# Life insurance industry in India

## Pre-liberalization

The Indian life insurance industry was nationalized in the 1950s and Life Insurance Corporation (LIC) was the only player till the year 2000 when the insurance sector was reopened to the private sector. The main products till then were conventional endowment plans sold on a tax saving platform through the tied agency channel. The Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body in the year 1999 and incorporated as a statutory body in the year 2000 to regulate and develop the insurance industry. IRDA opened up the market in August 2000 to private insurers and foreign entrants subject to an ownership limit of 26%. Today there are 24 life insurers operating in the country (23 private insurers and LIC).

## Post liberalization

After the opening up of the sector, a number of Indian business houses formed joint ventures with foreign insurers to enter the sector. Two types of entities entered this sector:

- Bank / financial institution backed (eg: ICICI Prudential Life, HDFC Life, SBI Life)
- Conglomerate backed (eg: Bajaj Allianz, Birla Sunlife, Tata AIA Life)

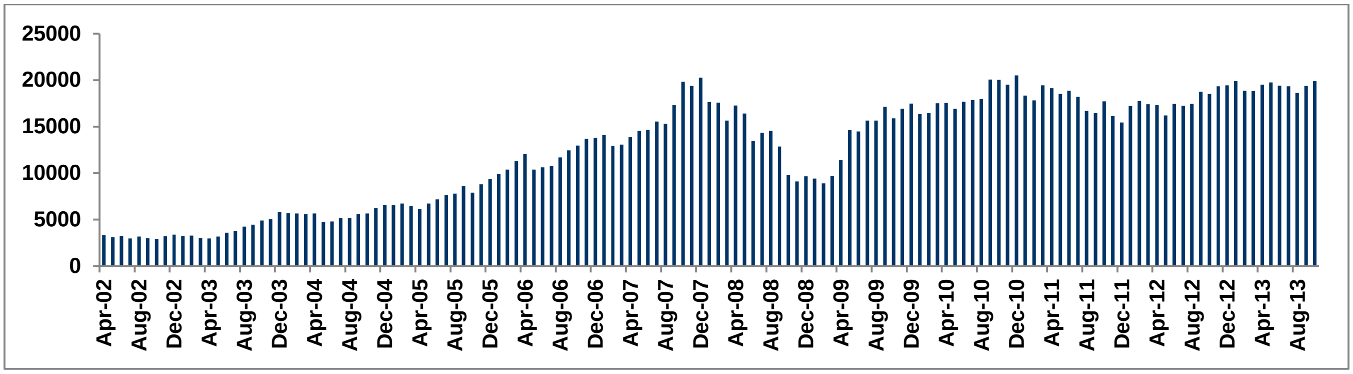
### Rapid growth phase (till FY2008)

Private players, with the help of the knowledge base of their foreign partners, introduced new products and set up innovative distribution channels to tap the market. The industry grew rapidly till FY2008. A few factors which supported growth in this phase were:

1. High savings rate and GDP growth
2. Low insurance penetration: The insurance penetration as at the end of FY2002 was only 2.1% leaving a lot of unmet demand in the market.
3. Outperforming stock markets: The BSE Sensex increased from 3,338 in April 2002 to 20,287 in December 2007. This encouraged the development of a unit-linked platform for insurance products which was intended to increase retail participation in equity markets.
4. Distributors well compensated: The product structures of linked products allowed a higher upfront charge from customers thereby enabling the distributors to be well compensated. Due to the positive trend in equity markets, the net returns for customers were attractive despite the prevalent charging structures.

In this phase the private players were focused on enhancing their distribution presence and increasing their market share. Private players adopted various strategies. The buoyancy in equity markets and the resultant high returns experienced in a relatively shorter time frame aided evolution of sales practices that were focused on the short term and not always in the long term interest of the customers.

