OPENING UP OF THE INSURANCE INDUSTRY – THREE YEARS ON

D M SATWALEKAR

2004

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THE A.D. SHROFF MEMORIAL TRUST

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Voluntary			
Public Provident Fund	all individuals	0.8 percent	Contributions
Superannuation plans	all employees	0.2 percent	Contributions
Personal pensions	all individuals	0.2 percent	
Purchase of annuity-like products			
Social assistance			
State level social assistance	differs by states	differs by states	State budgets
National Old Age Pension Scheme	destitute persons over age 65	15-20 percent of population over 65	Central budget

No. of establishments covered under the EPF Act as on 31st Mar 2003

	Exempted	Un-exempted	Total
No. of covered establishments	2564	341944	344508

Contributions Received during 2002-03 and cumulative (In Crores)

a. Employees' Provident Fund	Exempted	Un-exempted	Total
(i) During the year	3859.37	7528.77	11388.14
(ii) Cumulative	49882.54	58627.6	108510.14
Total	**53741.91**	**66156.37**	**119898.28**

b. Employees' Pension Fund	Employee's & Employer's Share	Government's share	Total
(i) During the year	4387.84	400	4787.84
(ii) Cumulative	28070.15	5143.02	33213.17
Total	**32457.99**	**5543.02**	**38001.01**

c. Employees' Deposit Linked Insurance Fund	Employer's Share	Government's share	Total
(i) During the year	158.62	-	158.62
(ii) Cumulative	1478.43	-	1478.43
Total	**1637.05**		**1637.05**

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The A. D. Shroff Memorial Trust has no specific views on these economic issues. This publication is issued for public education, and hence the views expressed are specifically those of the author.

THE A. D. SHROFF MEMORIAL TRUST

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OBJECTIVES

(i) Publication of one or more books in English, Hindi and regional languages 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 public lectures annually on subjects, which were of interest to the late Mr. A. D. Shroff, namely, banking, insurance, and industrial finance, the subject 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 and Economics, Mumbai.

(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

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A. D. Shroff
A brief profile

Mr. A. D. Shroff was an eminent economist, an industrialist, a banker and above all a stout champion of free enterprise and the market economy. He was considered one of the architects of free India's industrial development and modernization.

Among the earliest planners, he was a Member of the National Planning Committee of the Indian National Congress under Chairmanship of Pandit Jawaharlal Nehru in 1938. He was also one of the authors of the Bombay Plan prepared by eight industrialists in 1944.

He was one of the two non-official delegates to the Bretton Woods Conference and argued India's case with great vigour. He was the Chairman of several important Government Committees, including the one on Finance for the Private Sector. He was Chairman/Director of a large number of public companies, including Bank of India and New India Assurance.

His contribution can be best summed up from the following excerpts of the eulogies paid to him:

Mr. M. Nasrasimham, ex-Governor of the Reserve Bank of India: "He was a member of the Indian delegation to the Bretton Woods Conference in 1944, and the assiduous zeal and nationalistic dedication with which he argued India's case in the discussions there, even to the point, as the Keynes Papers indicate, of displeasing the British delegation." "He foresaw with remarkable prescience even then, what we with the wisdom of experience and hindsight have come to realize,

that a centralized command economy and a pluralist democratic polity do not go well together."

Mr. J.R.D. Tata: "Two qualities stand out: an exceptionally powerful mind and moral courage. Born in humble circumstances and without, therefore, the influence of wealth and position, Mr. Shroff would nevertheless have made his mark anywhere in the world. He attended meetings in which leading men in the fields of commerce, banking, and politics participated and there was no doubt about the impression he created, for instance, at the conference at Bretton Woods."

Mr. George Woods, ex-President of World Bank: "Few patriots did more than he (did) to make friends for the Indian nation and to build confidence in that nation among those throughout the world whose business it is to provide capital for sound investment opportunities." "His courage, his strength of mind, his passion for his countrymen, particularly for those who, like him, had roots in humble places, stirred admiration even among those who often could not share his opinions."

Introduction

In the series of annual public lectures organized by the A. D. Shroff Memorial Trust, Mr. Deepak M. Satwalekar, Managing Director & C.E.O. of HDFC Standard Life Insurance Co. Ltd., was invited this year to deliver one on "Opening up of the Insurance Industry – Three years on".

