challenge the only way would be to set up a separate company whose function would be to develop personal lines of insurance in urban areas. This is not to suggest that the existing companies are to stop this class of business. Far from it. The new company will compete with the existing companies so that the five together will be able to cover as wide a population as possible.

I have suggested a separate company for this class of business for the following reasons:

(a) The company will be saddled with the limited responsibility of developing personal lines business in the urban areas thus focusing its entire attention only to this segment.

(b) The company can operate through a number of branch offices situated in essentially residential areas. There is no need of divisional or regional office.

(c) Development of this business should be entirely through full time agents on commission basis.

(d) The new company can start with all the modern aids so that servicing of the clients is very prompt and efficient.

The start can be made with the Metro cities and thereafter extended to other centres. I am sure this experiment will be a great success thus enabling the spreading of financial security amongst the middle and lower income group of the population.

**Other Segments of the Society**

The existing four general insurance companies will continue to serve the other segments as at present. The 90s will see a tremendous increase in business especially from the industrial segment. The companies need to be ready to meet the requirements of the industrial sector, which needs to be provided service of a different kind, where technical approach, treatment of each risk on its own merits, risk improvement and loss minimisation are some of the vital considerations. The companies should gear themselves to provide the kind of service expected by this sophisticated community.

At the time of nationalisation, it was decided that aviation business of national airlines would be handled by the GIC. This was based on the logic that aviation business was highly specialised, that interaction and support of international market was essential, that the number of clients for this class of business was small and that there was no need of competition for such business.

This principle needs to be followed in some other classes of business too. If this is done, technical experience of a higher order for such other classes too will be built up and not get diffused.

I for one would recommend that the GIC should take over the business of marine hull, off-shore oil installation risks, satelite risks and nuclear power stations and the like.

**Emerging needs of the Clients**

General insurance is a service oriented industry selling protection to its clients. The industry has to be responsive to clients needs and must not hesitate to provide covers that are tailored to meet the requirements of the customers. The industry has also to devise new covers responding to the emerging needs in the country and ensure that trade and industry are well served in the matter of insurance needs.

This calls for greater flexibility and more discretionary powers to be given at all levels. It is only then that clients' needs will be properly met.

This is not to say that the general insurance industry is not responding to clients' needs. Certainly it has responded to the emerging insurance needs, for instance, consequent upon the Bhopal tragedy and Supreme Court judgment in the DCM case, the general insurance industry responded with a Public Liability/ Third Party cover which is available today to anyone insured upto a maximum limit of Rs. 13 crores.

In regard to Product liability cover which is being made a condition by overseas importers of Indian products, the industry has responded by making available Product Liability Insurance even in the highly sensitive and litigation conscious business community in the United States.

Arising out of the increased terrorists' activities, the industry has made available in a limited form coverage against damage by terrorists. Whilst what is available is not sufficient for the needs of the insured, it is certainly a step in the right direction.

One issue which bears looking into is whether the industry now with its strength and size cannot follow the pattern of insurance coverage offered in developed countries. For instance most developed countries particularly in respect of risks offering low and medium hazard profiles offer All Risks Policies. To some extent, the recent revision in the fire tariff has provided for a wider coverage. However, this is still far removed from the All Risk Policy which is a simple document covering almost all possible perils excluding war and nuclear damage. The format of such policies is simple. In a few lines what is excluded from the cover is stipulated leaving it to be understood that all other damage is covered. This makes for not only an easier understanding of the insurance cover by the insured but also simplification of procedures and administration for the insurer.

Another type of cover relevant to large risks having normal hazard profiles are covers which provide for a first loss indemnity subject to realistic duductibles. Certainly major industrial units in India are at a singular disadvantage by not being able to procure similar covers. Equally I would say that the insurance industry if it granted covers on this basis would also benefit because in that event every insured would take much greater pains and care to improve the risk management throughout the plant operations since —

(a) he would be entitled to recover losses only in excess of the deductibles; and

(b) he can only recover the loss upto the limit of the first loss/stop loss stipulated under the policy. Any loss over and above this limit has to be borne by him.

I would say that the general insurance industry in India having come of age and having the sort of financial strength and stability that it possesses, it can and should very seriously consider offering insurance coverage of the type indicated by me. With the extreme flexibility available in the international reinsurance market it could do so without exposing itself to any serious harm. I am sure that the industry will gear itself to respond to these needs.

