



# Module-C Unit-7

## JAIIB PAPER-1

### Indian Economy and Indian Financial System (IE & IFS)



## JAIIB IE & IFS Unit 7 – Insurance Companies

### Introduction



- Insurance can be defined as a contract between two parties, where one (the insurer) promises the other to indemnify or make good any financial loss suffered by the latter (the insured), in consideration for an amount received by way of **\*premium\***.
- The contract of insurance is referred to as the 'insurance policy'
- Losses cannot be determined beforehand, but can be reimbursed if and when they occur, through insurance.

### History And Development Of Insurance

#### Early History

- It finds mention in the writings of Manu (Manusmriti), Yagnavalkya (Dharma sastra) and Kautilya (Artha sastra).
- 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 precursor to modern day insurance

#### History of Insurance in Modern India

The tale of insurance in modern India started during the 1800 AD. The foreign insurance agencies started a marine insurance business which led to the start of the modern history of insurance in India.

- 1818:** In the year 1818, the birth of the first insurance company in India took place. The name of the insurance company was, Oriental Life Insurance with its HQ ay Calcutta.
- 1870:** In the year 1870, the history of insurance in India received a native touch with Bombay Mutual Life Insurance society becoming the first Indian insurance company to be established.

- **1912:** The year of 1912 led to the beginning of The Indian Life Insurance Companies Act. The act regulates the business of Life Insurance in the country.
- **1938:** With the aim to protect the interests of the insured people the earlier consolidated legislation was amended by the Insurance Act.
- **1956:** The business of Life Insurance was nationalized on the 1st of September of 1956. The year of 1956 also witnessed the formation of LIC Act that led to the formation of Life Insurance Corporation of India. The Government of India made a capital contribution of rupees 5 crore. During that period a total of 170 companies and seventy-five provident fund societies were doing the business of life insurance in the country. During the period between 1956 and 1999 the LIC held the solo rights of doing the business of life insurance in the country.
- **1972:** The year of 1972 led to the nationalization of the non-life insurance in the country. The enactment of General Insurance Business Nationalization, the business of non-life insurance was also nationalized. The four subsidiaries of General Insurance Corporation of India were also set up. During that period a total of 106 insurers were doing the business of non-life insurance in the country and those were amalgamated with the formation of GIC's four subsidiaries.

### Commendable milestones in the history of insurance in India.

- In 1993 the establishment of the Malhotra committee took place. R.N Malhotra was the chairperson of the committee.
- The year of 1994, witnessed the publishing of recommendations by the Malhotra committee.
- The year of 1995 led to the establishment of the Mukherjee committee.
- In 1996 the setting up of the (interim) Insurance Regulatory Authority (IRA) took place.
- The Mukherjee committee was set up in the year 1997 but wasn't made public.
- In the year 1997 the Indian Government transfers greater authorities to General Insurance Corporation, Life Insurance Corporation and the subsidiaries of those. It was with the respect to the flexibility of the insurance rules that were targeted to channelize the funds to the structure of infrastructure.
- In the year of 1998, the cabinet decided to permit 40% of the foreign equity in the companies of private insurance.
- In the year of 1999 the standing committee chaired by Mr. Murali Deora decided that the equity in the sector of private insurance should be limited to a total of

26%. The year also witnessed the renaming of the bill of IRA as Insurance Regulatory and Development Authority Bill.

- The year of 1999 witnessed the clearance of the Bill of Insurance Regulatory and Development Authority.
- In the year 2000, the President of India gave assent to the Insurance Regulatory and Development Bill.