In his address Mr. Satwalekar has made a comprehensive review of the working of the private sector companies recently set up in collaboration with some of the renowned international majors in the field. During the short period of three years, these companies have already captured over 12% of the total life insurance business. They have introduced innovative products and offered consumers much wider choice. The speaker has stressed the need to build up confidence among the insured to earn their goodwill by adopting business ethics and shunning short cuts and undesirable practices which was one of the principal reasons which led to the nationalization of life insurance in 1956.

He has pointed out that the industry should develop a consumer focus as customers are becoming increasingly conscious of managing their own financial affairs and are consequently looking not just at insurance products but at an integrated financial solution which offers them stability of returns along with adequate security.

The speaker has commended the role of the regulatory authority in putting into place a truly world class framework. However, he underlines that this is not enough and the thrust should be on enforcing regulations stringently. He has made a strong plea for the formulation of a unified Act related to insurance as the Insurance Act 1938 needs

substantial amendments in the light of far-reaching changes in the economy in the last few decades.

Mr. Satwalekar has also pointedly drawn attention to the need for tapping the vast rural market which has immense potential. Rural people do want cover against exigencies. Insurance and pensions are complementary in nature, as one covers the risk of dying too early while the other covers the risk of living beyond one's earning years. Hence urgent attention should be paid to the development of the pension sector by offering a level playing field for all pension providers.

This is a fine treatise on insurance and deserves careful study not only by professionals involved in the industry but also by serious students of economics and finance.

We are thankful to HDFC Ltd for their assistance in publishing this booklet.

M. R. Shroff
Chairman & Managing Trustee
The A. D. Shroff Memorial Trust

Mumbai,
2nd April 2004.

OPENING UP OF THE INSURANCE INDUSTRY - THREE YEARS ON

D M SATWALEKAR*

It is a privilege to be here today to deliver the A D Shroff Memorial Trust lecture and address this distinguished gathering.

Nani Palkhivala, in his foreword to A D Shroff's biography described him as a builder of financial institutions, a man of vision and above all a patriot who had enormous courage to stand up for what he firmly believed to be in the interests of the country. Don't we wish that there were many more like him, who did what he believed was right and not what would have been expedient.

Mr. M Narasimham, former Governor of the Reserve Bank of India has credited him with the ability to foresee - "with remarkable prescience even then, what we with the wisdom of experience and hindsight have come to realise, that a centralised command economy and a pluralistic democratic polity do not go well together."

It indeed took enormous courage to set up the Forum of Free Enterprise at a time when free enterprise was associated with all the ills plaguing the economy. While we live in a different era, I believe that this Forum provides an

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* The author is Managing Director and C.E.O. of HDFC Standard Life Insurance Co. Ltd. The text is based on the Annual Public Lecture delivered under the auspices of the Trust on 10th February 2004 in Mumbai.

important platform to continue to critically examine economic policy decisions.

It is in this spirit - embodied by A D Shroff - that I would like to present my views.

1. Introduction

Competition is not – and has never been – a zero sum game. Detractors of a more open economy forget that by providing better and more innovative products at lower prices, competition actually expands markets in ways that are inconceivable under monopolies.

The Indian economy has undergone major reforms in the past decade with the liberalisation of trade and investment as well as regulatory reforms in the key sectors of the economy.

Until December 1999, however, insurance remained untouched. It was then that the IRDA Bill was passed in Parliament. There was a big gap between the submission of the report of the Malhotra Committee on Reforms in the Insurance Sector in 1994 and the implementation of the recommendations made by the committee.

Insurance reforms have aimed at creating a more efficient and competitive financial system suitable for the requirements of the economy.

The critical reason to allow private sector insurers to enter the Indian insurance market was to give individual and corporate insurance consumers a competitive environment that will deliver products and services in response to their needs.

A liberalised, open and competitive insurance sector will contribute to India's economic and developmental objectives. By opening its insurance market to competition,

India has opened up the opportunity to merge its significant managerial and financial expertise in capital markets with the best practices from the world's leading insurance markets - resulting in heightened efficiency and enhanced service to customers.