Perhaps to fulfil this role of being innovative, I would suggest that the industry set up R & D facilities both in the GIC and the companies, and research in what is happening all over the world. One of the functions of the National Insurance Academy, a product of the insurance industry, is to carry out research. This aspect of the Academy's functioning can also be intensified so that the combined efforts of the R & D cells of the GIC, the companies and the Academy produce results of a high order.

## Inward Reinsurance Business

A very important portfolio in the business of a general insurance company is inward reinsurance from other companies. In the world there is a very sizeable volume of reinsurance business offered and India has to take advantage of this. Fortunately the industry enjoys the confidence of the international markets for its stability, competence and rich experience and the insurance industry can cash in on this image.

I personally feel that India has much to gain by developing reinsurance inward business. If we have the necessary expertise, a fairly decent sized portfolio of reinsurance inward, and the capacity to absorb large risks, we should be able to lead the reinsurance covers for many of the developing countries of Africa and Asia.

To develop this portfolio I would say the following facilities and steps are necessary. It is necessary to visit foreign countries on a regular basis. For this, facility for easy travel should exist.

The industry should secure its presence in the different markets of the world through different avenues available.

Industry's approach to acceptance of reinsurance business should be bolder. They have to make known to the world that the Indian market can absorb sizeable business. Initially, to create this image even larger sums than would normally be accepted, should be underwritten.

To act as leaders for any cover, say in Excess Loss, the industry should give an assurance to the leading company that the Indian market would absorb their entire reinsurance placements should they find any difficulty to place the cover with other companies. To enable this to be done, the Indian market must have ready arrangements to offload any part of such business which they feel is beyond the capacity of the Indian market.

It is necessary to persist with the business coming from any company or any market even if the business is not profitable for a number of years. By persisting with the business and rendering technical assistance and guidance where necessary, it will be possible to improve the quality of business. A long term perspective should be kept. It is only then that the industry will reap the fruits of this class of business.

Reinsurance business is very technical in nature and a lot of expertise is necessary. I would say the responsibility for developing this business should be with the GIC. This is not to say that the subsidiaries will not underwrite reinsurance inward business. Far from it. But all the companies need not take active steps as I have outlined above to develop the business. Five companies going after the same business would be very costly. The business can be underwritten for the Indian market as a whole by any one company and shared between all the companies.

I would like to see the day when a separate subsidiary is established by GIC to do only reinsurance business. A reinsurance company on the lines of the Swiss Re or Munich Re will enhance our world image.

## Surveyors or Loss Assessors

Surveyors or Loss assessors are very integral to the general insurance industry. The insurance Act, 1972 provides that claims of Rs. 20,000 and above must be settled only after a report is obtained from an approved surveyor who is licensed to act as a surveyor under the Act. There are about 14,000 licences issued by the authorities to act as surveyors.

Surveyors have a very important function to perform in the matter of settlement of claims. A high degree of expertise and a thorough knowledge of the subject they are dealing in is required on their part to be just and fair to all concerned.

To my mind the task before the insurance industry is to build up surveyors into a body of professionals. For a profession to be built up on healthy, sound and independent lines there has to be a regulating body. This body should have the authority to prescribe the education needed to qualify as a surveyor, to conduct examinations to prescribe the code of conduct, to issue guidelines and to meet out punishment to the guilty. It is only then that the profession will grow on sound healthy lines. For this it is necessary to have an Act of Parliament on the lines of the Chartered Accountants Act or the Cost and Works Accountants Act. It is only then that the profession will function on sound lines.

If felt necessary the general insurance industry may ask for a representation for a couple of seats on the Council of this body to see that the profession is guided and regulated on correct lines.

In any case the present system of licensing needs a second look. Mere possession of a technical qualification, without any knowledge of insurance, cannot qualify the person to act as a surveyor. The profession of surveyors cannot just be treated as an employment agency.

With new technological development taking place, newer type of risks being added and risks becoming more complex and larger, I am sure the general insurance industry realises that the need to professionalise the body of surveyors is paramount.

