Impact of fdi in life insurance sector

Economics, Insurance

A Comprehensive Project ON “ Impact of Foreign Direct Investment in life Insurance Industry” Submitted to Gujarat Technological University IN PARTIAL FULFILLMENT OF THE REQUIREMENT OF THE AWARD FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION UNDER THE GUIDANCE OF Prof. Himanshu Chauhan Submitted by Pratik PanchalEnrollment No. : 117010592053 Ajay vajaEnrollment No. : 117010592077 YEAR: 2011-2013 MBA SEMESTER III Affiliated to Gujarat Technological University Ahmedabad| DECLARATION

We, Panchal PRatik and Ajay Vaja student of AHMEDABAD INSTITUTE OFTECHNOLOGYhereby, declare that the Project report on “ Impact of Foreign Direct Investment on Indian Insurance” is our original work and has not been published elsewhere. This has been undertaken for the purpose of partial fulfillment of GUJARAT TECHNOLOGICAL UNIVERSITY requirement for the award of the degree of Master of Business Administration. (Signature) Date: __/__/2012Pratik Panchal Place: Ahmedabad Ajay Vaja Acknowledgement Perseverance, inspiration andmotivationhave played a great role in the success of any venture.

We are thankful to our collage for giving us the opportunity to work with such an eminent section of Indian financial sector. We are grateful to our faculty mentor Prof. Himanshu Chauhan for guiding us throughout the project and for supporting us through his constant guidance and encouragement. For their immense help in making our project fruitful. Finally, not to miss anyone, we thank all the people who have directly or indirectly helped us a lot throughout the project time period and in completion of our project successfully. Panchal Pratik P. Ajay Vaja MBA- III

Institute’s Certificate “ Certified that this Comprehensive Project Report Titled “ Impact of Foreign Direct Investment inlife Insurance Industry” is the bonafide work of Mr. Pratik Panchal (Enrollment No- 117010592053.)& Ajay Vaja (Enrollment No- 117010592077.) who carried out the research under our supervision. We also certify further, that to the best of my knowledge the work reported herein does not form part of any other project report or dissertation on the basis of which a degree or award was conferred on an earlier occasion on this or any other candidate.

Signature of the Faculty Guide (Prof. Himanshu Chauhan) (Dr. NehaParashar) (Certificate is to be countersigned by the HoD) INDEX CHAPTER NO. | NAME| PAGE NO. | 1. | INTRODUCTION Introduction of Life Insurance industryIntroduction of FDIImpact of FDI in INDIA| | 2. | LITERTURE REVIEW| | 3. | RESEARCH METHODOLOGY| | | a) OBJECTIVES OF THE STUDY| | | b) SCOPE OF THE STUDY:| | | C)RESEARCH DESIGN| | | c) RESEARCH SAMPLE| | | d) SOURCES OF DATA :| | | e) SAMPLING PLAN| | | f) DATA ANALYSIS| | | g) DATA COLLECTION :| | | CONCLUSION| | 4. | REFERENCES| | Life Insurance

Life insurance was initially designed to protect the income of families, particularly young families in the wealth accumulation phase, in the event of the head of household's death. Today, life insurance is used for many reasons, including wealth preservation and estate tax planning. Life insurance provides you with the opportunity to protect yourself and yourfamilyfrom personal risk exposures like repayment of debts after death, providing for a surviving spouse and children, fulfilling other economicgoals(such as putting your kids through college), leaving a charitable legacy, paying for funeral expenses, etc.

Life insurance protection is also important if you are a business owner or a key person in someone else's business, where your death (or your partner's death) might wreak financial havoc. Life insurance is a great financial planning tool, but should never be thought of as a savings vehicle. In general, there are often far better places to hold and grow yourmoneyas you get older. History of Life Insurance in India In India, insurance has a deep-rooted history. It finds mention in the writings of Manu (Manusmrithi), Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra).

The writings talk in terms of pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine. This was probably a pre-cursor to modern day insurance. Ancient Indian history has preserved the earliest traces of insurance in the form of marine trade loans and carriers' contracts. Insurance in India has evolved over time heavily drawing from other countries, England in particular. 1818 saw the advent of life insurance business in India with the establishment of the Oriental Life Insurance Company in Calcutta. This Company however failed in 1834.

In 1829, the Madras Equitable had begun transacting life insurance business in the Madras Presidency. 1870 saw the enactment of the British Insurance Act and in the last three decades of the nineteenth century, the Bombay Mutual (1871), Oriental (1874) and Empire of India (1897) were started in the Bombay Residency. This era, however, was dominated by foreign insurance offices which did good business in India, namely Albert Life Assurance, Royal Insurance, Liverpool and London Globe Insurance and the Indian offices were up for hard competition from the foreign companies.

In 1914, the Government of India started publishing returns of Insurance Companies in India. The Indian Life Assurance Companies Act, 1912 was the first statutory measure to regulate life business. In 1928, the Indian Insurance Companies Act was enacted to enable the Government to collect statistical information about both life and non-life business transacted in India by Indian and foreign insurers including provident insurance societies.

In 1938, with a view to protecting the interest of the Insurance public, the earlier legislation was consolidated and amended by the Insurance Act, 1938 with comprehensive provisions for effective control over the activities of insurers. The Insurance Amendment Act of 1950 abolished Principal Agencies. However, there were a large number of insurance companies and the level of competition was high. There were also allegations of unfair trade practices. The Government of India, therefore, decided to nationalize insurance business. Birth of Life Insurance of India

An Ordinance was issued on 19thJanuary, 1956 nationalizing the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The LIC absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies—245 Indian and foreign insurers in all. The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector. The history of general insurance dates back to the Industrial Revolution in the west and the consequent growth of sea-faring trade and commerce in the 17th century. It came to India as a legacy of British occupation.

In 1968, the Insurance Act was amended to regulate investments and set minimum solvency margins. The Tariff Advisory Committee was also set up

then IRDA and Opening of Life Insurance Business in India This millennium has seen insurance come a full circle in a journey extending to nearly 200 years. The process of re-opening of the sector had begun in the early 1990s and the last decade and more has seen it been opened up substantially. In 1993, the Government set up a committee under the chairmanship of RN Malhotra, former Governor of RBI, to propose recommendations for reforms in the insurance sector.

