Indian Insurance : At The Crossroads *

I am grateful to the New India Assurance Company Limited for inviting me to this special function organised on the occasion of launching a new financial product for credit insurance by the Honourable Union Minister of Finance. It is fitting that New India Assurance, the first insurer fully set up by Indians in 1919 and the country's largest non-life insurer today should lead the way in product innovation. All of us present here are thankful to the Honourable Finance Minister for taking some time off from his extremely busy schedule and making himself available for launching of this new insurance product.

In an uncertain world, most of us would like to smoothen our lives (and consumption patterns) by balancing the favourable and unfavourable events. Insurance allows individuals to transfer risks by participating in risk pooling arrangements, in which each one sets aside a bit for the rainy day when times are good and draws on the fund in adversity. Thus, risk pooling advantages, by their very nature, increase when the number of participants increase and the risks they face are uncorrelated. Insurers provide a medium for risk pooling. Obviously, the price of insurance - the premium - is intrinsically related to the probability of the adverse situation arising. If the number of insurers increase, it is then more likely that the premium would be actuarially fair, as competition preclude monopolistic rents that could be charged by the insurer.

The almost two century-old Indian insurance industry today stands at the crossroads. The Insurance Regulatory and Development Authority Act, 1999 has paved the way for liberalisation of the insurance sector, following recommendations of the Committee on Insurance Sector Reforms (Chairman: Shri R.N. Malhotra) in the backdrop of financial sector reforms and in light of international commitments. The Reserve Bank has allowed commercial banks (and non-banking financial companies) to contract insurance business under Section 6 (1) (o) of the Banking Regulation Act. With the entry of players after decades of the state monopoly, the insurance sector faces new challenges.

The opening up of the insurance industry in less developed countries - and in India - is the cumulation of a long debate. The proponents of liberalisation have argued that a free market would ensure the benefits of competition. Those opposed to liberalisation have pointed out that the very need for nationalisation arose in the Indian insurance sector because of a string of failures. It is, therefore, necessary to recognise that the present programme of liberalisation would be successful, if and only if, we are able to build the proper safeguards for the functioning of the industry. Viewed in this light, the on-going programme of insurance liberalisation has to be evaluated from two angles: first, the benefits to the economy and second, the sustainability of the competitive process, especially, given the past history of insolvencies before the nationalisation of the insurance industry. In a sense, the liberalisation of the insurance sector is as much a challenge to the insurers as to the supervisors, including the Reserve Bank of India, especially in view of the emergence of the *banc assurance* market.

The scope for product innovation is underscored by the fact that the insurance business is often classified in great detail in many developed countries, on the basis of business specialisation and risk and claims characteristics, with *niche* insurers operating in some of the segments. For instance, the European Directive on Life and Non-Life Insurance classify the life business into 7 classes (including unit linked insurance and pensions) and non-life insurance into 17 classes (including credit insurance) for independent authorisation. Of course, in India, although the insurance sector is bifurcated into life and general by the Insurance Act, the insurance companies have already taken up a number of businesses.

It will be appreciated that the benefits of liberalisation - in terms of coverage and cheaper premium - are likely to flow with a gestation lag. The challenges of creating demand by product innovation to suit consumer needs has already begun. A clear example of this is the Business Credit Shield that is being launched by New India Insurance in alliance with Indo European Credit Guarantee (P) Limited. The fact that an existing insurer rather than a new entrant is introducing this new product is itself a testimony to the compulsions of liberalization and competetion.

The credit insurance business - which offers protection to suppliers of goods and services against the effects of debtor insolvency, in cases of domestic credit, export credit and political risk, individually and increasingly comprehensively – has grown rapidly in the past three decades - especially in Europe - with a worldwide premium of around US $ 5 billion according to a recent study commissioned by the International Credit Insurance Association. Bouts of economic crises have enlarged the scope of credit insurance from the original role of protecting the capital at risk in accounts receivable to an essential part of comprehensive credit and financial management. The credit insurance expansion has been in terms of both new players in both the private and the public sectors and new products. Credit insurance has also recently been used to enhance asset securitisation deals.

In the UK, for example, the credit insurance business - which is now almost two centuries old - offers covers for late payment and insolvency of debtors - with options for insuring the whole or the partial turnover and in certain cases, for supplier default. Besides, credit insurers also offer credit intelligence and credit management facilities, including national and international debt collection. The Association of British Insurers points out that credit insurance in the UK is a competitive market not only because of the large number of insurers and the multinational competition but also because of the competing types of domestic cover such as “self insurance” or provisioning (which is limited to bigger companies) and factoring.

The Business Credit Shield is a commendable maiden venture by New India Assurance in introducing domestic credit insurance in the Indian economy. If successful, the product would also offer a competitive product to the exporters especially at the shorter end of the market. The basic features of the product - coverage for insolvency and protracted default (with discretionary credit limit facilities), political risk for exporters, indemnity up to 90 per cent of the agreed loss - are, more or less, in line with international practices. The minimum turnover limits, minimum DCL requirements and the emphasis on strong credit management are equally necessary especially from the angle of business security.

The prerequisite of risk management is, of course, information. In order to develop an institutional mechanism for sharing of credit related information, the Credit Information Bureau has been recently set up by the State Bank of India, in collaboration with HDFC Limited and foreign technology partners. As the insurance business spreads to newer activities, it would be a good idea to build up a co-operative database of their particular risk and claim characteristics. For instance, in case of credit insurance, British credit insurers do contribute to an international database through which commercial information is exchanged with others in the industry and also allows insurers to offer credit intelligence to their clients at very little cost.

Such a database of activity-wise profiles could also have externalities if we do finally move to a system in which minimum capital and other prudential requirements are based on particular business profiles depending on the particular risk and claims characteristics, as is the case in many countries rather than on an aggregate business. This would allow stipulations (such as minimum capital levels) to be fixed more efficiently (than the present across-the-board requirement) and encourage diversification.

As all of us present here do experience, the economic situation in the world is becoming more and more uncertain with new complexities. With increase in uncertainties, the needs for reducing the economic burden of risk are increasingly felt. Business firms are required to identify key risk issues, define the amount of risk that can be taken, find out risk mitigation options and make an appropriate choice from such options. One of the key risk issues, which is common to any business, is risk of default or non-payment by debtors. Introduction of such credit insurance by New India Assurance in the India market should, hopefully, turn out to be a landmark in this regard.

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* Address delivered by Shri Vepa Kamesam, Deputy Governor, Reserve Bank of India at the launch of insurance product "Business Credit Shield" of The New India Assurance Co.Ltd. at Mumbai on 12/9/2001.