**Audit by the Comptroller & Auditor-General**

Prior to nationalisation one very important argument advanced by the industry against nationalisation was that general insurance was a service oriented industry. The nature of its business was such that many an officer had to take decisions on the spot as to whether to accept a risk or not. In the matter of settlement of claims the officer had to use his discretion as to the amount of claim payable. In the event of nationalisation this aspect, namely, initiative and judgment of the officer, could suffer.

After nationalisation, the general insurance industry has been subject to audit by the Comptroller and Auditor General. As a result of this audit many a decisions of the officers are queried. Action taken in good faith and based on the circumstances than prevailing are questioned. The audit by the C & A.G. has destroyed the initiative and sapped the morale of the officers which is very dangerous for this service oriented industry.

Whereas the LIC, the banks and many other financial institutions are not subject to audit by the C & A.G. the only reason why this service organisation has come within the ambit of the C & A.G.' audit is that the GIC and its subsidiaries are registered as companies. Had they been established as Corporations like the LIC then the GIC and its subsidiaries would not have been subject to audit by the C & A.G. This situation needs to be remedied. The Government can insist on having very powerful internal audit teams doing every aspect of audit similar to the one done by the C. & A.G. to ensure that frauds and other malpractices do not prevail. But the audit of the C. & A.G. should be done away with. I am sure the internal audit will be much more rewarding in the long term, as it will be conducted by people in the industry who know the intricacies of the business.

**Taxation**

The real profits of a general insurance company can be determined only after provision of Unexpired Risk Reserve. The Income-tax Act accepts this position and has provided a schedule to take care of this. Barring this provision of allowing Unexpired Risk Reserve as specified in the Income-tax Rules, the income of a general insurance company should be arrived at like any other company. This aspect is misunderstood by the tax authorities and there are disputes every now and then between the general insurance companies and the tax authorities.

In this situation the general insurance companies have also found a drafting loophole whereby the tax payment or provisions or any other reserve which they create is also sought as an item of expense and the taxable profit is arrived at after claiming such items.

It is not understood why two arms of the Government should be fighting against each other wasting precious time and money. Why cannot the law be altered to make things simpler so that there is no scope for dispute. The tax authorities should see the view point of the general insurance companies, arrive at a settlement and either change the tax laws or issue departmental instructions which both sides must adhere to.

Whilst I am on the subject of taxation, I would like to mention two other points. In these days of heavy inflation, the correct amount of insurance which a company should take is the reinstatement value of the asset. If this is not done then in the event of the destruction of the asset the claim amount would not suffice to replace that asset.

When a company takes an insurance on reinstatement value basis, the tax authorities have been treating the difference between the original value of the asset and the reinstatement value as capital gain and levying tax on the same. This is a matter which the Government needs to look into and rectify.

One other matter which I would want the Government to consider is the question of allowing a deduction in the income as under Section 80C of the Income-tax Act in respect of all premiums paid by an individual in respect of his personal insurances. Recently the Government has granted this relief in respect of medical insurance. I would urge the Government to consider allowing such deduction in respect of the premiums paid by the individual in respect of all the different personal insurance covers. This is with a view to make the public aware of the existence of these insurance covers and make them insurance conscious.

## II

# LIFE INSURANCE

I shall now deal with life insurance which was nationalised way back in 1956. Here I would like to give a few excerpts from the speeches made by the then Finance Minister outlining the objectives of nationalisation.

"…. The nationalisation of life insurance business is a further step in the direction of more effective mobilisation of people's savings."

"….Insurance is an essential social service which a welfare state must make available to its people…"

"…. With the profit motive eliminated, and the efficiency of service made the sole criterion under nationalisation, it would be possible to spread the message of insurance as far and as wide as possible…"

I have just picked up these excerpts as in the course of my paper, I will be referring to these three important aspects referred by the then Finance Minister viz. people's savings, social service and elimination of profit motive.

**Progress of the Life Insurance Corporation**

The main business of the Life Insurance Corporation of India (LIC) is classified in two categories viz. Individual insurance and Group schemes. Over the last 32 years LIC has made rapid progress in both these categories. The new business for the year 1987-88 for individual insurance is expected at the record figure of over Rs. 12,800 crores. This has to be compared with Rs. 278 crores in 1957, the first year of nationalisation. The total business in force for individual insurance as on 31st March, 1987, the last year for which the annual accounts are available stood at Rs. 48,151 crores from 298.6 lakh policies. Under Group schemes also LIC has made good progress. The Life Fund stood at Rs. 14,502 crores as on 31st March, 1987 and the accretion for the year was of the order of Rs. 1,837 crores.