The objective was to complement the reforms initiated in the financial sector. The committee submitted its report in 1994 wherein, among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies are allowed to enter by floating Indian companies, preferably a joint venture with Indian partners. Following the recommendations of the MalhotraCommittee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutorybody in April, 2000.

The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market. The IRDA opened up the market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26%. The Authority has the power to frame regulations under Section 114A of the Insurance Act, 1938 and has from 2000 onwards framed various regulations ranging from registration of companies for carrying on insurance business to protection of policyholders’ interests.

Today there are 23 life insurance companies operating in the country, including LIC a public sector company and 22 other private sector life insurance companies competing with LIC for Life insurance business from the customers in India. Regulatory Framework for Life Insurance in India The main regulation that regulates the life insurance business is the Life Insurance Corporation Act, 1956. Deposits

Every insurer should, inrespectof the insurance business carried on by him in India, deposit with the Reserve Bank of India (" RBI") for and on behalf of the Central Government of India the following amounts, either in cash or in approved securities estimated at the market value of the securities on the day of deposit, or partly in cash and partly in approved securities: * In the case of life insurance business, a sum equivalent to one per cent of his total gross premium written in India in any financial year commencing after the 31 day of March, 2000, not exceeding rupees hundred million..

Investments Every insurer is required to invest and keep invested cert ain amount of assets as determined under the Insurance Act. The funds of the policyholders cannot be invested (directly or indirectly) outside India.

An insurer involved in the business of life insurance is required to invest and keep invested at all times assets, the value of which is not less than the sum of the amount of its liabilities to holders of life insurance policies in India on account of matured claims and the amount required to meet the liability on policies of life insurance maturing for payment in India, reduced by the amount of premiums which have fallen due to the insurer on such policies but have not been paid and the days of grace for payment of which have not expired and any amount due to the insurer for loans granted on and within

the surrender values of olicies of life insurance maturing for payment in India issued by him or by an insurer whose business he has acquired and in respect of which he has assume liability. Every insurer carrying on the business of life insurance is required to invest and at all times keep invested his controlled fund (other than funds relating to pensions and general annuity business and unit linked life insurance business) in the following manner, free of any encumbrance, charge, hypothecation or lien:

For the purposes of calculating the investments, the amount of deposits made with the RBI by the insurer in respect of his life insurance business shall be deemed to be assets invested in Government securities. In computing the assets to be invested by the insurer, any investment made with reference to the currency other than the Indian rupee which is in excess of the amount required to meet the liabilities of the insurer in India with reference to that currency to the extent of such excess and any investment made in purchase of any immovable property outside India or on account of any such property shall not be taken into account.

Further, an insurer should not out of his controlled fund invest any sum in the shares or debentures of any private limited company. Where an insurer has accepted reassurance in respect of any policies of life insurance issued by another insurer and maturing for payment in India or has ceded reassurance to another insurer in respect of any such policies issued by himself, the assets to be invested by the insurer shall be increased by the amount of the liability involved in such acceptance and decreased by the amount of the liability involved in such cession.

In case of an insurer incorporated or domiciled outside India or an insurer incorporated in India whose share capital to the extent of one-third is owned by, or the members of whose governing body to the extent of one-third consists of members domiciled elsewhere than in India, the assets required to be invested should, (except to the extent of any part which consists of foreign assets held outside India) be held in India by way of a trust for the discharge of the liabilities.

Every Insurer shall invest and at all times keep invested his segregated fund of unit linked life insurance business as per pattern of investment offered to and approved by the policy-holders. The insurer is permitted to offer unit linked policies only where the units are linked to categories of assets that are both marketable and easily realizable. However, the total investment in other approved category of investments should at no time exceed twenty five per cent of the funds. List of Life Insurance Companies in India 1. Bajaj Allianz Life Insurance Company Limited . Birla Sun Life Insurance Co. Ltd 3. HDFC Standard Life Insurance Co. Ltd 4. ICICI Prudential Life Insurance Co. Ltd 5. ING Vysya Life Insurance Company Ltd. 6. Life Insurance Corporation of India 7. Max Life Insurance Co. Ltd 8. Met Life India Insurance Company Ltd. 9. Kotak Mahindra Old Mutual Life Insurance Limited 10. SBI Life Insurance Co. Ltd 11. Tata AIA Life Insurance Company Limited 12. Reliance Life Insurance Company Limited. 13. Aviva Life Insurance Company India Limited 14. Sahara India Life Insurance Co, Ltd. 15. Shriram Life Insurance Co, Ltd. 6. Bharti AXA Life Insurance Company Ltd. 17. Future Generali India Life Insurance Company Limited 18. IDBI Federal Life Insurance 19. Canara HSBC Oriental Bank of Commerce Life Insurance Company Ltd. 20. AEGON

Religare Life Insurance Company Limited. 21. DLF Pramerica Life Insurance Co. Ltd. 22. Star Union Dai-ichi Life 23. IndiaFirst Life Insurance Company Limited 24. Edelweiss Tokio Life Insurance Co. Ltd. Types of Life Insurance Life insurance protection comes in many forms, and not all policies are created equal, as you will soon discover.

While the death benefit amounts may be the same, the costs, structure, durations, etc. vary tremendously across the types of policies. WHOLE LIFE Whole life insurance provides guaranteed insurance protection for the entire life of the insured, otherwise known as permanent coverage. These policies carry a " cash value" component that grows tax deferred at a contractually guaranteed amount (usually a low interest rate) until the contract is surrendered. The premiums are usually level for the life of the insured and the death benefit is guaranteed for the insured's lifetime.

With whole life payments, part of your premium is applied toward the insurance portion of your policy, another part of your premium goes toward administrative expenses and the balance of your premium goes toward the investment, or cash, portion of your policy. The interest you accumulate through the investment portion of your policy is tax-free until you withdraw it (if that is allowed under the terms of your policy). Any withdrawal you make will typically be tax free up to your basis in the policy. Your basis is the amount of premiums you have paid into the policy minus any prior dividends paid or previous withdrawals.