**BSE Sensex**




Source: www.bseindia.com

| Financial year (all nos. in %) | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Total savings/ GDP | 24.9 | 25.9 | 29.0 | 32.4 | 33.4 | 34.6 | 36.8 | 32.0 | 33.7 | 34.0 | 30.8 |
| Household savings / GDP | 23.2 | 22.3 | 23.2 | 23.6 | 23.5 | 23.2 | 22.4 | 23.6 | 25.2 | 23.5 | 22.3 |
| Financial savings /GDP | 10.5 | 10.0 | 11.0 | 10.1 | 11.9 | 11.3 | 11.6 | 10.1 | 12.0 | 10.4 | 8.0 |
| Insurance/ Financial savings | 14.4 | 16.1 | 13.4 | 15.2 | 14.3 | 15.0 | 22.0 | 21.0 | 26.2 | 19.5 | 19.8 |

Source: CSO, RBI

**Life Insurance sector summary**

| Financial year | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| No of companies | 12 | 13 | 13 | 14 | 15 | 16 | 18 | 22 | 23 | 23 | 24 | 24 |
| No of branch offices | 2306 | 2445 | 2612 | 3001 | 3865 | 5373 | 8913 | 11815 | 12018 | 11546 | 11167 | 10253 |
| Insurance penetration (in %) | 2.15 | 2.59 | 2.26 | 2.53 | 2.53 | 4.10 | 4.00 | 4.00 | 4.60 | 4.40 | 3.40 | 3.17 |
| No of individual agents ( in '000s) | 477 | 1039 | 1557 | 481 | 1424 | 1993 | 2520 | 2937 | 3742 | 2639 | 2359 | 2126 |

Source: IRDA Handbook, FY2012

## Slowdown phase (FY2008- till date)

Since FY2008, life insurance companies have had a turbulent period, with the industry declining in 3 out of the last 4 years. The retail weighted premium for the industry declined at a compounded annual rate of 2.2% from FY2008 to FY2013. This was driven by the following factors:

1. Slowdown in the economy: The GDP growth which had touched a high of 9.6% in FY2007 dropped to 5.0% in FY2013[1].
2. Volatility in capital markets leading to risk aversion on part of consumers and lower preference for financial savings. The financial savings rate that had peaked at 12% of GDP in FY2010 came down to 8.0% in FY2012. Within financial savings, share of life insurance came down from 26.2% to 19.8%.
3. ULIP regulations: On the ULIP front two things changed for the customer:
   - The sluggish performance of equity markets reduced net returns.
   - Customers started getting affected by sales practices like return based selling, short term products, mis-selling etc. which were detrimental to their interests in the long term.

[1] Central Statistics Office (CSO)

Hence, in order to protect customer interests, IRDA revised the ULIP product regulations with effect from September 2010. These regulations ensured that product term was increased, surrender charges were reduced and a maximum limit was put on charges. Consequently, insurance companies had to recalibrate their business strategies and sales models.

Since agents needed some time to adapt to the new regulatory environment and product structures, the share of Agency channel decreased and Bancassurance gained prominence. Another factor in favour of Bancassurance was that it primarily catered to people who were already their customers for banking unlike in Agency which is a more intensive channel in terms of contacting and selling to a potential customer. The share of individual agency declined for private players from 55% in FY2009 to 42% (est.) in FY2013 on retail received premium basis.

There has also been a shift towards traditional products with share of linked products decreasing from 86% in FY2009 to 35% in FY2013[2]. This was primarily because customers were becoming risk averse. Also, companies needed to move to a more balanced mix between linked and traditional products from an expense affordability perspective.

The change in regulations thus ensured that companies focus on providing a better value proposition to customers and enhance their operational efficiencies.