As a result of the last valuation conducted as at 31st March, 1987, the reversionary bonuses declared were Rs. 72.50 per thousand sum assured per annum for whole life policies and Rs. 58 for endowment policies. Besides, this LIC has also declared a terminal bonus which is a fixed amount ranging between Rs. 50 and Rs. 250 per thousand sum assured and is related to the number of years the policy has been in force. The valuation surplus amounted to Rs. 808.92 crores. The Government's share of the surplus come to Rs. 39.34 crores. The tax paid by the LIC during the year 1986-87 is of the order of Rs. 69.12 crores. Though the performance is praiseworthy, LIC has a long way to go to play the very important role assigned to it in the national economy.

Here I would like to inform my listeners that there are three elements which determine the premium which a life office charges for the covers that are granted namely, mortality, interest earnings and expenses. In the early stages of the industry, it was very difficult to forecast these elements correctly, especially over a long period of time. The actuary, therefore, was very conservative keeping safe margins in these elements in constructing the premium rates. Not having charged the correct rates inasmuch as he had kept margins, the actuary was happy to release these margins over a period in the shape of bonus to policy-holders.

Out of this was born the concept of with-profit policies and without-profit policies, where the actuary made a specific provision for bonus in the premium rate of with-profit policies. This extra provision is referred to as a bonus loading. With this concept the need to keep very high margins reduced as the bonus loading itself acted as a safety value.

When a valuation is conducted the surplus arising from the business is determined. The valuation surplus mainly arises from two sources — the actual experience of the elements being different from the assumed conservative ones and from the bonus loading.

**LIC's Role as a Savings Media — Individual Insurance**

The most common form of life insurance is any type of endowment policy which performs the dual role of providing protection in case of early death, as well as providing savings for a future date. The role which a life insurance company plays as a savings media is very important, especially in an inflationary situation. If the earnings on the savings do not match with inflation then savings in real terms will be a losing proposition.

If one were to take yield as a yardstick, I must say that LIC's policies as a savings media have not been able to perform as effective a role as many other savings media such as PPF, Units of the UTI, Post Office Deposit Schemes, National Savings Certificate and the like. This is true even after adjusting the premium for the risk cover.

The reasons for this situation are not difficult to analyse.

(i) LIC's pattern of investment is regulated by Government and a good portion of the investible funds is taken by Government for their socially oriented programmes. This portion earns a low rate of interest. LIC has the freedom only to the extent of 10% of its investible funds for such investment which have high risk and high rewards. This has had a great impact on the interest earning of the LIC. Their gross rate of interest earning was only 7.87% in 1979-80 which went upto 10.28% in 1986-87.

(ii) LIC's expenses for securing and servicing their business is very high. There have been tremendous efforts in recent years to reduce these expenses and I must say these are bearing fruits. A very great effort will still be needed to reduce the expenses further. I must state however that life insurance business has to be sold and the cost of sales are quite high.

(iii) LIC has to pay a huge amount to the Government every year in the shape of taxes and Government's share of profits. The March 1987 account reveals that these two items have accounted for over Rs. 98 crores.

In the matter of investment pattern the Government must place LIC on a better wicket especially as life insurance has a compulsory savings element combined with risk cover. If this does not happen then there will be a demand for only risk covers from LIC, the savings going elsewhere. In the present situation in India, only risk cover under individual insurances is not desirable for the lower income and middle income group earners as they will be prone to spending the money on consumer durables rather than save elsewhere. Term assurance covers may be all right for the upper income groups as in any case they will save for tax benefits.

A sizeable improvement in the yield to the policyholders is possible if the LIC does not have to pay the Government what it does today. I will deal with this subject later on.

As regards expenses, the LIC has to work under certain handicaps. Unless modern tools like the computer are put to full use the expenses will be high. However, as I mentioned earlier the position is gradually improving.