Any amounts withdrawn above your basis may be taxed as ordinary income. As you might expect, given their permanent protection, these policies tend to have a much higher initial premium than other types of life insurance. But,

the cash build up in the policy can be used toward premium payments, provided cash is available. This is known as a participating whole life policy, which combines the benefits of permanent life insurance protection with a savings component, and provides the policy owner some additional payment flexibility. UNIVERSAL LIFE

Universal life insurance, also known as flexible premium or adjustable life, is a variation of whole life insurance. Like whole life, it is also a permanent policy providing cash value benefits based on current interest rates. The feature that distinguishes this policy from its whole life cousin is that the premiums, cash values and level amount of protection can each be adjusted up or down during the contract term as the insured's needs change. Cash values earn an interest rate that is set periodically by the insurance company and is generally guaranteed not to drop below a certain level.

VARIABLE LIFE Variable life insurance is designed to combine the traditional protection and savings features of whole life insurance with the growth potential of investment funds. This type of policy is comprised of two distinct components: the general account and the separate account. The general account is the reserve or liability account of the insurance provider, and is not allocated to the individual policy. The separate account is comprised of various investment funds within the insurance company's portfolio, such as an equity fund, a money market fund, a bond fund, or some combination of these.

Because of this underlying investment feature, the value of the cash and death benefit may fluctuate, thus the name " variable life". VARIABLE UNIVERSAL LIFE Variable universal life insurance combines the features of

universal life with variable life and gives the consumer the flexibility of adjusting premiums, death benefits and the selection of investment choices. These policies are technically classified as securities and are therefore subject to Securities and Exchange Commission (SEC) regulation and the oversight of the state insurance commissioner.

Unfortunately, all the investment risk lies with the policy owner; as a result, the death benefit value may rise or fall depending on the success of the policy's underlying investments. However, policies may provide some type of guarantee that at least a minimum death benefit will be paid to beneficiaries. TERM LIFE One of the most commonly used policies is term life insurance. Term insurance can help protect your beneficiaries against financial loss resulting from your death; it pays the face amount of the policy, but only provides protection for a definite, but limited, amount of time.

Term policies do not build cash values and the maximum term period is usually 30 years. Term policies are useful when there is a limited time needed for protection and when the dollars available for coverage are limited. The premiums for these types of policies are significantly lower than the costs for whole life. They also (initially) provide more insurance protection per dollar spent than any form of permanent policies. Unfortunately, the cost of premiums increases as the policy owner gets older and as the end of the specified term nears. Term polices can have some variations, including, but not limited to:

Annual Renewable and Convertible Term: This policy provides protection for one year, but allows the insured to renew the policy for successive periods thereafter, but at higher premiums without having to furnish evidence of

insurability. These policies may also be converted into whole life policies without any additional underwriting. Level Term: This policy has an initial guaranteed premium level for specified periods; the longer the guarantee, the greater the cost to the buyer (but usually still far more affordable than permanent policies).

These policies may be renewed after the guarantee period, but the premiums do increase as the insured gets older. Decreasing Term: This policy has a level premium, but the amount of the death benefit decreases with time. This is often used in conjunction with mortgage debt protection. Many term life insurance policies have major features that provide additional flexibility for the insured/policyholder. A renewability feature, perhaps the most important feature associated with term policies, guarantees that the insured can renew the policy for a limited number of years (i. e. term between 5 and 30 years) based on attained age. Convertibility provisions permit the policy owner to exchange a term contract for permanent coverage within a specific time frame without providing additional evidence of insurability. Foodfor Thought Many insurance consumers only need to replace their income until they've reached retirement age, have accumulated a fair amount of wealth, or their dependents are old enough to take care of themselves. When evaluating life insurance policies for you and your family, you must carefully consider the purchase of temporary versus permanent coverage.

As you have just read, there are many differences in how policies may be structured and how death benefits are determined. There are also vast differences in their pricing and in the duration of life insurance protection.

Many consumers opt to buy term insurance as a temporary risk protection and then invest the savings (the difference between the cost of term and what they would have paid for permanent coverage) into an alternative investment, such as a brokerage account, mutual fund or retirement plan. Section I: Industry overview

The insurance industry in India has come a long way since the time when businesses were tightly regulated and concentrated in the hands of a few public sector insurers. Following the passage of the Insurance Regulatory and Development Authority Act in 1999, India abandoned public sector exclusivity in the insurance industry in favor of market-driven competition. This shift has brought about major changes to the industry. The beginning of a new era of insurance development has seen the entry of international insurers, the proliferation of innovative products and distribution channels, as well as the raising of supervisory standards.

Evolution of the industry The growing demand for insurance around the worldcontinues to have a positive effect on the insurance industryacross all economies. India, being one of the fastest-growingeconomies (even in the current global economic slowdown), has exhibited a significant increase in its GDP, and aneven larger increase in its GDP per capita and disposableincome. Increasing disposable income, coupled with the highpotential demand for insurance offerings, has opened manydoors for both domestic and foreign insurers. The followingtable briefly depicts the evolution of the insurance sectorin India.