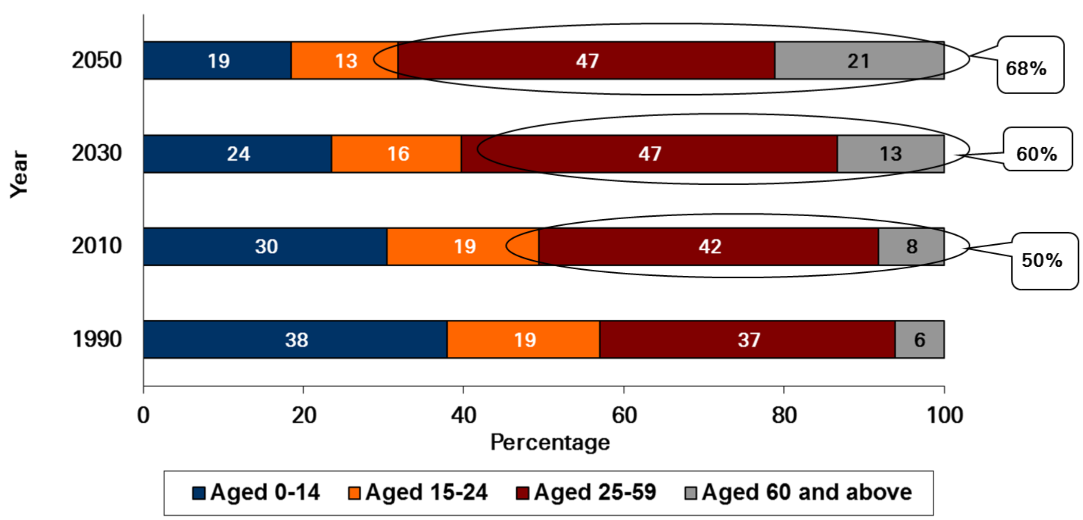
## Opportunity

### Increase in working population

The working population in India is increasing and about 50% of the population is below 25 years of age. About 13 million people enter the working age group each year in urban India. This trend is favourable for the insurance industry in two ways:

1. Rising workforce will fuel economic activity and will lead to more income and saving
2. The target customer segment for the insurance industry is the working and retired population. With increasing workforce, this size of this segment is expected to increase, translating into more customers for the insurance industry

The chart below represents the trend of working and retired population. It is expected that the target population will expand from around 600 million in 2010 to around 900 million by 2030.




Source: United Nations Population Division

[2] IRDA handbook FY2012

## Rising incomes and savings pool

As a result of its growth, India is seeing a rise in the number of affluent households. This trend is promising for the financial services industry as the surplus incomes are likely to be channeled into savings avenues like life insurance.

| Number of households in millions | FY2015F | FY2025F |
|---|---|---|
| Mass affluent (` 90,000 to ` 1 mn per annum) | 166.6 | 221.1 |
| High net-worth households (over ` 1 mn per annum) | 3.3 | 9.5 |

Source: NCAER, McKinsey

## Low penetration of protection

Life insurance has been traditionally positioned as a long term goal oriented savings tool with the need for protection being not fully exploited. Lower awareness towards protection needs has resulted in India being a largely under insured market. An indicator of the protection level is Sum Assured (SA) to GDP ratio. The chart below compares the SA to GDP ratio for a few developed economies and India. Clearly there is immense potential for the protection market itself even when compared to economies like Thailand, Hong Kong and Singapore.

| Country | SA % of GDP |
|---|---|
| Japan | 321% |
| United States | 191% |
| Hong Kong | 153% |
| South Korea | 152% |
| Germany | 105% |
| France | 97% |
| India | 57% |
| China | 33% |

Source: McKinsey estimates - for year 2010, except India which is for year 2009

## Rising health care spends

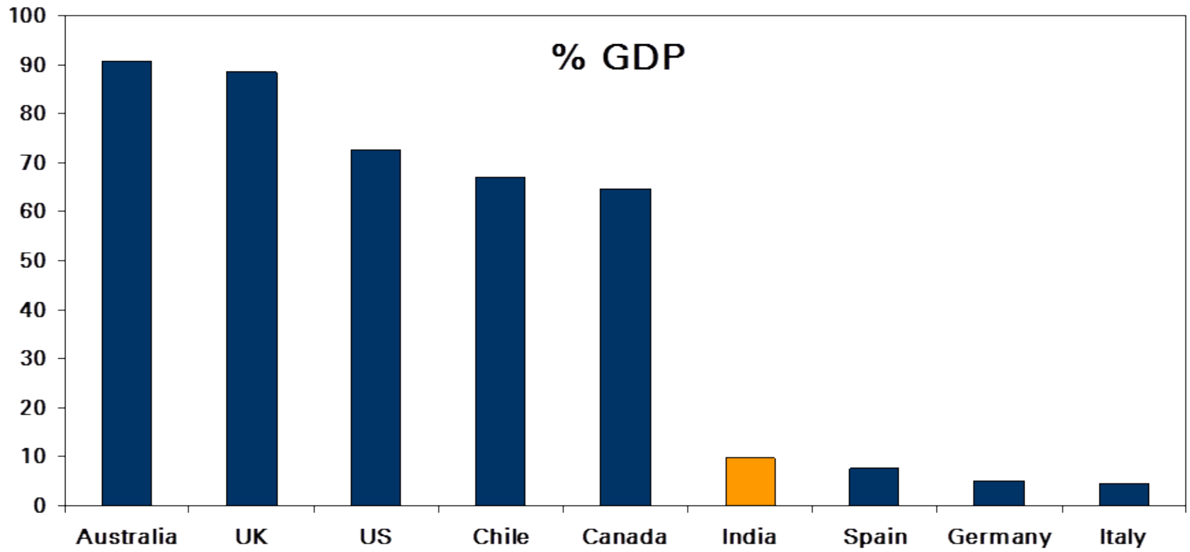
India spends 3.9% of GDP on health care compared to an average of 5.7% in other low and medium income countries. 59% of this spend is out of pocket for which people need to dip into savings[3]. The total premium collected for health insurance by both life and non-life companies in FY2013 was `158.18 billion[4], of which the share of life insurance companies was less than 5%. Moreover with rising affluence, private health care spends are increasing. Relatively lower health care spends with a high proportion of out of pocket expenses signifies tremendous opportunities for life insurance companies. As bulk of the working population in India is self-employed, life insurers with their large retail distribution are well placed to harness this opportunity.