I must mention that the LIC has come out with several new plans to cater to the needs of the various clients. However as a monopoly organisation it has the obligation to provide all types of covers which may be required by the public. Of course it goes without saying that these covers must be actuarially feasible.

I would also say that if the LIC has devised any plan it should be open to all segments of the society and not restricted to a few as has happened in the case of the Convertible Term Assurance policy. It is also necessary for the LIC actuaries to research in what is the world trend and introduce new covers suitable for the Indian market.

**Janata Life Insurance Corporation**

Having pointed out the shortcomings of individual insurance in the matter of yield on savings, one may ask what is the solution. I would say the LIC has to start a new Corporation to cater to the insurance needs of the lower and middle level income earners. My suggestion would be on the following lines.

This corporation will issue only one type of policy. I would say the LIC actuaries should study various plans available abroad, conduct some research as to the local needs and come out with an attractive and flexible plan. It can be a combination of term assurance plus savings plan with an increasing sum assured, to take care of inflation, without going in for additional policies. The plan would be so designed that it meets the needs of the lower and middle income groups and at the same time is very easy to operate. Since the policy is meant to be a janata policy there should be a limit on the premiums to be paid. Of course, this limit would be revised from time to time as the value of the rupee depreciates.

The organisation structure for this corporation will be very simple namely, Head office and Branches.

They will so organise themselves with the help of computers that a very small staff basically officer oriented, will be needed. The business will be procured by the existing trained agency force of the LIC, numbering over 200,000 who will be paid suitable commission. There will not be any other intermediary in the shape of development staff between the agent and the branch. This corporation will control costs very effectively. The only item of cost where it can be generous is on publicity. The corporation will get its policy conditions gazetted so that a very simple document is issued as proof of cover. The Government should be requested to waive stamp duty on these policies.

The investment pattern of this corporation will be simple and high yield oriented. Say 50% of the funds will be placed in special deposits with the Government of India and the balance 50% in bonds of public and private sector companies so that the average yield on its funds is more than 12%, and at the same time, it does not need an elaborate investment department to make the investments. Investment decisions on bonds should be based on the credit rating of the Credit Rating Information Services of India Ltd.

This corporation will be a subsidiary of the LIC. A very small capital will be provided by LIC just by way of working capital. The LIC should not look upon this corporation as a source of income. They should also provide the expertise necessary for this corporation.

I would urge the Government not to tax this corporation like other savings corporations so that the income on savings of the ordinary man are not taxed.

In computing the premiums the actuary should aim at as low a premium as possible with very bare margins. Since all policyholders will be participating in the profits, no bonus loading should be provided. This would provide an attractive cover at a very low cost.

In its marketing policy the LIC has been laying a lot of stress on developing rural business in view of the vast potential. I am sure the new cover I have proposed will enable the LIC to make a real breakthrough on this count and if a vigorous marketing strategy is adopted it will be able to tap this vast potential. I would urge the LIC and the Government to take up this task of setting up the Janata Life Insurance Corporation at the earliest.

**Group Schemes**

So far I have talked about individual insurance. The other category of LIC's business is group schemes. Here the concept is that insurance is taken for a group of persons. The group can comprise of any body like the employees of a company, or Government, members of an association or body, or any group who can be separately labelled, like teachers, railway porters, etc.

Group insurance schemes basically grant term assurance, meaning that if death occurs during the period of the cover the sum assured becomes payable.

Term assurance is normally provided on one year basis, the premium increasing as the age advances. Combined with term assurance a savings element can also be incorporated.

Since term assurance provides death risk only protection is provided at a very small cost. Also since a large number of lives are covered under one master policy, expenses of management get reduced. These group schemes, therefore, can provide cover to the masses at a very lost cost.

The LIC in recent years has introduced some group schemes for the weaker sections of the community through various Government agencies like the Central Government scheme for Municipal Sweepers and Railway Porters, the Gujarat Government scheme for low salaried employees of small shops and establishments, the Uttar Pradesh Government scheme for Teachers, cover for landless agricultural labour and the like.

In respect of a salaried employee the compulsory retirement benefits like provident fund and gratuity provide him with savings on his retirement. But what is missing is the insurance cover. As individual insurance is costly, this missing link can be effectively provided by the group insurance scheme of the LIC.