Exhibit. 1. 1. Tracing the chronological evolution of the insurance industry Year | Event| 1818| Oriental Life Insurance Co. was established in Calcutta. |

1870| The first insurance company, Bombay Mutual Life Insurance Society, was formed. | 1907| The Indian Mercantile Insurance Limited was formed. | 1912| * Life Insurance Companies Act and the Pension Fund Act of 1912 * Beginning of formal insurance regulations| 1928| The Indian Insurance Companies Act was passed to collect statistical data on both life and non-life. 1938| The Insurance Act of 1938 was passed; there was strict state supervision to control frauds. | 1956| * The Central Government took over 245 Indian and foreign life insurers as well as provident societies and nationalized these entities. * The LIC Act of 1956 was passed. | 1957| The code of conduct by the General Insurance Council to ensure fair conduct and ethical business practices was framed. | 1972| The General Insurance Business (Nationalization) Act was passed. | 1991| Beginning of economic liberalization| 1993| The Malhotra Committee was set up to complement the reforms initiated in the financial sector. 1994| Detariffication of aviation, liability, personal accidents andhealthand marine cargo products| 1999| The Insurance Regulatory and Development Authority (IRDA) Bill was passed in the Parliament. | 2000| * IRDA was incorporated as the statutory body to regulate and register private sector insurance companies. * General Insurance Corporation (GIC), along with its four subsidiaries, i. e. , National Insurance Company Ltd. , Oriental Insurance Company Ltd. , New India Assurance Company Ltd. and United India Assurance Company Ltd. , was made India’s national reinsurer. 2005| Detariffication of marine hull| 2006| Relaxation of foreign equity norms, thus facilitating the entry of new players| 2007| Detariffication of all non-life insurance products except the auto third-party liability segment| In India, the Ministry ofFinanceis responsible for

enacting and implementing legislations for the insurance sector with the Insurance Regulatory and Development Authority (IRDA) entitled with the regulatory and developmental role. The government also owns the majority share in some major companies in both life and non-life insurance segments.

Both the life and non-life insurance sectors in India, which were nationalized in the 1950s and 1960s, respectively, were liberalized in the 1990s. Since the formation of IRDA and the opening up of the insurance sector to private players in 2000, the Indian insurance sector has witnessed rapid growth. Current scenario A growing middle-class segment, rising income, increasing insurance awareness, rising investments and infrastructure spending, have laid a strong foundation to extend insurance services in India. The total premium of the insurance industry has increased at a CAGR of 24. % between FY03 and FY09 to reach INR2, 523. 9 billion in FY09. The opening up of the insurance sector for private participation/global players during the 1990s has resulted in stiff competition among the players, with each offering better quality products. This has certainly offered consumers the choice to buy a product that best fits his or her requirements. The number of players during the decade has increased from four and eight in life and non-life insurance, respectively, in 2000 to 23 in life and 24 in non-life insurance (including 1 in reinsurance) industry as in August 2010.

Most of the private players in the Indian insurance industry are a joint venture between a dominant Indian company and a foreign insurer. Life insurance industry overview The life insurance sector grew at an impressive CAGR of25. 8% between FY03 and FY09, and the number of policies issued increased at a CAGR of 12. 3% during the same period. As of August 2010,

there were 23 players in the sector(1 public and 22 private). The Life Insurance Corporation ofIndia (LIC) is the only public sector player, and held almost 65% of the market share in FY10 (based on first-year premiums).

To address the need for highly customized products andensure prompt service, a large number of private sector players have entered the market. Innovative products, aggressive marketing and effective distribution have enabled fledgling private insurance companies to sign up Indian customers more rapidly than expected. Private sector players are expected to play an increasingly important role in the growth of the insurance sector in the near future. In a fragmented industry, new players are gnawing away the market share of larger players.

The existing smaller players have aggressive plans for network expansion as their foreign partners are keen to capitalize on the enormous potential that is latent in the Indian life insurance market. ICICI Prudential, Bajaj Allianz and SBI Life collectively account for approximately 50% of the market share in the private life insurance segment. To tap this opportunity, banks have also started entering alliances with insurance companies to develop/underwrite insurance products rather than merely distribute them. Non-life insurance industry overview Between FY03 and FY10, the non-life insurance sector grew at a CAGR of 17. 05%.

Intense competition that followed the de-tariffication and pricing deregulation (which was started during FY07) decelerated the growth momentum. As of August 2010, the sector had a total of 24 players (6 public insurers, 17 private insurers and 1 re-insurer). The non-life insurance sector offers products such as auto insurance, health insurance, fire insurance and

marine insurance. In FY10, the non-life insurance industry had the following product mix. Private sector players have now pivoted their focus on auto and health insurance. Out of the total non-life insurancepremiums during FY10, auto insurance accounted for 43. % of the market share. The health insurance segment hasposted the highest growth, with its share in the total non-life insurance portfolio increasing from 12. 8% in FY07 to 20. 8% in FY10. These two sectors are highly promising, and are expected to increase their share manifold in the coming years. With the sector poised for immense growth, more players, including monocline players, are expected to emerge in the near future. The last two years has seen the emergence of companies specializing in health insurance such as Star Health & Allied Insurance and Apollo DKV.

In the last decade, it was observed that most players have experienced growth by formulating aggressive growth strategies and capitalizing on their distribution network to target the retail segment. Although the players in the private and public sector largely offer similar products in the non-life insurance segment, private sector players outscore their public sector counterparts in their quality of service. Growth drivers > India’s favorable demographics help strengthen market penetration The life insurance coverage in India is very low, and many of those insured are underinsured.

There is immense potential as the working population (25–60 years) is expected to increase from 675. 8 million to 795. 5 million in the next 20 years (2006–2026). The projected per capita GDP is expected to increase from INR18, 280 in FY01 to INR100, 680 in FY26, which is indicative of rising disposable incomes. The demand for insurance products is expected to

increase in light of the increase in purchasing power. > Health insurance attracts insurance companies The Indian health insurance industry was valued at INR51. 2 billion as of FY10. During the period FY03–10, the growth of the industry was recorded at a CAGR of 32. 9%. The share of health insurance was 20. 8% of the total non-life insurance premiums in FY10. Health insurance premiums are expected to increase to INR300 billion by 2015. Private sector insurers are more aggressive in this segment. Favorable demographics, fast progression of medical technology as well as the increasing demand for better healthcare has facilitated growth in the health insurance sector. Life insurance companies are expected to target primarily the young population so that they can amortize the risk over the policy term. > Rising focus on the rural market

Since more than two-thirds of India’s population lives in rural areas, micro insurance is seen as the most suitable aid to reach the poor and socially disadvantaged sections of society. Poor insurance literacy and awareness, high transaction costs and inadequate understanding of client needs and expectations has restricted the demand for micro-insurance products. However, the market remains significantly underserved, creating a vast opportunity to reach a large number of customers with good value insurance, whether from the base of existing insurers or through retail distribution networks.