## Pension needs

The demographic profile of India offers huge opportunity for the pension market as well. In the absence of an organized social security net, individuals would need to accumulate monies to fund their post retirement period. Even though the population would continue to be dominated by a young work

[3] World Bank database for the period CY2011
[4] IRDA Journal, June 2013

force, the absolute number of people needing annuities would grow at a high pace. As of March 2012, India had ` 8,000 billion in terms of pension assets which is less than 10% of GDP[5]. The chart below depicts the relative comparison of Indian pension assets as compared to some of the other economies. Life insurers are uniquely positioned to leverage the pension opportunity as they can provide relevant solutions at both the accumulation and annuity phases.




Autonomous funds as a % of GDP, Source: OECD statistics, 2010

## Industry outlook

The above factors amply demonstrate the huge growth potential for the life insurance business in India. To summarise, in spite of the trends of various macro-economic factors in the near term, the life insurance sector has potential because of the growth drivers mentioned above. The potential of the life insurance market till FY2020 is shown in the below forecast:

| ` trillion | FY2002 | FY2013 | FY2020* |
|---|---|---|---|
| Nominal GDP | 23.48 | 100.21 | 266.55 |
| Household savings | 5.45 | 22.37* | 59.51 |
| Gross financial savings | 2.86 | 10.97 | 29.17 |
| Insurance flows | 0.41 | 1.80 | 4.78 |
| Insurance AUM | 2.30 | 17.68 | 58.95 |

Source: RBI, CSO, Life Insurance Council
*Company estimates; CAGR of 15% used for FY2020 estimates

## Potential landmines for countries with demographic dividends

However, these trends might turn into potential landmines in the absence of an enabling environment. Some of the challenges faced in this regard are:

1. **Lack of social security plan and poor healthcare facilities:**
   Demographic dividend is achieved due to bulk of the population being young and in the working age group. Over time, as this group of people grows old and retires, the dependency ratio would rise enormously. So would their need for financial security and health care. In India, there is no

[5] EPFO annual report, IRDA annual report FY2011, OECD statistics

mandated retirement provision for workforce that is self-employed or working on a contractual basis and this comprises more than 80% of the total workforce of 460 mn people.

2. **Need for basic and higher education:**
   It is critical to ensure that the increasing population becomes employable and hence, there is a tremendous need for providing basic and higher education facilities. It is estimated that in India, out of every 100 children, 19 continue to be out of school. Of every 100 children who enroll, 70 drop out by the time they reach the secondary level[6]. India's literacy rate of 73%[7] is lower than the world average of 84%[8].

3. **Unemployment:**
   We would continue to see a huge inflow of people into the working age group for several years in the future. However, if the generation of employment opportunities is not in line with the increased labour supply, this will not only lead to high unemployment levels but also have impact on society in the form of increased social unrest.

4. **Skewed gender ratio and gender discrimination:**
   One of the major issues facing Indian society today is the fact that women continue to suffer from gender discrimination at various levels. This fact is reflected in high levels of female infanticide, discrimination in education opportunities, and lack of healthcare facilities. This causes an unbalanced population, poor human capital development and inhibits the entry of women in workforce. According to the 2011 census, the sex ratio in India was 943 females per 1000 males. This is on the lower side compared to the developed countries and needs to improve in the medium to long term.

5. **Flight of money and human capital:**
   In the event of their not being sufficient avenues for investment, the increased household savings may either get channeled into unproductive assets like gold and real estate, or at a macro level, may result in flight of capital abroad. Also, there is a real possibility of human brain drain in the event of there being insufficient opportunities in the country.