Here I would like to state that for a life office, individual insurance business is its bread and butter. The same applies to LIC. There are salary savings schemes too for various groups which are individual insurances. Thus there is a conflict of interest between group schemes and individual insurance. Development of group schemes could affect individual insurance business.

As I pointed out earlier that there can be many persons who need only life cover as their savings have been taken care of. LIC should very willingly provide this cover. LIC should actively sell these group schemes to employers and to various bodies for covering their members. The LIC should be ready to prepare tailor-made separate schemes for various clients so that the needs of all are met and the scheme should be financially acceptable to all groups.

I am of the view that group insurance schemes will only be developed effectively if LIC were to completely segregate this class of business from the individual insurance business. This is on account of the conflict of interest between these two categories. The LIC should set up a separate Corporation to do this class of business.

LIC's group schemes at present are handled by an exclusive Department known as the Group and Superannuation Department with a separate fund. This G & S Department handles other schemes like group gratuity scheme and group superannuation scheme. This whole G & S Department with all its activity can be taken over by the new Corporation.

Here I would like to mention one latest development that has taken place. The Payment of Gratuity Act, 1972 has recently been amended whereby funding of the gratuity liability of the employers is made compulsory. The statute provides that all employers who employ less than 500 employees and who do not have an approved fund must necessarily acquire insurance as prescribed from an insurer. Today LIC is the only insurer. This will mean that, after Government issues the Notification, perhaps a couple of lakhs of employers will have to seek cover from LIC. This is one more reason why group business should be handled by a separate Corporation. Also this will give the LIC an opportunity to sell many group insurance schemes to those very employers who are with the LIC for the gratuity scheme.

Whilst I am on the subject of group insurance, I would like to make a mention on one point. In respect of the group schemes relating to employee retirement benefits like Group Gratuity Scheme and Group Superannuation Scheme, the LIC has since some years introduced the concept of 'Cash Accumulation Scheme'. The premiums paid under these schemes are retained by the LIC as separate funds on behalf of the employer on which interest is paid. The present rate of interest paid, which varies according to the size of the fund, is 10.8% to 11.2%. This has been achieved by having a different pattern of investment for the Group Fund.

As I mentioned earlier, the G & S Department has a separate fund and it is in order for the Government to prescribe a different pattern of investment which enables this Department to earn a rate of interest more than that earned by the fund pertaining to individual insurance. Though the G & S Fund is a separate fund in the books of the LIC, in the published annual accounts, the operations of this fund are not shown separately as is done for Capital Redemption and Annuity Certain Business. The Individual Insurance Fund and Group Scheme Fund are merged together. With the result some doubts are created in the mind of the public that G & S business is carried on or the back of individual insurance business in the matter of interest rates. I may state that the interest earned on the combined Life Fund is less than what is allowed under this scheme. To remove this doubt, the LIC must publish the accounts of the G & S Department separately. This will clear all doubts. Of course, if a separate corporation is formed then the controversy will end.

**Development of Housing**

In the National Housing Policy of the Government provision of housing has the topmost priority. LIC's contribution by way of loans for house building activity through various agencies is substantial. There was a recent announcement by the Union Minister of State for Finance, Mr. Eduardo Faleiro, that LIC would be coming out with new loan schemes to own or build flats. This is good. But I am convinced that the LIC can do much more than this.

Here I would like to refer to the good work done by Housing Development Finance Corporation in the matter of providing housing as well as housing loans. As compared to HDFC, LIC's organisation is spread all over the country. LIC has vast resources at its command. I feel that if the necessary will is there LIC can perform as well as if not better than HDFC. LIC should enter the field of house construction. It has the necessary expertise for this sort of activity. Also LIC should increase the amount of funds which it earmarks for housing.

To ensure that this activity succeeds LIC should form a separate subsidiary for Housing Development. The functions of this subsidiary will be similar to those of HDFC. With the expertise and funds available, LIC would be able to develop and construct houses for lower and middle income groups in a big way.

The LIC can come out with a new insurance plan whereby policyholders under the plan would be given preferential treatment in the matter of allotment of houses constructed by LIC. The plan should be so devised that it helps the policyholder to repay the cost of the flat over a period. Such a policy will be savings oriented giving the policyholder a savings in the shape of his flat a dear and appreciating commodity. I am sure if the insurance cover is well conceived it will find favour with the public.