I expect the emerging competitive market to speed the development of a modern, service-oriented industry. It should also provide expertise, capacity and an appetite for certain types of risks that are currently not available.

2. Performance of insurance players

There is a Chinese curse which says, "May you live in interesting times". We, in the insurance industry, are indeed living in interesting times. I assure you though that far from being a curse, especially for the customer, the past three years have witnessed big strides and will flag off big changes ahead.

Three years in the life of an industry is a very short period, but so much has happened since the insurance industry was opened up for private participation, that its impact cannot be ignored.

It has been a very exciting period marked by competition, innovation, training, distribution channel development and creating increased awareness for the consumer. In short, a period of intense learning for us all.

I shall restrict my comments to the life insurance sector. Three developments stand out of the performance of the insurance players during the last three years.

The **first** is innovation in product development and consumer choice.

Competitive forces have brought to the fore the best in product development and feature differentiation. The

consumer can now choose from a range of features as he is offered an unbundled product with a wide variety of riders, or options, to choose from - unlike in the past when he was offered a bundled product with features he may not have really wanted, but still had to pay for.

A sophisticated insurance product suited for financially literate people that deserves special mention is the unit linked plan which is structured to permit investors to choose the asset classification mix they wish to put their savings in. The wide variety of funds and the option to switch between them, allows the financially sophisticated consumer to make his or her investment decision based on market conditions.

The **second** development has been the evolution of distribution channels.

The awareness of the central role of the customer in the scheme of things and the desire to reach him when he wants, where he wants and how he wants, have led to the development of alternate channels of distribution, including bancassurance, brokers, the internet and direct marketing. While the traditional tied agency model continues to be the dominant distribution channel for most insurers today, the nature and quality of the agent has improved dramatically. The new breed of agents is better educated, better trained and is licensed by the IRDA to sell insurance.

As anticipated, product innovation has also been catalysed by the emerging channels of distribution. Insurance companies, together with their channel partners, have designed products specifically for their customers. For instance, customised versions of insurance savings products are being offered by our bancassurance partners as alternatives to pure deposit products. Customers for housing finance can now buy protection offered by life insurers along with their housing loans.

The **third** development has been the increased emphasis on building consumer awareness.

There is clearly a need for a strong partnership approach between the insurers, the regulator and also the consumer. Fortunately, this approach is already quite clearly evident in India. While the insurers are reaching out to widespread geographical areas through their distribution networks, the regulator has also pitched in by using the media to get the message of life insurance across to the masses.

Today - three years on - the private players have made their presence felt in the life insurance sector in India.

Post opening up of the insurance sector the private sector companies in life insurance have notched up a market share of 12.78% as at the end of February 2004. This significant market share of the new business done has witnessed the private sector mobilise Rs. 1,666.3 crores of premium income. **(Annexure A)**

The fact that the private sector has cornered a significant share of new business in just three years of operations is a vote of confidence from customers.

However, this confidence needs to be continuously earned by the insurers by adopting a strong business ethic that shuns short cuts and unethical practices and contributes to the development of a strong insurance industry in India.

3. Looking forward

This has been a brief synopsis of what has transpired in the three years since the sector was opened up to competition. Having noted that the insurance sector has had one of the smoothest entries into a liberalized era with multiple providers from both the public and private sectors, it is time to look ahead and see what is needed to be done

to leverage on this good start. Based on the experiences of these past three years, I would like to highlight certain broad trends that have emerged and will play a role in the evolution of the insurance sector. There are several issues that need to be addressed, and I shall touch upon a few that I think are important.

Most importantly, the **focal point for this evolution will be the customer**. Fuelled by competition, increased awareness will bring the customers on to centre-stage. The customer will be the single most important factor driving change in the life insurance business. Customers in India are increasingly becoming more aware and are actively managing their financial affairs. Today, while boundaries between various financial products are getting blurred, people are increasingly looking not just at products but at integrated financial solutions that can offer them stability of returns along with total protection. The key to success therefore would be in providing insurance solutions, not insurance products.

In an increasingly competitive scenario the key differentiator will be the customer experience that each life insurance player can offer in terms of quality of advice, product choice, policy servicing, and settlement of claims. Service would focus on enhancing the customer experience and maximizing customer convenience.