6. **Longevity risk for insurance companies:**
   With the shift in the demographic profile, customer behavior and preferences are expected to change resulting in both opportunities and risks for businesses. For the insurance industry the increasing longevity of customers might result in risks of unmanageable long term liabilities.

7. **Supply side bottlenecks:**
   A persistent increase in working population will inevitably lead to a huge upsurge in demand and consumption. However, if there are supply side bottlenecks, it could lead to high levels of inflation. In fact, the current inflation levels in the Indian economy could be attributed to this fact.

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[6] www.unicef.com - Tackling the challenges to India's demographic dividend, by Yogesh Vajpeyi
[7] Census of India 2011
[8] World Bank database

# Addendum 1: World Demographics

*(All numbers in this section based on UN's press release on World Population Prospects- The 2012 revision)*

The report, "World population prospects - The 2012 revision" by United Nations Department of Economic and Social Affairs brings to light some interesting trends in the growth of World's population. The report states that the World population reached 7.3 bn in July 2013 and is expected to reach 9.6 bn by CY2050 with most growth coming from developing countries, especially Africa. As shown in the table below, population in the most developed nations is expected to grow at a slow pace in the next 35 years and even decline after 2050. Europe is expected to show a decline in population in the period CY2013 - CY2050. According to the report, India would be world's most populous country surpassing China by CY2028.

**Annual population growth in %**

| Region | 1950-2013 | 1950-1980 | 1980-2013 | 2013-2050E | 2050-2100E |
|---|---|---|---|---|---|
| World | 1.65 | 1.89 | 1.44 | 0.78 | 0.26 |
| More developed regions | 0.69 | 0.96 | 0.44 | 0.11 | -0.03 |
| Less developed regions | 1.97 | 2.25 | 1.71 | 0.90 | 0.30 |
| Least developed countries | 2.42 | 2.33 | 2.51 | 1.89 | 0.96 |
| Other less developed countries | 1.90 | 2.24 | 1.58 | 0.68 | 0.06 |
| Africa | 2.51 | 2.46 | 2.55 | 2.07 | 1.12 |
| Asia | 1.79 | 2.12 | 1.48 | 0.50 | -0.18 |
| Europe | 0.48 | 0.78 | 0.20 | -0.12 | -0.21 |
| Latin America and the Caribbean | 2.07 | 2.58 | 1.60 | 0.64 | -0.12 |
| Northern America | 1.16 | 1.32 | 1.01 | 0.62 | 0.28 |
| Oceania | 1.76 | 1.98 | 1.55 | 1.07 | 0.41 |

**Age group wise split of population as % of total**

| Periods> | 2013 | | | | | | 2050E | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Region | 0-14 | 15-24 | 25-59 | 60+ | 80+ | Total | 0-14 | 15-24 | 25-59 | 60+ | 80+ | Total |
| World | 26 | 17 | 45 | 12 | 1.7 | 100 | 21 | 14 | 44 | 21 | 4.1 | 100 |
| More developed regions | 16 | 12 | 48 | 23 | 4.5 | 100 | 16 | 11 | 41 | 32 | 9.5 | 100 |
| Less developed regions | 28 | 18 | 45 | 9.4 | 1.1 | 100 | 22 | 14 | 44 | 19 | 3.2 | 100 |
| Least developed countries | 40 | 20 | 35 | 5.4 | 0.5 | 100 | 30 | 18 | 42 | 10 | 1.1 | 100 |
| Other less developed | | | | | | | | | | | | |
| Countries | 26 | 17 | 46 | 10 | 1.2 | 100 | 20 | 13 | 45 | 22 | 3.8 | 100 |
| Africa | 41 | 20 | 34 | 5.4 | 0.5 | 100 | 32 | 18 | 41 | 8.9 | 0.9 | 100 |
| Asia | 25 | 17 | 47 | 11 | 1.3 | 100 | 18 | 12 | 46 | 24 | 4.3 | 100 |
| Europe | 16 | 12 | 50 | 23 | 4.5 | 100 | 15 | 10 | 41 | 34 | 9.5 | 100 |
| Latin America and the Caribbean | 27 | 18 | 45 | 11 | 1.6 | 100 | 18 | 12 | 45 | 25 | 5.7 | 100 |
| Northern America | 19 | 14 | 47 | 20 | 3.7 | 100 | 18 | 12 | 42 | 27 | 8.1 | 100 |
| Oceania | 24 | 15 | 45 | 16 | 2.9 | 100 | 20 | 13 | 43 | 23 | 6.2 | 100 |