**Government's Share of Surplus**

I have mentioned earlier that the then Finance Minister at the time of nationalisation of life business had referred to the elimination of profit motive. Over the years LIC has paid huge amounts to the Government as share of the surplus or profits. Against the capital of Rs. 5 crores paid by Government, the share of surplus of the Government as a result of the last valuation, which now is conducted every year, was Rs. 39.34 crores.

I have pointed out earlier how valuation surplus arises. The surplus belongs to the policyholder, representing partly his own money and partly interest earned on such monies. The Government must apply its mind whether they should take a share from this surplus.

Though Government is the owner of the LIC, they must consider themselves merely as Trustees and the LIC should be deemed to be owned by the policyholders like a mutual insurance company. It is only then that the avowed objectives of nationalisation will be achieved.

If the Government does want a return on their capital of Rs. 5 crores, they can ask LIC to pay a reasonable dividend.

**Taxation of LIC**

The present system of taxation of LIC is that the entire surplus emanating at any valuation is taken as income and tax at 12-1/2% is levied thereon. I feel there is no rationale behind treating the surplus as income. I have pointed out earlier how surplus arises. By taxing the surplus, the savings of the people are being taxed.

I want the Government to consider life insurance as a social service, as a means of providing savings for the future. There are other financial institutions which cater to peoples savings and such organisations are not taxed, say, UTI. Then why is the LIC taxed?

An argument can well be advanced that the income which a person earns from his savings are subject to tax whereas the policy monies received from the LIC is not. It has, however, to be noted that income from saving with UTI or such sources are allowed tax relief of various nature — say Section 80L of the Income-tax Act. As a result of this most middle level income earners as well as all low level income earners are not taxed on the income from their savings. On the other hand, the large majority of policyholders of the LIC though belonging to the lower and middle level income group are indirectly paying a tax not only on the income on their savings but perhaps also on part of their savings.

The Government has to take a view on the subject. Assuming that the Government comes to the conclusion that they would rather tax the LIC than allow the higher income bracket policyholder to escape taxation on their savings, I would say that what has to be taxed is that part of the surplus which belongs to the shareholder.

In any case, I would request the Government not to tax the Janata Insurance Fund, which proposal I have made earlier in case the same is set up.

## III

# THE ACTUARIAL PROFESSION

When speaking on insurance I feel I must refer to the actuarial profession.

The actuarial profession in India is comparatively young inasmuch as Indians started taking to the profession only in the thirties. Today we have in India about 130 Fellows of the Actuarial Society of India of whom nearly half the number would be aged more than 60.

Prior to nationalisation of life insurance, the actuarial profession was a highly prized one. Intelligent young graduates with mathematical or statistical gackground took to this profession. The rewards available to the profession were commensurate with the efforts and the time the student had to put in to qualify.

Now the position has changed. LIC has become the single employer of the profession. The Government of India who at one time were the single largest employer of actuaries and actuarial students in the office of the Controller of Insurance have closed down this office. A stage has now been reached when very few young graduates take to the profession.

This trend has to be reversed in the interest of the industry.

I would recommend to the LIC and the Government that they take the following action:

(a) LIC is very much aware of the need to develop the profession and has taken many steps in this direction, like providing monetary help to actuarial students in the shape of reimbursement of fees and cost of study courses, special increments on passing actuarial examinations etc. This policy of LIC, I feel, only encourages those working in the LIC to take to the profession to better their prospects. This policy does not attract the right material at the university level to take to the profession. For this LIC should —

(i) have a definite recruitment policy for actuarial students and make it known to all Universities;

(ii) give an assurance to absorb qualified actuaries or actuarial students with attractive compensation;

(iii) announce a scheme to award scholarships to students who take up actuarial studies. The scholarships should be awarded on the basis of academic performance and for a sufficiently long period, say three years.

Only action on these lines will encourage graduates with the right academic qualifications to take to the profession.

(b) The Government must recognise the need and value of the actuarial profession. Under various statutes like the Payment of Gratuity Act, the Income-tax Act, the Wealth-tax Act, etc. the term actuary must be defined and where actuarial work is involved, specific provision should be made to see that the authorities rely on actuarial reports by qualified actuaries.