In terms of **distribution channels,** the past three years have seen the emergence of corporate agents, brokers and direct sales force in addition to the individual financial consultant. While insurance will continue to be sold primarily through personal interaction, the internet will be effectively used by companies for offering information and by customers for doing comparison shopping. Web-sites will

emerge which will provide this evaluation service comparing the products of different insurers.

Two, potential changes to look out for in terms of the distribution channel will be – one, the gradual evolution of the independent brokers, largely because they will be seen as being independent of the insurance company and representing the interests of the customer; and two bancassurance, which is a specialized form of the corporate agency model. Complex insurance products will however continue to be sold by the agency force. **(Annexure B)**

Arriving at the optimal mix of distribution channels quickly would be critical to the long-term success of the insurers. The insurers' strategy and target market would influence the choice of apprpriate distribution channels. In addition to a wide distribution reach, low distribution costs would play an equally important role in determining long term viability.

Technology, on the other hand, will play a crucial role in delivering the highest standards of service to both the end customer as well as the intermediary. Technology will also help reduce costs significantly and hence get reflected in the pricing of products.

While these trends would be market driven, there are several measures that the insurers, the regulator, and perhaps most importantly, the policy makers will have to address.

1. Regulatory framework

The initial years have been a period of an orderly development of a regulatory framework marked by the absence of the heavy hand of the law in micro matters of product pricing and design. The regulator had chosen to concern itself with the broader issues of policyholder protection and the development of an orderly market. The

significance of the process of regulatory evolution in the insurance industry can be fully appreciated only in the context of the turmoil created by regulatory issues in other recently liberalized sectors In the country. We can be proud of having a regulatory framework of truly global standards.

The future development of the insurance industry would however, depend on how the regulatory regime is enforced. Unfortunately, in the race to gain market share and establish a presence in the market place, we may come across certain questionable market practices, which could adversely affect the image of the insurance industry in the long run. The hope is that the regulator will take action against those who violate the regulations, rather than bringing in fresh additional regulations to strangulate all players, especially those who observe the regulations stringently.

While the regulatory authority has done a commendable job in putting in place a truly world class regulatory framework, it needs to focus now on stringently enforcing regulations.

Also, given the rapid convergence we are seeing in the financial sector, the need for greater co-ordination amongst the different regulators of the financial markets is paramount. No longer will products be offered by specialist institutions – for example, you can get a housing loan from a housing finance company, a bank, commercial or co-operative or from a non-banking finance company. Similarly, it is possible that in the near future, you may be able buy pensions from providers other than life insurance companies. It would be essential to maintain consistency in the regulations applicable to each provider, so as not to create a disadvantageous position for any one provider. These

regulations could be in respect of capital adequacy, equity holding structure, permissible debt-equity norms, access to different sources of funds, investment guidelines, etc. Convergence of the regulatory framework will be crucial to the development of an integrated well functioning financial system.

2. Simplification and rationalisation of insurance laws

Another cause for concern is the delay in the formulation of an unified Act addressing all issues related to insurance. The Insurance Act, 1938 definitely needs amendment to keep up with the changes that have happened in the economy as well as in the markets. Many restrictions enshrined in the Act need to be removed from there and reframed as regulations issued by the regulator, thus enabling a quicker response to changing market conditions.

Experience in other countries suggests that, with the lines between financial services sectors blurring, the laws and policies will have to keep pace with changes in such a dynamic environment.

While this underscores the importance of keeping the principal legislation simple, the regulatory authority will be able to respond faster to emerging issues and market conditions through sub-ordinate legislation or regulations.

The principal legislation covering the Insurance Act, 1938, the IRDA Act, 1999, the LIC Act, 1956, the General Insurance Business Nationalisation Act, 1971, the Marine Insurance Act, 1965, Insurance Rules, 1939 and Ombudsman Rules, 1998 should, therefore, be combined to create a flexible unified principal legislation. Although work on this project has been going on for some time, we hope that the

next Parliament will find the time to enact this important piece of legislation.

3. Risk management

As India opens up more to global markets and participants and becomes an integral part of the global economy, it will feel the effects of market movements and shocks from across the world. No more will we be safely protected from the effects of global forces. Not only will companies need to face up to it, but so also will regulators. The role of the regulator in monitoring the risk profile of each participant will be crucial to maintain the good health of the sector.

