Publication: Mint **Date: Wednesday, 30th December, 2015**

Edition: National

LIFE INSURANCE

Foundation laid for long lasting changes

Wider distribution, higher foreign stake and more made the insurance industry more robust

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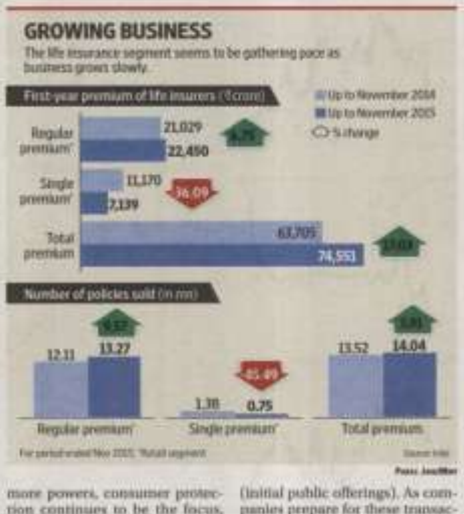
When we look back, the year 2015 will be one of the most important years for the insurance industry in India. The Insurance Laws (Amendment) Bill, 2015, was finally passed by Parliament. The Insurance Laws (Amendment) Act, 2015, allows for raising the foreign direct investment cap in the insurance sector to 49% from 26%. More importantly, it allows greater power to the Insurance Regulatory and Development Authority of India (Irdai) to fix distributor's incentives.



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Fixing incentives is one of the most important steps that the regulator needs to take to make sure that distributors of life insurance sell with a long-term view and in line with customers' needs as opposed to selling in order to pocket commissions alone. A fat front-loaded commission structure in a long-term product like insurance encourages incentive-based sale, something that was pointed out in the Sumit Bose committee report, which aimed to identify why financial products are missold and offer solutions. According to the report, distributor's incentives was the root cause for mis-selling, and it suggested that all financial products with the same function have the same incentive structures so that the distributor is commission neutral.

Running a tighter ship

With Irdai given greater powers, it's now possible to work on a distribution model that is in line with the recommendations.

"The Act was the biggest reform for the insurance industry this year, and it will definitely change the way the industry works. The regulator now has more powers, consumer protection continues to be the focus, and even for the industry, there is greater transparency in decision making," said Anuj Agarwal, managing director and chief executive officer, Bajaj Allianz Life Insurance Co. Ltd.

What is also expected to change is the level of corporate governance as foreign companies increase their stake in India. "Insurers in developed markets follow strict regulatory guidelines and this is applicable not just to the home country but in every other country they operate in. By increasing stakes in India, these companies are likely to bring more corporate governance, greater accountability and thereby a focus on improving productivity," said R.M. Vishakha, chief executive officer and managing director, IndiaFirst Life Insurance Co. Ltd.

In fact, improving productivity will be a focus area for insurers since that can influence their valuations. "The Act has created an ecosystem for mergers, acquisitions, consolidations and IPOs (initial public offerings). As companies prepare for these transactions, they will need to take serious steps towards improving their valuations, which should bring greater focus on improving productivity and reducing costs," said Anuraag Sunder, director-insurance, PwC India.

Better distribution

Insurance distribution, too, got attention, although the focus was more on increasing the footprint to improve the spread of insurance. Early this year, Irdai announced a new distribution channel called the Insurance Marketing Firm. These firms are allowed to sell products of two life, two non-life and two health insurers, and can also sell other financial products such as mutual funds and National Pension System (NPS).

"Insurance Marketing Firms didn't take off in India because the industry is still heavily dependent on agents. These in India are akin to independent financial advisers in the UK and, therefore, a good step to usher in more corporatised and responsible distribution channel," said Agarwal. "It's a matter of time before large agents see the merit in these firms, which will lead to product differentiation as insurers focus on developing niche products," he added.

The biggest reform in the distribution, however, came in September when Irdai finally came out with the much awaited guidelines on corporate agents, allowing them to choose between tying up with a single insurer or up to three insurers in the same line of business. Corporate agents, primarily banks, became important for life insurance after product regulations put pressure on costs and commissions leading to many agents leaving the business. Banks' wider network and relatively low expenses became attractive for insurers as a preferred distribution channel. Insurers who were not promoted by banks demanded an open architecture—where banks can distribute products of multiple insurers. Irdai explored many options and finally settled for making open architecture a choice.

The insurance industry has largely welcomed this even though banks that also run insurance companies may not open up. "Many large- and medium-sized banks are willing to open up to get more choice and better productivity. It also drives competition, which, in turn, reduces the number of complaints. Big banks may not open up right away as they have their own insurance companies, but with time, they will also see merit in offering their customers greater choice," said Agarwal.

Life insurance products

In terms of products sold, the industry remained skewed towards traditional plans—opaque, bundled products with higher margins than unit-linked insurance plans (Ulips). Irdai, however, came out with draft guidelines defining caps on management expenses. "The draft looks balanced. The regulator, instead of capping expenses at the company level, has gone granular. It has capped expenses at the product and premium payment term levels. For insurers that mainly sell participating plans, this will mean higher expenses over-runs for the shareholders," said Amitabh Chaudhry, managing director and chief executive officer, HDFC Standard Life Insurance Co. Ltd. There was also continued focus on online term plans. "The response to online term insurance has been encouraging—nearly 80% of term insurance was sold online this year. Also, the number of insurers selling these surged—about 15 insurers offered online plans this year as opposed to 8-9 insurers last year," said Yashish Dhaiya, founder, Policybazaar.com, an insurance portal.

"Term insurance market has grown 30% since last year, and this would further increase, as more insurers innovate offerings within this space," he added.

Digitisation was an aspect that the entire industry focussed on. "The pressing need is to reduce costs and adopt technology. We have to find ways to make insurance a pull product. As push products, distributors' incentives play an important role, which drives up costs," said Vishakha. "A good example of a pull product coupled with digitisation are the Pradhan Mantri insurance schemes. The whole system is integrated and electronic and we spend no money as cost of acquisition. This brings home the fact that you need simple products to make them pull customers," she added. One such scheme is Pradhan Mantri Jeevan Jyoti Bima Yojana, a group life insurance term plan that comes with a sum assured of ₹2 lakh and premium of ₹330 per annum. Pradhan Mantri Suraksha Bima Yojana is a personal accident insurance with a sum assured of ₹2 lakh at a yearly premium of ₹12. Claim is payable on accidental death, permanent total disability or permanent partial disability.

The year is another important milestone for the life insurance industry in India as some big bang changes took place. However, it's only in the coming years that we will see the effects of these reforms.