In FY09, individuals generated new business premium worth INR365. 7 million under 2. 15 million policies, and the group insurance business amounted to INR2, 059. 5 million under 126 million lives. LIC contributed most of the business procured in this portfolio by garnering INR311. 9 million

of individual premium from 1. 54 million lives and INR1, 726. 9 million of group premium under 11. 1 million lives. LIC was the first player to offer specialized products with lower premium costs for the rural population. Other private players have also started focusing onthe rural market to strengthen their reach.

Government tax incentive Currently, insurance products enjoy EEE benefits, giving insurance products an advantage over mutual funds. Investors are motivated to purchase insurance products to avail the nearly 30% effective tax benefit on select investments (including life insurance premiums) made every financial year. Life insurance is already the most popular financial product among Indians because of the tax benefits and income protection it offers in a country where there is very little social security. This drives more and more people to come within the insurance ambit. Emerging trends

Exploring multiple distribution channels for insurance products: To increase market penetration, insurance companies need to expand their distribution network. In the recent past, the industry has witnessed the emergence of alternate distribution channels, which include banc assurance, direct selling agents, brokers, online distribution, corporate agents such as non-banking financial companies (NBFCs) and tie-ups of parabanking companies with local corporate agencies (e. g. NGOs) in remote areas. Agencies have been the most important and effective channel of distribution hitherto.

The industry is viewing the movement of intermediaries from mere agents to advisors. Product innovation With customers asking for higher levels of customization, product innovation is one of the best strategies for companies to increase their market share. This also creates greater efficiency as

companies can maintain lower unit costs, offer improved services and distributors can increase flexibility to pay higher commissions and generate higher sales. The pension sector, due to its inadequate penetration (only 10% of the working population is covered) offers tremendous potential for insurance companies to be more innovative.

Consolidation in future The past few years have witnessed the entry of many companies in the domestic insurance industry, attracted by the significant potential of insurance sector. However, increasing competition in easily accessible urban areas, the FDI limit of 26% and the recent downturn in equity markets have impacted the growth prospects of some small private insurance companies. Such players may have to rethink about their future growth plans. Hence, consolidation with large and established players may prove to be a better solution for such small insurers.

Larger companies would also prefer to take over or merge with other companies with established networks and avoid spending money in marketing and promotion. Therefore, consolidation will result in fewer but stronger players in the country as well as generate healthy competition. Mounting focus on EV over profitability Many companies are achieving profitability by controlling expenses; releasing funds for future appropriations as well as through a strong renewal premium build up. As a few larger insurers continue to expand, most are focused on cost rationalization and the alignment of business models to ground level realities.

This will better equip insurers to realize reported embedded value (EV) and generate value from future new business. In the short term, companies are

likely to face challenges to achieve the desired levels of profitability. As companies are also planning to get listed and raise funds, the higher profitability will help companies to get a better valuation of shares. However, in the long term, companies would need to focus on increasing EV, as almost 70% of a company's EV is influenced by renewal business and profitability is not as much of an indicator for valuation.

Hence, players are now focusing on increasing their EV than profitability figures. Rising capital requirements Since insurance is a capital-intensive industry, capital requirements are likely to increase in the coming period. The capital requirement in the life insurance business is a function of the three factors: (1) sum at risk; (2) policyholders' assets; (3) new business strain and expense overruns. With new guidelines in place, capital requirements across the sector are likely to go up due to: Higher sum assured driving higher sum at risk Greater allocation to policyholders' assets due to lower charges

Back loading of charges is resulting in high new business strain, and expense overruns due to low productivity of the newly set distribution network (and inability to recover corresponding costs upfront) For non-life insurance companies, the growing demand for health insurance products as well as motor insurance products is likely to boost the capital requirement. With the capital market picking up and valuations on the rise, insurance companies are exploring various ways of increasing their capital base to invest in product innovation, introducing new distribution channels, educating customers, developing the brand, etc.

This is due to the following reasons: A major portion of the costs in insurance companies is fixed (though it should be variable or semi-variable in nature). Hence, the reduction in sales will not result in the lowering of operational expenses, thus adversely impacting margins. As such, reduced margins would impact profitability, and insurers would need to invest additional funds. The sustained bearishness in capital markets could further pressurize the investment margins and increase the capital strain, especially in the case of capital/return guarantee product.

Besides, companies are likely to witness a slowdown in new business growth. Companies may also opt for product restructuring to lower their costs and optimally utilize capital. According to IRDA Regulations 2000, all insurance companies are required to maintain a solvency ratio of 1. 5 at all times. But this solvency margin is not sustainable. With the growing market risks, the level of required capital will be linked to the risks inherent in the underlying business. India is likely to start implementing Solvency II norms in the next three to four years.

The transition from Solvency I norms to Solvency II norms by 2012 is expected to increase the demand for actuaries and risk management professionals. The regulator has also asked insurance companies to get their risk management systems and processes audited every three years by an external auditor. Many insurance companies have started aligning themselves with the new norms and hiring professionals to meet the deadline. Contribution of the insurance sector to the economy Insurance has had a very positive impact on India’s economic development.

The sector is gradually increasing its contribution to the country's GDP. In addition, insurance is driving the infrastructure sector by increasing investments each year. Further, insurance has boosted the employment scenario in India by providing direct as well as indirect employment opportunities. Due to the healthy performance of the Indian economy, the share of life insurance premiums in the gross domestic savings (GDS) of the households sector has increased. The increased contribution of the insurance industry from the household GDS has been ploughed back into the economy, generating higher growth.

The following factors showcase how the contribution of the insurance industry has strengthened economic growth: Contribution of insurance to FDI The importance of FDI in the development of a capital deficient country such as India cannot be undermined. This is where the high-growth sectors of an economy play an important role by attracting substantial foreign investments. Currently, the total FDI in the insurance sector, which was INR50. 3 billion at the end of FY09, is estimated to increase to approximately INR51 billion in FY10.