The volatility in the capital and financial markets has a direct bearing on the risk profile of insurance companies. Going forward the day may not be far when insurance companies may be permitted to invest in overseas markets. Incidentally, the government is already talking about permitting the new breed of pension providers the option to invest overseas. This will expose the insurance companies to cross-country risks as never before.

Insurers will need to take appropriate risk mitigation measures to minimize risk, while regulators will need to strengthen their armory of risk measuring tools.

The post liberalization period has been not too long, especially when measured in insurance terms. Accurate up to date data on mortality and morbidity experiences is not available. The insurers are taking the initiative to set up a Mortality and Morbidity Investigation Bureau, with technical assistance from the Actuarial Society of India to record, compile and disseminate data on the said subject. The importance of such data cannot be overemphasized, if companies are to price their risks appropriately. Going forward we can expect insurance companies to design

products that may guarantee the mortality risk premium or have the flexibility to adjust them over time.

The implications of all these decisions on the capital requirement and the solvency margins demanded by the regulator will create a dynamic interplay amongst conflicting situations that insurance companies will have to address appropriately.

4. The rural market

Insurance companies have established a presence and extended coverage in the rural areas as well, but there is a lot more that needs to be done.

I believe it is a myth that rural insurance is not profitable. People want cover against exigencies and are willing to pay the price for such cover. The challenge that faces new and old insurance companies is to recognize that the rural market is also segmented, and hence to design products that meet their differing needs without sacrificing profits. Not all people living in rural areas exist below the poverty line, and neither have all benefited equally from the increase in rural incomes. Appropriate distribution channels, service delivery mechanisms will be as crucial to success as will be a proper assessment of the mortality and morbidity risk in rural India. Rural customers will be better served if insurers are allowed to freely choose the products they offer, priced appropriately for the risk assessed, than if some parliamentary desire or regulatory requirement compels them to enter rural markets.

There is a lesson to be learnt from the "sachet" success of the FMCG companies, which designed and priced the product- shampoos, to begin with- to access a new untapped market, driven only by commercial considerations bereft of any regulatory compulsions. The rural consumer has been

the biggest beneficiary of this non-regulatory, commercial initiative. There has to be an economic incentive for a market or category or customer to be effectively and aggressively targeted.

While we should be concerned about addressing the needs of the rural markets, we should keep an eye on the changing population dispersion. Official projections show that while the overall population is expected to grow at an average rate of 1.6% p.a. between 1991 and 2016, there are distinct differences in the trends in urban and rural India. Urban population is expected to grow at 3.3% per annum resulting in possibly 50% of Indians living in urban areas by 2020. This is happening on two counts. One is the inorganic growth of urban India, and the other is that organic population growth and changing employment sources are getting many erstwhile rural areas being re-designated as urban areas. Even today more than half the rural GDP comes from non-agricultural output.

5. Pension reforms – the role for insurance companies

An area of business, which has been a key segment for insurers worldwide and will be critical to the growth and development of the insurance industry in India, is that of insurance against longevity or increased life expectancy. Economic development leads to better living standards and to better health and consequently to enhanced life expectancy. The net result is the increased importance of planning for retirement.

Having spoken at length about life insurance, I would now like to address the subject of 'pensions'. These two sectors are complementary in nature, as one covers the risk of dying too early and the other covers the risk of living beyond one's earning years. This is an area which needs

priority focus from a societal point of view, and I am happy that in recent times it is receiving a lot of attention.

It is never too early to start planning for retirement. If you are not a Government employee, then you are most likely not eligible for a 'non-contributory, inflation indexed, defined benefit pension' linked to your last drawn salary. Most of us in the private sector, and even the self-employed who open a PPF account are members of a "defined contribution" scheme. This does not guarantee you a defined pension on retirement, since the annuity that you will contract for will be dependent on the final value of the balance in your account, which in turn depends on what returns you will have earned over the years. A falling interest environment , like we are experiencing now, makes it all the more crucial that we plan our financial requirements early and save adequately.

