



cutting through complexity

# Higher FDI in Indian Insurance sector – a buzz for the industry

## The view from Transactions and Restructuring

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### What's in it for companies entering India?

This long pending decision of the Indian government to increase the cap on Foreign Direct Investment (FDI) in the Indian insurance sector is a great opportunity for global industry participants who want to improve their market position and diversify their operations in India.

India enjoyed robust growth of ~7.2 percent from FY01 to FY10.<sup>1</sup> However, the uncertain global business environment resulted in lower growth from FY10 to FY14 and stressed balance

sheets as high interests hampered investments. In contrast, the long term growth outlook is bright owing to inherent strengths that characterize the Indian economy – burgeoning consumer and urban class, growing working age population and high domestic demand amongst others. Household and financial savings are expected to increase from US\$369 billion to US\$540 billion and from US\$202 billion to US\$248 billion respectively over the next two years on account of higher disposable incomes.<sup>2</sup> The Indian economy is expected to exhibit one of the highest growth rates amongst the larger economies, reaching a GDP of over US\$7,700 billion by Purchasing Power Parity in 2018.

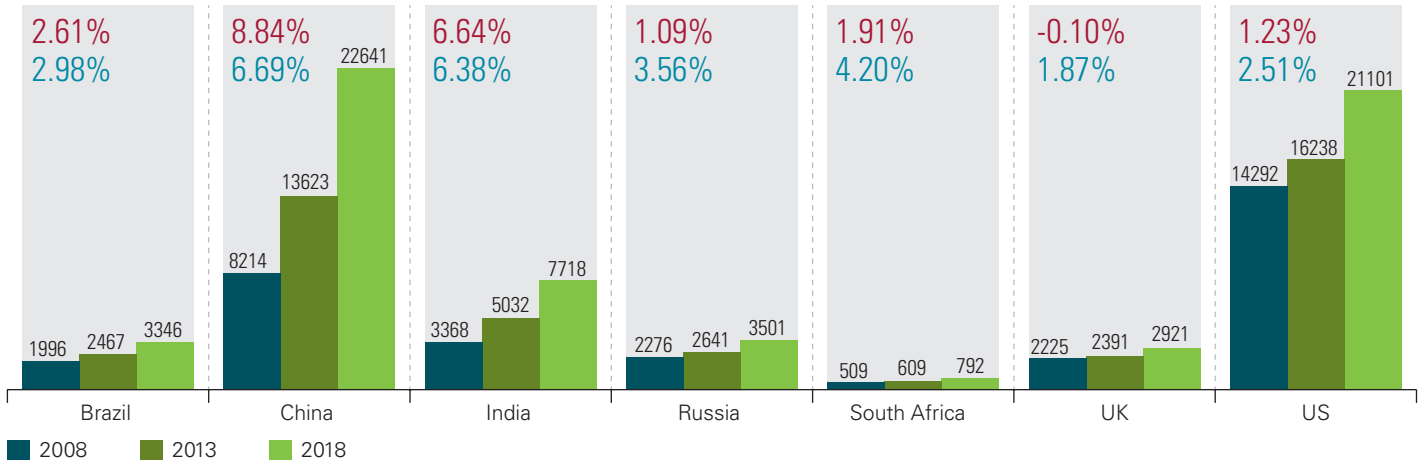
The first major reform initiative by the new Indian government led by the **Prime Minister Narendra Modi** – increasing the FDI limit in the Indian insurance sector from **26 percent to 49 percent** – will be a welcome move for many companies wishing to enter the market or expand the ownership of their current operation. We expect the legislation, once approved, to trigger new M&A and an inflow of capital as insurers take up the option to increase their stake to **49 percent**.