It is difficult to estimate, but an equal amount of additional foreign investment, can roughly flow into the sector if the government increases the FDI limit from 26% to 49%. The insurance sector, by virtue of attracting long-term funds, is best placed to channelize long-term funds toward the productive sectors of the economy. Therefore, the growth in their premium collections is expected to translate into higher investments in other key sectors of the economy. Therefore, the liberalization of FDI norms for

insurance would not only benefit the sector, but several other criticalsectors of the economy.

Section II: Industry at cross-roadsof development Insurance industry: significantly untapped latent potential India’s insurance industry has witnessed rapid growth during the last decade. Consequently, many foreign companies have expressed their interest in investing in domestic insurance companies, despite the Government of India’s regulation, which mandates that the foreign shareholding limit is fixed at 26% for the life as well as non-life insurance sectors. The country’s strong economic growth in recent years has helped increase penetration levels substantially. Premium income, as a percentage of GDP, increased from 3. % in FY03 to 7. 6% in FY09. However, the penetration of insurance in India still continues to be low, as compared to other developed and developing economies. The Indian life insurance sector has witnessed exponential growth, driven by innovation in product offerings and distribution owing to market entrants since the opening up of the sector in 2000. Currently, it is the fifth-largest life insurance market in Asia. The rapid expansion in the life sector coincided with a period of rising household savings and a growing middle class, backed with strong economic growth. Innovative product design (e. . launch of ULIPs) and aggressive distribution strategies (e. g. development of banc assurance) by private sector players have significantly contributed to strong premium growth. The following diagram shows the increasing premium per capita during the same period. The global economy has slowly started recovering from the economic recession. Lagging employment, coupled with declining aggregate wages, a weakened residential and commercial real estate market, tight credit and a

behavioral shift on the part of consumers from consumption to savings are factors contributing to a delayed recovery.

Although the global insurance industry has not been impacted by the financial crisis as much as the banks, it still has its set of issues. The leading five issues on the global insurance watch list are: * Managing risk: The most significant concern for insurance companies is risk in all its forms. Increasingly, insurance companies are adopting an enterprise-wide view of managing risks—employing a framework to address them across the organization. * Promoting compliance: The cost of regulatory compliance and the attendant reputational risk of non-compliance are on the rise. Growing globally: The expansion into new markets is expected to help drive profits, as developed economies witness slower growth in the demand for insurance. * Lack of innovation around products and delivery: Theuse of technology and emphasis on innovation will helpprovide better service and delivery. Institutions can alsostrengthen their ties with customers and differentiatethemselves from competition. * Adapting to demographic shifts: The demographicchanges in North America, Europe, Japan and other areasis starting to shift assets from equities to annuities as wellas other fixed-income products.

According to Swiss Re, among the key Asian markets, India is likely to have the fastest-growing life insurance market, with life premium poised to grow at a CAGR of 15% for the next decade, slightly faster than the 14% expected for China. The growing consumer class, rising insurance awareness and greater infrastructure spending have made India and China the two most promising markets in Asia. Europe and the Americas represent relatively

mature insurance markets. Though India’s penetration appears higher, it is not excessive, given the high level of investments in insurance policies underwritten.

Nonetheless, besides India, Taiwan is the other Asian market that shares similar characteristics. Taiwan has the highest insurance penetration in Asia, largely driven by the immense popularity of ULIPs. The progress of the Indian insurance industry over the last decade has been the most crucial period in the establishment of this industry; post the formation of IRDA in 2000. The initial four to five years witnessed the entry of many private players, each trying to acquire market share.

The latter part of this phase witnessed a heightened focus on the expanding product range, developing innovative products and building a robust distribution channel. The last one to two years have been very critical as the industry is trying to sustain its growth in light of the new regulationsbeing formulated. The Indian insurance industry is at a threshold from where it can witness the next growth wave, if presented with a favorable policy framework and an enabling distributionenvironment. The industry is poised to witness the emergence of new leaders who would carve a niche for themselves by using nstruments such as alternative channels of distribution, cost management and product innovation, among others. At this cross section, the role of the regulator is very significant. IRDA is in the finalization stage of most of the regulations pertaining to the industry. The regulator has introduced certain regulations to help improve disclosures, profitability, capital, consumer protection, etc. Promoting health insurance * IRDA has allowed insurance companies to offer “ Health plus Life Combi Product,” a

policy that would provide life cover along with health insurance to subscribers.

Under the guidelines issued by the IRDA, life and non-life insurance firms can also partner in offering the healthplus- life cover. The combi products may be promoted by all life insurance and non-life insurance companies, however, a tie up is permitted between one life insurer and one nonlife insurer only. Thus, a life insurer is permitted to enter an alliance with only one non-life insurer and vice-versa. * The sale of combi products can be made through direct marketing channels, brokers and composite individual and corporate agents, common to both insurers.

However, these products are not allowed to be marketed through “ bank referral” arrangements. The regulator further specified that the guidelines do not apply to micro insurance products, which are governed by IRDA (Micro Insurance) Regulations, 2005. * Under the ” Combi Product,” the underwriting of the respective portion of the risks will be underwritten by respective insurance companies, i. e. , life insurance risk will be underwritten by the life insurance company and the health insurance portion of risk will be underwritten by the non-life insurance company. Implications

Life insurance has a much deeper penetration in India, as compared to the non-life insurance segment. This step is in sync with the government’s, regulator’s and the insurance company’s strategy to cover more people under the insurance umbrella. As insurers leverage on the marketing and operational network of their partner insurers, the proposed product innovation is expected to facilitate policy holders to select an integrated product of their choice under a single roof without shopping around the

market for two different insurance coverage options from two different insurers.

Therefore, insurers are expected to offer appropriate covers as an attractive proposition for the policyholders. India Foreign Direct Investment Trends India FDI Inflows a The decade gone by would be considered as the golden year for foreign direct investment (FDI) in India. Between year 2000-11, India attracted cumulative FDI inflow of USD 237 Bn. 70% of this FDI constituted equity inflows, rest being re-invested earnings and other zcapital. Over the last decade, FDI in India grew at CAGR 23% The bull run in India FDI started in FY 2006-07 when it grew at 146% over the previous year.