Looking at the same issue from a macro perspective, there are several drivers for pension reforms all over the world including the fiscal burden of defined benefit schemes for government as well as companies, rapid demographic changes, the need to channelise savings towards productive economic activity etc.

The average life expectancy of an Indian is expected to be 80 years by the year 2020. That is, the average Indian will be living 20 years beyond his or her earning years. We often lament that the birth rate in this country is not reducing fast enough and is therefore keeping us mired in poverty, or a low growth trajectory. This is fine while looking at the impact it has on suppressing per capita figures, but just look at it in another context. In 1991 there were 111 million Indians in the age group 0 to 4 years, and this will rise to 121 million by 2013 ie less than a 10%

increase. On the other hand, Indians in the age group 60 and over will double from 51 million in 1991 to 101 million by 2013. The total population is expected to increase by 49% between 1991 and 2016, however, the share of the aged in the total population will be 8.9% in 2016.

However, the compelling reason driving pension reform in India has been the fiscal burden of defined benefit schemes for government employees. **(Annexure C).** This has imparted momentum to the changes in the government pension system which have been kicked off for only those who have joined central government services from 1st January 2004.

As per the 1991 census, there were 314 million workers in the country. Of these 47 million (15.2%) were regular salaried employees. Of these around 11 million were covered under the non-contributory, indexed, defined benefit pension funded by the state and central governments. Another 23 million of the salaried non-government workers were covered by mandatory Employee Provident Fund and the Employee Pension Scheme. What this means is that 34 million, or less than 11% of the working population has got old age income security.

The 97 million casual/contract workers and the 166 million self-employed people are outside the scope of the current rigid system. The flexibility provided by the individual pension savings type of accounts offered by insurance companies can bring old age income security to a significantly large and productive component of the nation's population.

A study done by Prof. Vaidyanathan at the IIM-Bangalore on partnership and proprietorship firms is really interesting and revealing. According to this study, this sector (he refers to these firms as the "Bhagidari" sector, rather

than the more commonly used term "unorganized sector") accounts for 33% of the national income. Its share in the manufacturing sector is more than 45%, and in the services sector more than 75%. And it is the services sector which is contributing increasingly to the growth in GDP. The share in savings of this sector is more than 40%.

To me, it is absolutely clear that this sector cannot be left out of any scheme that is to provide for old age income security. The only compelling reason to keep them out of any form of retirement benefit scheme is to assume that these, effectively, self-employed people never retire and they will die in the saddle, and hence don't need such a benefit.

A serious cause for concern, however, has been the fact that all debate regarding reforms in the pension sector has focused on the central government employees retirement scheme. Currently, another 29 million salaried non-government employees are covered under the Employee Provident Fund , which now has a corpus in excess of Rs 120,000 crores. This includes amounts being managed by exempt funds in the corporate sector. All of these funds have to be invested in a prescribed manner – 25% in central government securities, 15% in state government securities and state government guaranteed securities, 30% (was 40% until recently) in public sector companies and public financial institutions, and the balance in any of the above, including not more than 10% in private sector debt.

Anyone who will retire in the next few years may not be able to look forward to a happy retired life safe in the knowledge that he will get a large corpus back from the EPF. The quality of these mandatory investments is suspect. Look at the large allocation to the state government sector.

Over the next five years Rs 45,000 to Rs 60,000 crores of state government guaranteed paper will mature for repayment and will most certainly devolve on the state governments, and given the precarious financial position of the state governments I am worried. The rating agencies have already expressed concern regarding the possibility of default by the issuer and the consequent devolution of the liability onto the state government. Take the large allocations made to investment in PSU and PFI bonds. There was a time when these PFIs were pillars of strength, but today, we see that IFCI has already defaulted on bonds in which the EPF has invested. This does not include the additional exposure of the EPF in such bonds which have not yet come up for redemption as well as investments made by exempt funds.

I have not yet talked about the interest rate risk that the EPF is exposing all its members to. Even after considering that the EPF has invested in the past in high yielding government securities and the Special Deposit scheme of the government, it does not seem to be willing to acknowledge the sharp drop in interest rates that we have seen in the economy over the last few years. Reports suggest that the current yield on their investments is 7.5% - 8.5%pa and yet the EPF is assuring a return of 9.5%. By declaring such an unrealistic return, not only is it putting itself at risk, but also all the exempt funds which are required to pay its members a similar return. The cascading effect of this irresponsible behaviour is truly frightening in terms of its effects on the rest of the financial sector.