<sup>1</sup> CSO, Economist Intelligence Unit Data

<sup>2</sup> Insurance March 2014 report, India Brand Equity Foundation

### GDP at PPP (USD bn)

CAGR 2008-13 CAGR 2013-18



Note: CAGR for Real GDP in Local Currency Unit  
Source: CSO., Economist Intelligence Unit Data

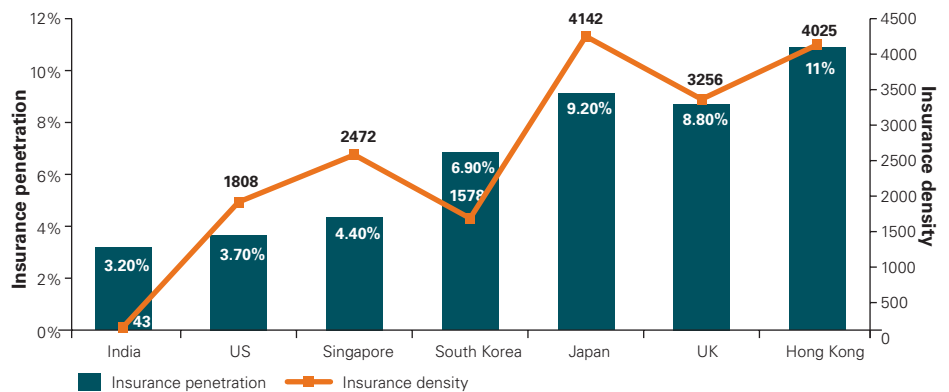
A critical factor making India an attractive market for global insurers is its favorable demography, low insurance penetration and the increasing life expectancy of individuals. Currently, the general insurance penetration in India is only 0.8 percent and life is 3.2 percent of GDP. In 2013 the life and general insurance density respectively was just US\$43 and US\$11 significantly lower than other Asian countries.

We also expect that the rising affluent middle class, along with increased insurance awareness will trigger increased demand for insurance products. As a result of the above factors, the Indian insurance industry is expected to grow from US\$66.4 billion in FY13 to around US\$350-400 billion in 2020.<sup>3</sup>

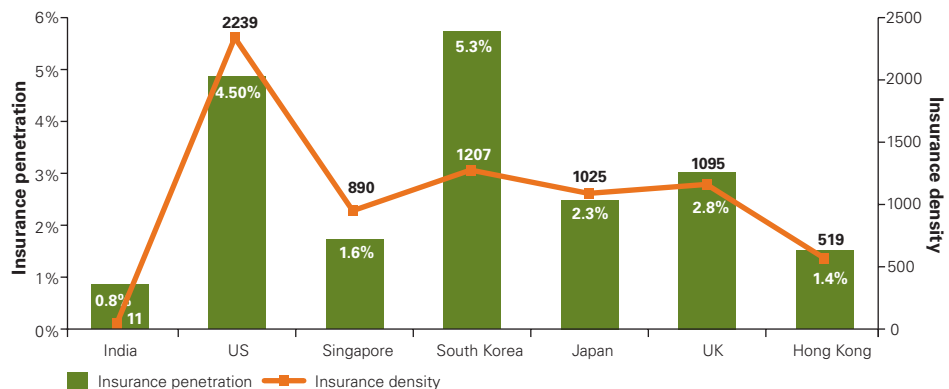
The disparity between the current and forecast position creates a lucrative opportunity for foreign players to unleash their potential in the country. Global investors are also quietly taking stock of new regulations that support their endeavors to bridge the huge insurance divide in the Indian economy.

Also, improved financial conditions in the Indian economy, combined with improving consumer sentiment will encourage demand for unit-linked

### Life insurance penetration and density (FY 2013)



### General insurance penetration and density (FY 2013)



Source: Insurance Regulatory and Development Authority (IRDA)

<sup>3</sup> Insurance March 2014 report, India Brand Equity Foundation

and pension products. Global insurers can also think of expanding in India's microinsurance sector where there are just 5 million policy holders in comparison to a potential market of around 140-300 million people.<sup>4</sup>