FDI peaked in year FY 2007-08 and only marginally declined in the following years of economic crisis. For the eight months of FY 2011-12 (Apr- Nov 2011), India has already garnered USD 33 Bn. of FDI matching the full year FDI of the previous year. Share of top five investing countries in India stood at 69%. Mauritius was the top country of origin for FDI flows into India primarily driven by the tax haven status enjoyed by Mauritius. Services sector (Financial & Non-financial) attracted the largest FDI equity flows amounting USD 31 Bn. (20. % share). Other high share sectors in top five were - Telecom (8%), Computer Software & Hardware (7%), Housing & Real Estate (7%) and Construction (7%). Over the years, Automatic route has become the most used entry route for FDI investments in India indicating the gradual liberalisation of FDI policy. In FY 2010-11, 64% of Equity FDI inflows in India came via “ Automatic Route” almost trebling from 22% share in FY 2000-01. “ Acquisition of shares” constituted 25% and “ FIPB/SIA” constituted 11% of equity inflows in 2010-11.

India’s FDI policy has progressively liberalised since nineties and only a few sectors, primarily in services sectornow has FDI cap on investment. India’s inward investment regime is now be considered most liberal and transparent amongst emerging economies. Financial Sector FDI Over the last decade, BFSI (Financial, Insurance & Banking services) was the most preferred destination for FDI in India. FDI in the BFSI sector accounted for over 12% of the total cumulative FDI inflows into India and over 59% of the FDI in Services sector.

Between 2000-11, Services sector (BFSI and Non-Financial) attracted FDI of USD 31 Bn. With a 59% share, BFSI FDI share amounted to USD 18 Bn. The subsectors with BFSI attracted the following FDI equity inflows - Financial : USD 13 Bn. , Banking: USD 2. 9 Bn and Insurance: USD 2. 3 Bn. Cumulative Inflows Mauritius had the largest share of FDI investment at 43% amongst top countries investing in Indian Financial services sector. Singapore (14%), UK (11%), USA (8. 5%) and Cyprus (3%) were the other countries in the top five lists.

Top 10 BFSI FDI Equity inflows in India over the last decade amounted USD 4. 2 Bn. Key US investors in Indian BFSI sector included Merill Lynch, Morgan Stanley, Bank of New York Mellon, JP Morgan, Citibank Overseas, Franklin Templeton, New York Life, Metlife, AIG, Pramerica and PE/VC firms like Warburg, Blackstone, Carlyle, KKR & Co. and Apollo. Development of Indian capital markets (especially corporate bond markets) and further policy liberalisation in commercial banking will be the key for future investments in Indian BFSI segment.

FDI Inflows from United States United States of America has been one of the top FDI investors in India. Reported cumulative FDI Equity Inflows from USA into India between 2000 –2011 were $9. 8 Bn, placing it at rank 3rd after Mauritius & Singapore. If we account for the US FDI equity inflows into India routed through tax havens, the FDI number will be considerably higher. Keeping up with overall trend, the Services sector (Financial & Non-Financial) accounted for the highest share of cumulative FDI equity inflows from USA with share of 22% amounting USD 2. Bn. USA FDI equity inflows in services sector represented 7% of the total FDI equity inflows in Indian services sector and in Financial services sector represented 8. 5% of the total FDI equity inflows from all countries amounting USD 2. 6 Bn. Following were the top FDI inflows from USA in Indian financial services: #1 Citibank Overseas Investment Corp. into E-serve International: USD 112 Mn. #2 Bank of New York Mellon into Kotak Mahindra Bank: USD 102 Mn. #3 JP Morgan International Finance into JP Morgan Securities India Ltd. : USD 75 Mn.

FDI in Insurance sector Indian insurance sector got liberalised in 2001. Since then the sector has grown at 20% annually and have seen entry of 41 private insurance companies (Life: 23, General: 18) with many of them choosing to enter with a foreign joint venture partner. Investment through the FDI can be a maximum of 26%. In 2011, India was ranked 9th in life insurance business and 19th in general insurance business globally. The insurance density stood at USD 64. 4 (USD 9. 9 in 2001) and insurance penetration was 5. 2% (2. 3% in 2001).

India has 49 life and general insurance companies with total investment of USD 6 Bn. as of March 2011. There are 24 companies operating each in the

life insurance and general insurance with an investment of USD 4. 7 Bn. and USD 1. 3 Bn. respectively. One company operates in re-insurance sector. FDI in Indian insurance sector stood at USD 1. 36 Bn of which life insurance comprised USD1. 1 Bn and general insurance comprised USD 0. 2 Bn of FDI. American companies have been investing in the Indian insurance sector since it opened up in 2001.

As of March 2011, there are four American insurance players operating in India as joint venture partners namely - New York Life, Metlife, AIG and Pramerica Financial. In 2011, Berkshire Hathway announced its entry into India Life insurance segment and Libery Mutual Group also got necessary approvals from IRDA for entry into general insurance business with an Indian partner. Besides insurers, US based brokers like Marsh & McLennan and Aon corp have also entered Indian markets. The total investment by American insurance companies in India is USD 315 Mn contributing 26% equity capital of USD 1. Bn. Share capital of the entities they were joint venture partners of. American origin FDI constituted 23% of FDI. India’s insurance industry is expected to reach USD 350-400 Bn. in premium income by 2020 making it among the top 3 life insurance markets and amongst top 15 general insurance markets. It’s estimated the Indian insurance sector would attract USD 15-20 Bn. of investments in next couple of years. Liberalization of foreign investment in insurance sector thereby permitting up to 49% FDI will accelerate this flow f investments putting Indian insurance sector on a fast track to the top of the global insurance market. FDI in Financial Inclusion Indian Financial Inclusion sector is predominantly characterized by rural retail banking, Non-Banking Financial Corporations & Micro Finance

Institutions (MFIs). For over a decade now, the Indianmicrofinance industry has been a posterchild of Indian Financial Inclusion. As of2010, microfinance institutions had a clientbase of 26 million borrowers and the totalloan outstanding was in excess of $3 Bn.