(c) Though the office of the Controller of Insurance has been disbanded, the statutory post of Controller of Insurance under the Insurance Act remains. The Government has not been able to fill up this post perhaps for two reasons. The grade offered for this post is too low and the Controller of Insurance is not independent inasmuch as he has to report to the Additional Secretary in-charge of Insurance in the Ministry of Finance. The post has to be upgraded and he should be reporting directly to the Secretary, Finance.

(d) The office of the Controller of Insurance used to perform several other functions besides administration of the Insurance Act like advising the Government on all actuarial and technical matters connected with pension schemes and savings scheme, conducting actuarial valuations for postal Life Insurance Fund, State Government Life Insurance Funds and Employees State Insurance Fund, fixing contribution rates for Family Pension benefits under the Employees' Provident Fund Act, Coal Mines Provident Fund Scheme etc.

Today when the Government needs some actuarial calculations to be made, it has to consult and rely on actuaries in the LIC or private firms of consulting actuaries. This position is not desirable. The Government should set up a Government Actuary's Department, as exists in the U.K. to perform all the above functions and act as actuaries to the Government.

(e) Abroad, actuaries are doing very useful work in the field of general insurance. A lot of statistical theories are being applied to general insurance business like credibility theory in experience rating, general risk theory of fitting statistical curves to claims distribution and the like.

It is necessary that GIC also applies actuarial techniques in the matter of rating risks. With this end in view the GIC should also recruit actuaries.

I am sure if action on these lines is taken the profession will revive.

## IV

## GRATUITY GUARANTEE FUND

You may wonder why this subject finds a place in this paper. Recently, the Government has amended the Payment of Gratuity Act, 1972 whereby provision has been made to compulsorily fund the gratuity liability of every employer who is required to pay gratuity to his employees. The basic intention of the Government for this move is to protect the interest of the workers in respect of their retirement benefits. This move is laudable and should be implemented. It is, however, necessary to examine whether the creation of a fund or insurance as it is called in the Act to cover the gratuity liability will fully protect the workers.

In the Act, Government have provided the words ".... obtain an insurance in the manner prescribed ....". The Rules in this regard have not yet been framed. But I do not think it is the intention of the

Government to introduce a new insurance scheme whereby gratuity can be guaranted under all circumstances. The insurance cover referred to will perhaps be only on the lines of the cash accumulation scheme currently in vogue with the LIC.

Though gratuity is payable at a future date, for every year of service that the employee renders he earns some gratuity and a cost is incurred. To satisfy accounting principles, it is necessary to provide in the year's account the appropriate cost of the liability incurred neither more or less. This can be achieved if the cost is determined on actuarial principles. The actuarial basis takes into account that a certain liability has been incurred by the company for gratuity but the liability will become due for payment at a future date on the happening of a specified event and on the assumption of a continuing business determines the present value of such a liability.

It has to be noted that the present value of the future liability will always be less than the liability figure itself as it is expected that interest will accrue and, in due course, the amount of the present value with interest will reach the figure of the liability. The position will exist whether there is a private trust fund set up to take care of the gratuity liability or whether there is an insured scheme as provided at present by the LIC.

In the event of the failure of any employer, it will be found that that amount available in the fund or under the insurance scheme will not be sufficient to pay the gratuity which is earned by all the employees upto that date. The intention of the Government to protect all employees in every case will not be achieved.

The only way to remove this drawback is to create a Gratuity Guarantee Fund from which employees affected by the failure of employers can be paid gratuity. This fund can be operated on lines similar to the Deposit Insurance Corporation (now called the Deposit Insurance and Credit Guarantee Corporation) which protects the deposit holders from failure of banks. It is absolutely essential that the Government set up the Gratuity Guarantee Fund to protect the workers from losing their hard earned retirement benefits in case of failure of companies. The setting up of this Gratuity Guarantee Fund will be one more step in the direction of social security.

**Conclusion**

India is at the threshold of a tremendous forward surge in its economy which will lead to a substantial improvement in the level of the living standards of its masses. I do believe that the Indian insurance industry has infinite possibilities for growth. The captains of the insurance industry should plan their strategies to seize the emerging opportunities thus providing protection to all and mobilising savings so that they can be channelised into further development of the country.

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