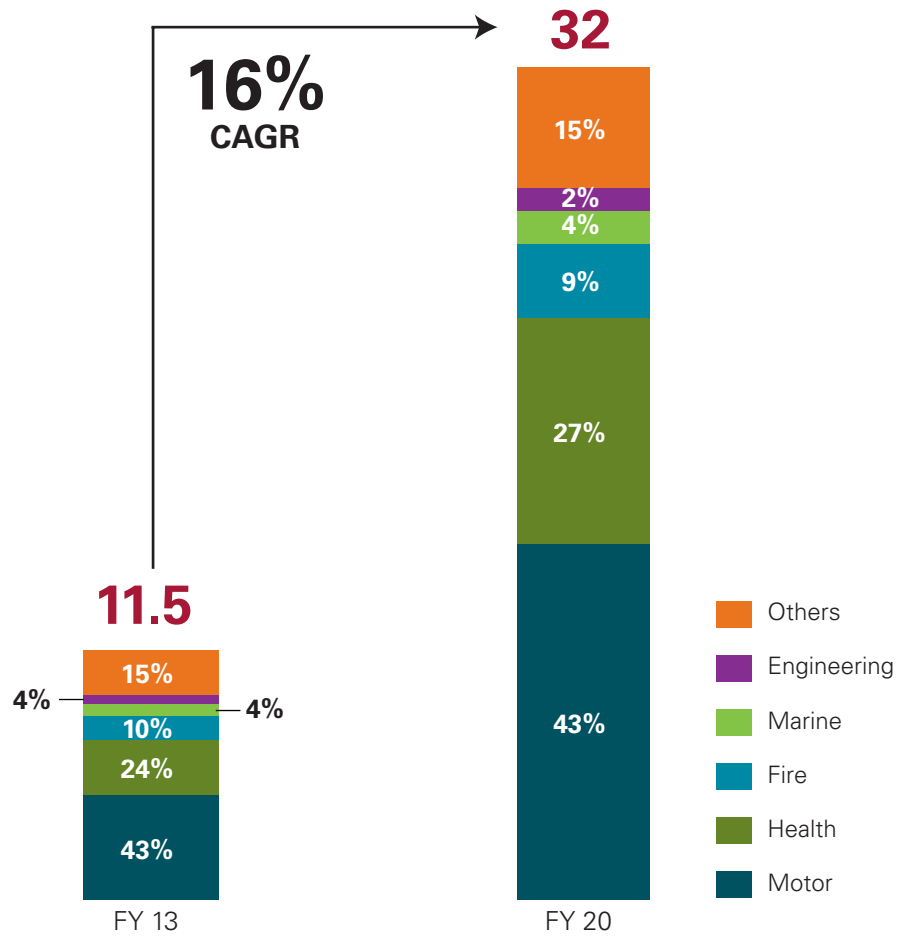
It is also expected that the proposed increase in the FDI limit will have a follow on impact on other sectors, including the pension industry creating further momentum.

## Performance of the sector

In general insurance, motor business continues to be the dominant segment contributing 43 percent of the Gross Direct Premium in FY13, followed by the health segment contributing 24 percent in the same period.<sup>5</sup> However, India has one of the highest combined ratio among all the developed and emerging economies. For 2010-12, its combined ratio was 123 percent of which the claim ratio was 88 percent and the expense ratio was 35 percent.<sup>6</sup> However, individual company performance is improving, of the twenty seven insurers, fourteen were profitable in FY13 against eight in FY12.<sup>7</sup>

The private life insurance industry in India has been shrinking since 2010 due to regulatory changes related to Unit Linked Insurance Plan (ULIP) products and the economic slowdown. To make up for loss of retail business, private sector players have focused on increasing their group business premium which has seen a growth of ~15 percent over the last 3 years. In the life insurance segment, out of 24 companies 17 reported profit in the year 2012-13. Many private players in the life insurance sector have incurred losses due to a lack of scale and the long term and capital intensive nature of business. It is believed that life insurers will benefit the most from the increase in the FDI limit as many of the new life insurance companies have not raised fresh capital in the last few years.

## General insurance gross direct premium (USD billion)



Source: Insurance Regulatory and Development Authority (IRDA), KPMG Analysis

## Direction of the regulation

India's current business climate is conducive for economic growth. The maiden annual budget led by Narendra Modi's government is pro-growth in its orientation, aiming in the right direction of boosting foreign investments and hence fostering growth in the economy. The insurance sector of India has also received tremendous support from the regulatory bodies over the last decade which has helped the industry to open up through detariffication, pool dismantling and electronic policy documents, ultimately leading to more competition in the industry.

We expect to see future regulation continue to develop the industry, examples include licensing of banks as brokers, regulations around sub broking and insurance marketing firms to move towards an open architecture model over the next few years.