I have not yet talked about the shortages in the pension funds of the public sector banks, the railways, posts and telegraph department, telecom department, the

coal miners, Assam tea plantations, seamen and the defence services. Over and above all this is the continuing drain arising out of the non-contributory, inflation indexed, defined benefit pension of the civil service which is completely unfunded and paid out of the current revenues of the government.

At the moment though there is uncertainty over how the newly constituted Pension Regulatory Authority will interact with the IRDA, in as much as life insurance companies will be possibly regulated by both.

With effect from January 1, 2004, all new central government employees will be covered by the new contributory pension scheme. The government has established, through an ordinance, a new regulatory body called the Pension Fund Regulatory and Development Authority, on similar lines, I think, as the IRDA. Ideally speaking, given that insurance and pension are complementary issues, there should have been just one regulator for the two sectors. Also given the convergence of the financial sector, some countries have experimented with having a single regulator for the entire financial sector, including banks, capital market players, insurance and pension companies. We could have begun by at least having one regulator for the insurance and pension sectors. Given the current situation, however, one can only hope for a high level of co-ordination between the two regulators to ensure a level playing field for all pension providers. In the absence of any clarity so far from the government, there is confusion regarding the possible entry norms, capital structure and foreign equity holdings that will be permissible for pension providers, and whether these would be different than those prescribed for the insurance companies. And if this is so,

how are the two sets of companies to compete on a level playing field.

It is in this backdrop that I would like to make the case for insurance companies as pension providers. There are several reasons why the insurance companies are ideally suited to helping their customers plan for their retirement needs through an orderly accumulation and an appropriate annuity thereafter. Arguing against the nationalization of the insurance business in 1955, A D Shroff had said that "the insurance habit could be created and stimulated only through a highly efficient and individualized sales service". The same holds true for pensions.

Insurance companies in India are already playing an important role in the pension sector as direct financial vehicles, through group insurance plans and personal pension plans, as an alternative instrument for post retirement savings. I believe that the insurance companies are adequately capitalized to take on this business, and also have the necessary distribution, investment and servicing capabilities to enable them to make a quick start.

Conclusion

In the increasingly complex world that life insurance companies operate in, the keys to success would depend on a) the ability to understand the customer needs and service them efficiently and effectively at the lowest cost, b) the development of systems to manage the multi-level risks faced by them, and c) practise the highest levels of transparency and corporate governance to increase customer confidence.

In the backdrop of demographic shifts resulting in ageing populations and lengthened life expectancies all over the world, including India, life insurance companies will focus more on helping their customers plan for their

retirement needs through an orderly accumulation and an appropriate annuity thereafter. Life insurance companies with their investment management expertise and their actuarial skills are best positioned to ride this turmoil. Pensions will be a critical growth area for the insurance industry.

The government, urgently needs to take a holistic view of reforms in the pension sector, and not just restrict its activities to that affecting its own employees. We need a single regulator for this sector. Today, the EPFO, Ministry of Labour, Ministry of Finance and the Income Tax department regulate parts of the system, and unfortunately there is no co-ordination between them. Also the regulatory aspect is restricted to checking adherence to administrative norms. There is no evaluation of whether actuarial valuations have been done and whether funding levels are appropriate.

Although A D Shroff's relentless campaign did not succeed in changing government policies at the time, today we need someone with his vision to ensure that pension reforms are properly put in place.

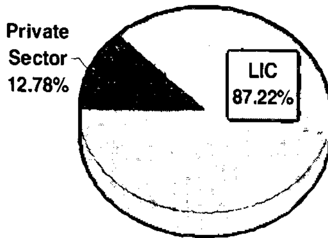
In this world, corporations and institutions have an enormous responsibility to support the reinstatement of a business ethic that shuns short cuts and unethical practices; that builds a management style to reflect this ethic; that is quick to promote an active public service strategy and is in tune with the environment in which it operates. In the long run, this approach makes business sense as customers are likely to be much more discriminating in a world of information and transparency and are likely to gravitate to those institutions that have impeccable standing, enlightened leadership and a strong element of social responsiveness.