### **Privatisation And Foreign Direct Investment (FDI) In Insurance Sector**

- **2000:** First opened to private players and FDI, when the Government permitted FDI to the extent of 26% in Indian insurance companies.
- **2015:** Increased to 49%
- **Budget 2021-22 provided for increase in the cap for FDI to 74%.**

### **Insurance Penetration and Density**

- The measure of insurance penetration and density reflects the level of development of insurance sector in a Country
- While insurance penetration = Percentage of insurance premium to GDP,
- Insurance density is calculated = ratio of premium / population (per capita premium, expressed worldwide in US Dollars per capita).
- During the first decade of insurance sector liberalisation, the insurance sector reported increase in insurance penetration
  - ❑ **From 2.71% in 2001 to 5.20% in 2009.**
  - ❑ **Declining = 3.30% in 2014.**
  - ❑ **Increasing from 2015 and in 2019 = 3.76%.**

### **The level of insurance density has reported consistent increase**

- ❑ From USD 11.5 in 2001 to USD 64.4 in the year 2010.
- ❑ Declining up to 2016.
- ❑ Increasing from 2017 and in the year 2019, the insurance density was USD 78.
- The insurance penetration in the life insurance sector in 2019 was 2.82%, whereas the density was USD 58.
- The penetration of non-life insurance sector in the country was 0.94% in 2019, whereas the density was USD 19.

### **Number Of Insurance Companies Operating In India**

**As at the end of March 2020, there were 68 insurers operating in India;**

- 24 were life insurers
- 27 were general insurers
- 6 were standalone health insurers and
- 11 were re-insurers, including branches of foreign reinsurers and Lloyd's India.

**68 insurers in operation:**

- 8 were in the public sector and
- 60 were in the private sector.

**In the Public Sector**

- Two specialised insurers, namely ECGC and Agriculture Insurance Corporation (AIC),
- 1 life insurer namely LIC of India (LIC),
- 4 in general insurance and
- 1 in reinsurance namely GIC Re were in the public sector.

**In the private sector:**

- There were 23 life insurers,
- 21 general insurers,
- 6 standalone health insurers and
- 10 reinsurers including branches of foreign reinsurers and Lloyd's India.

#### Registered Insurers and Reinsurers

Type of Insurer	Public Sector	Private Sector	Total
Life	1	23	24
General	6	21	27
Standalone Health	-	6	6
Re-insurers	1	10	11
<b>Total</b>	<b>8</b>	<b>60</b>	<b>68</b>

Source: IRDA Annual Report 2019-2020

### **Legislations Governing Operation Of Insurance Companies**

**Some of the important Acts that govern the establishment and operations of Insurance Companies in India are**

- The Insurance Act, 1938,
- The LIC Act, 1956 and
- General Insurance Business Nationalisation Act, 1972 (GIBNA).
- **1<sup>st</sup>** : The Indian Life Assurance Companies Act, 1912 was the first statutory measure to regulate the business of insurance.

- Later, the Indian Insurance Companies Act was enacted in 1928, to enable the Government to collect statistical information about life and non-life insurance business transacted in India.

### The Insurance Act, 1938

- This act, which consolidated and amended earlier legislation, was enacted in 1938
- **Objective:** To protecting the interest of the insuring public. It had comprehensive provisions for detailed and effective control over activities of insurers.
- For the administration of the above, an insurance wing was established and attached first to the Ministry of Commerce and then to the Ministry of Finance.
- The actuarial and operational matters were looked after by the Controller of Insurance.
- The act was amended in the years 1950, 1968, 1988 and 1999.
- **Specifies:** Section 35 of the General Insurance Business (Nationalisation)
- **Act:** The restrictions and limitations applicable, as specified by the Central Government

### The important provisions of the Act relate to:

#### Registration

- Every insurer is required to obtain a Certificate of Registration from the Controller of Insurance, by making the payment of requisite fees.
- Registration should be renewed annually.

#### Accounts and audit:

An insurer is required to maintain separate accounts of the receipts and payments in each class of insurance, viz., Fire, Marine and Miscellaneous Insurance.