The challenges of operating in India should not be underestimated but in our view the direction of regulation and government policy is expected to have a beneficial impact on growth, profitability and ease of doing business in a difficult market.

<sup>4</sup> Insurance March 2014 report, India Brand Equity Foundation

<sup>5</sup> IRDA Annual Report 2012-13

<sup>6</sup> India General Insurance "Vision 2025", ficci.com, October 2013

<sup>7</sup> India 2013 Insurance Industry report



## Opportunities for foreign investors in life insurance

- Proposal to increase FDI to 49 percent from 26 percent limit.
- Market is still dominated by one Public Sector player, providing opportunities for private sector players to target specific growth opportunities.
- As distribution moves towards open architecture, licensed distributors of insurance services could provide a one stop solution for all financial services needs of the consumer.
- The pension segment has a very low contribution to the overall life insurance sales as of now and is expected to increase substantially with growth and ageing of the private sector work force.



## Opportunities for foreign investors in general insurance

- Proposal to increase FDI to 49 percent from 26 percent limit.
- Low penetration, especially in health insurance provides significant room for growth.
- Opportunity to forge partnerships with healthcare providers to provide a seamless value chain.
- State governments are aggressively promoting universal health insurance and are aiming to provide minimum levels of health.
- Insurance cover to all citizens leading to rapid growth opportunities, improving performance of motor insurance.
- Conformity in product structures provide opportunities for differentiation in a fast growing, but crowded market.

## Arguments for and against the increase in the FDI limit?

The proposed regulation to increase the FDI to 49 percent will only be allowed after the prior approval of the Foreign Investment Promotion Board (FIPB) and support from the parliament. There is also a rider attached to the increase that management control must remain in Indian hands.

There are many arguments which are currently going on in the Indian market both in favor and against this move. The

opposition parties along with some major existing players have shown resistance to this new regulation on the grounds that this will threaten the stability of the Indian financial market and hence requires fresh scrutiny. The resistance is also due to the fact that in some cases, where there are multiple Indian partners, increasing the stake of the foreign insurance company to 49 percent will make it the largest shareholder.

On the other hand, it is also true for the economy to have a well developed and evolved insurance sector an increase in the FDI limit is an important step, providing long term funds for the

development of infrastructure where there's currently a funding gap of almost US\$300 billion<sup>8</sup> and help improve the adoption of international best practice. With one of the lowest FDI limits globally for insurance, we feel that the increased FDI cap is necessary for the cash starved insurance sector. It is estimated that around US\$3-4 billion<sup>9</sup> can flow into the sector following an increase in the FDI limit. 70-75 percent of this is expected in the life insurance sector.

In addition, with the increase of the FDI cap there is a possibility of certain insurance companies looking to IPO. Given recent poor performance, many insurers are reluctant to consider an IPO at this stage. However, with the help of foreign players, profitability can improve as the foreign partner can help:

- deliver product innovation
- leverage technology (particularly in relation to distribution)
- implement client servicing tools

It can also protect consumers against insolvency through adoption of improved governance and risk management tools. In addition, there is potential for consolidation, with a number of smaller players exiting.

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## A winning formula

In this challenging business environment, the new regulation is mutually beneficial for both – Indian and foreign players.

We believe the change will act as a catalyst to help the industry rediscover its growth while presenting foreign investors with the ability to capitalize on the underlying opportunity. Active foreign participation is critical for the sector, bringing improving standards and implementation of best practice and in turn driving competition, better quality products and improved customer experience and choice.

<sup>8</sup> FDI can keep the insurance sector afloat, thehindubusinessline.com

<sup>9</sup> Best practices, cash flow ensured, deccanchronicle.com, 27 July 2014 (1INR=US\$0.016)

# Industry views:

**HDFC Life** CFO Vibha Padalkar

“It is a very positive announcement and we have been expecting it for a long time. This will boost the industry in terms of capital infusion and employment generation. The insurance companies were waiting for this relaxation and now this will encourage companies to enter the capital markets.”

**Bharti AXA** General Insurance Managing Director and CEO  
Amarnath Ananthanarayanan

“Overall direction of increasing FDI is good as it will increase capital investment in the insurance sector.”



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