Annexure A

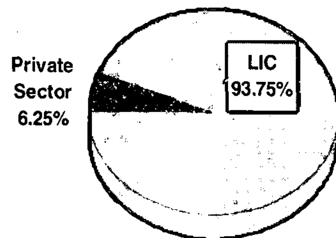
	Premiums	No. of policies / schemes	No. of lives covered under Group Schemes	% of lives covered under Group Schemes
Private Sector	166,629.31	1,288,500	1,417,582	28.44
LIC	1,137,126.91	19,341,707	3,566,606	71.56
Total	1,303,756.22	20,630,207	4,984,188	100.00

Market share (End of February 2004)

Premiums

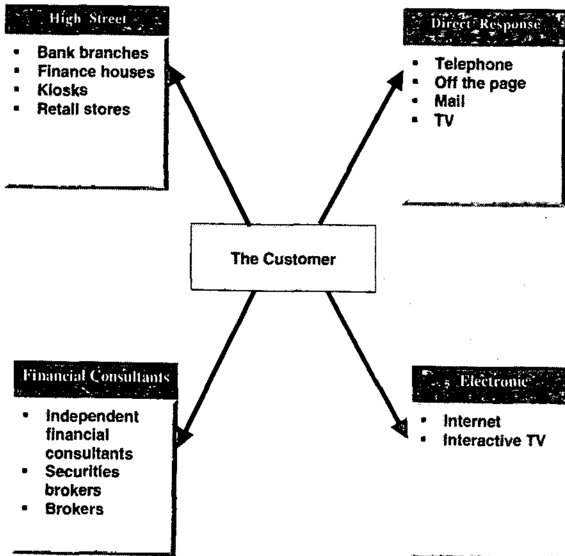


No. of policies / schemes



Annexure B

Intermediaries and distribution channels



Annexure C

Pension expenditure of the Government

(in Rs. Crores)

	Civil	Telecom	Railways	Defence	Posts	Total
1990-91	480.42	85.18	886.00	1670.12	150.31	3272.03
1991-92	582.80	102.71	1040.00	1840.07	182.28	3747.86
1992-93	700.56	117.39	1251.00	2312.77	203.64	4585.36
1993-94	817.97	142.14	1488.00	2530.76	227.43	5206.30
1994-95	933.91	156.27	1686.00	2704.13	253.41	5733.72
1995-96	1103.30	199.42	2117.00	3196.59	311.73	6928.04
1996-97	1425.04	251.77	2509.00	3682.62	384.39	8252.82
1997-98	1948.41	412.85	3509.00	4947.12	558.25	11375.63
1998-99	2803.10	451.65	4144.00	7270.28	676.76	15345.79
1999-00	3285.72	437.02	4018.00	11024.02	681.56	19446.32
2000-01	4021.00	575.00	5167.00	10539.00	815.00	21117.00
2001-02	4320.00	685.00	5800.00	10770.00	835.00	22410.00
CAGR	25%	23%	21%	20%	19%	21%

Projections of Financial Savings

Gross Savings (in Rs. Billion)

	2000	2005	2010	2015	2020	2025
Currency	21100	29100	39700	50500	61400	67900
Net deposits	88400	122100	166400	211900	257500	284800
Shares and Debentures	15000	20700	28200	35900	43600	48200
Net Claims on Government	29100	40100	54700	69700	84600	93600
Provident and Pension Funds	**56100**	**77500**	**105600**	**134500**	**163500**	**180800**
Gross Savings	236500	326600	445300	567100	689000	762100

Source: The Reserve Bank of India

Annexure D

Government-sponsored schemes for old age income security in India

Program	Coverage	Percentage of working population covered	Contributions
Employees' Provident Fund	Employees in firms with more than 20 employees	5.8 percent	Employer and employee contributions
Employees' Pension Fund	same as above with some exemptions	5.4 percent	Employer, government contributions
Civil Service Pension Scheme	civil servants at state and federal level	3.5 percent	State or central government budgets
Government Provident Fund	civil servants at state and federal level	Most civil servants	Employee Contributions
Special Provident Funds	certain occupations and employees in Jammu and Kashmir	0.5 percent	Employer and employee contributions

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