The number of clients is expected toincrease to 64 million in 2012. Investments in NBFCs & MFIs not traded on the stock exchange fall under the purview of Foreign Investment Promotion Board (FIPB). FIPB has set the following rules for FDI in start-up companies. From a slow start in 2006, equity investments in the Indian Microfinance sector skyrocketed in the 3 years from 2006 to 2009. The sector saw a total of 32 deals with a total invested capital of ~$230 mnbetween 2006 to 2009. Private equity investments constitute ~70% of the total investments in Indian Micro Finance sector. 0% is constituted by Microfinance focused funds and private investors. US based private equity firms, Sequoia capital, Silicon Valley Bank & Sandstone capital have invested ~$150 mn in the Indian Microfinance sector. Another area within Financial Inclusion which has attracted private equity investors is technology services for microfinance institutions. US based Private equity firms like Blackstone, Intel Capital has invested ~$50 mn in Financial Information Network & Operations (FINO), a technology services company in the Financial Inclusion sector.

The large size of the unbanked population means that there is great potential for continued high growth. Although the MFI sector is currently tweaking its business model to new regulatory reality, the high growth potential holds a significant promise for the investors in years to come FDI in Capital Markets Indian bourses both securities & commodities are amongst

the favorite hunting spots for foreign investors betting on India's growth story. These businesses appeal to investors as theyhave long term horizons and signify bets onthe country's growth.

In 2004, 13% of thetotal PE investments made in the banking &financial services space were in stockexchanges. Since the beginning of 2007, 17 transactions (including consortium deals)took place with a disclosed deal value ofmore than $1. 15 billion. Out of this, 8 dealswith disclosed value of more than $268million happened in 2010 only. In 2010, NSE had 12 foreign investors with a total foreign investment of 32% compared to BSE which had 8 foreign investors with share of 27% investments. In the same period, MCX had 22% foreign holding & NCDEX 15% foreign investments.

Some of the key US investors active in Indian exchanges are NYSE group, Atlantic LLC, Goldman Sachs, Morgan Stanley, Citigroup, Northwest Venture Partners, George Soros, Argonaut ventures. Fidelity, Intel Capital, Merril Lynch, and Bessemer Capital are some of the US investors. Most of the transactions involving these exchanges have been secondary in nature. The change in regulations (restricting the single investor holding to 5%) also added to the spurt in secondary deals. The lucrative exchange space continues to attract more players who are looking to increase their market shares.

India outward FDI in USA Strong economic growth and progressive liberalization has induced Indian companies toexpand their presence into new markets and USA is the largest recipient of Indian outboundinvestments. During 2004-09, India invested USD 5. 5 Bn. in US across 127 Greenfield projects. 80% ofthis investment went into five sectors – Metals, Software & IT

services, Leisure &Entertainment, industrial machinery, equipment & tools and financial services. The topthree states for Indian investments were Minnesota, Virginia and Texas. 10 Indiancompanies accounted for more than 70% of the US $5. Bn invested in Greenfield initiativesin US. In the same period, Indian companiesinvested USD 21 Bn. in mergers &acquisitions in United States. 83% of M&Ainvestments from India were in thefollowing sectors – Manufacturing, IT & ITenabled services, Biotech, Chemicals &Pharmaceuticals, Automotive and Telecom. As of FY2010, US accounted for 6. 5% ofIndia's outward FDI flows making Indiathe second largest investor in USA. As far as Indian Financial services sector investments in US goes, only a few public and private sector banks have expanded in USA by providing niche services (e. g. remittances).

Indian outbound deals in the US are predominantly majority stakes paid in cash and financed with debt. In future, the nature of collaboration is likely to evolve with Indian companies seeking more alliances and transactions involving minority stakes & joint ventures rather than focusing on majority stakes. US offer Indian companies many benefits for investment notably - abundant naturalresources, large consumer markets and access to innovation. Reciprocally, India'sinvestment in this world's largest recipient of FDI brings new skills, strengthenmanufacturing and will create jobs in the US. Literature review Dunning and Narula, 1996) Export growth in India has been much faster than GDP growth over the past few decades. Several factors appear to have contributed to this phenomenon including foreign direct investment (FDI). However, despite increasing inflowsof FDI especially in recent years there has not been any attempt to assess its contribution to

India's exportperformance one of the channels through which FDI influences growth. The Government of India recognizes thesignificant role played by foreign direct investment in accelerating the economic growth of the country and thusstarted a swing of economic and financial reforms in 1991.

India is now initiating the second generation reformsintended for a faster integration of the Indian economy with the world economy. As a consequence of theintroduction of various policies, India has been quickly changing from a restrictive regime to a liberal one. Now FDIis also encouraged in most of the economic activities under the automatic route. Studies about Western firms propose that market size and expected growth are the most essential determinants ofFDI into the area. Political and economic stability is also an important factor affecting FDI.

Over the past 30 years, there have been various studies done on the impact of outbound and inbound activity of multinationals on thegrowth and fiscal restructuring of the economies that they operate in. These studiessuggest that this is dependent on three main variables; the type of FDI taken on, the composition of the localresources and capabilities of the country, and the economic and organizational policies followed by governments. Firms employ FDI in order to best utilize or manage more efficiently the existing competitive advantages. (Love and Lage-Hidalgo, 2000)

Labor cost which is one of the main components of the cost function also influences FDI. Some studies find verylittle or negative relationship between wages and FDI, Some studies suggest that higher wages do not alwaysdiscourage FDI in some markets and therefore there is a positive relationship between wages and FDI. As higher labour costs leads to higher

productivity which gives better quality goods. Latelystudies are aimed towards the impact of specific policy variables on FDI in the host country. Trade, tariff, taxes andexchange rate are included in these policy variables. Asied (2002).

Emphasize on policy reforms in developingcountries that act as a determinant of FDI. They state the corporate tax rates and the sincerity to foreign investmentare important determinants of FDI. Horizontal FDI is linked with market seeking behavior and is induced by lowtrade costs. Therefore high tariff barriers motivate firms to take on horizontal FDI. Thus production abroad byforei