Apart from the regular financial statements, the companies are required to maintain the following documents in respect of each class of insurance:

- Record of Cover notes specifying the details of the risk covered
- Record of policies
- Record of premiums
- Record of endorsements
- Record of Bank guarantees
- Record of claims
- Register of agency force and business procured by each with details of commission
- Register of employees
- Cash Books

- Reinsurance details
- Claims register

**Investments:**

- Investments of insurance company are usually made in approved investments under the provisions of the Act.
- The guidelines and limitations are issued by the Central Government from time to time.

**Limitation on management expenses:**

- The Act prescribes the maximum limits of expenses of management including commission that may be incurred by an insurer.
- The percentages are prescribed in relation to the total gross direct business written by the insurer in India.

**Prohibition of Rebates:**

- The Act prohibits any person from offering any rebate of commission or a rebate of premium to any person to take **insurance**.
- Any person found guilty would be punished with a **fine up to five hundred rupees**.

**Powers of Investigation:**

- The Central Government may at any time direct the Controller or any other person by order, to investigate the affairs of any insurer and report to the central government.

**Other Provisions:**

- Other provisions of the Act deal with the licensing of agents, surveyors, advance payment of premium and Tariff Advisory Committee (TAC).

**The LIC Act, 1956**

- **In 1956:** The management of the life insurance business of all the insurers and provident societies, then operating in India, was taken over by the Central Government and these businesses were nationalised.
- **LIC was formed:** September, 1956
- **Capital contribution:** Rs. 5 crores from the Government of India.
- The Life Insurance Corporation Act, 1956 was passed by the Parliament.
- **Objectives:** To conduct the business with utmost economy, in a spirit of trusteeship, to charge premium not higher than warranted by strict actuarial considerations to invest the funds for obtaining maximum yield for the policyholders consistent with safety of the capital.

- **Section 37 of the Act also:** provides Central Government guarantees for sums assured and bonuses declared under LIC policies.

This does not apply to ULIP policies.

- **Section 38 of this Act:** provides that LIC cannot be terminated by any law relating to the winding up of companies or corporations, unless the Central Government orders and directs it to be so.

### General Insurance Business Nationalisation Act, 1972

- Came into force on 1st January, 1973.
- This Act gave effect to clause (c) of Article 39 of the constitution of India.
- **Article 39 (c) read as follows:** “The State shall direct its policy towards securing that the operation of the economic system does not result in concentration of wealth and means of production so as to prove harmful to the common interest of the community.”
- The General Insurance Corporation of India (GIC) became the holding company with four subsidiaries,
  - United India Insurance Company with Head Office in Madras,
  - Oriental Insurance Company with Head Office in New Delhi,
  - National Insurance Company with Head Office in Calcutta
  - New India Assurance Company with Head Office in Bombay.
- The ownership of all shares on vested in the Central Government with effect from 1st Jan 1973.

**Objectives of the Act** The object of the Act was primarily,

- To provide for the acquisition of the shares of the existing general insurance companies
- To serve the needs of the economy by development of general insurance business
- To establish the GIC by the central government under the provisions of the Companies Act of 1956, with an initial authorised **share capital of Rs 75 crores.**
- To aid, assist, and advise the companies in the matter of setting up of standards in the conduct of general insurance business.
- To encourage healthy competition amongst the companies as far as possible
- To ensure that the operation of the economic system does not result in the concentration of wealth to the common detriment.
- To ensure that no person shall take insurance in respect of any property in India with an insurer whose principal registered office is outside India.

### Reinsurance

- Reinsurance involves transferring some portion of risk by insurers to the reinsurers, enabling the insurance companies to focus on their core business.
- For the insurers, this works as a capacity enhancer, as reinsurers offer risk coverage and technical services.
- The presence of reinsurers also decreases volatility for insurers.
- The Indian experience with reinsurance can be assessed with respect to the nationalisation of the general insurance sector, as well as the liberalisation of the insurance sector.
- With the General Insurance Business (Nationalisation) Act, 1972 (GIBNA), the general insurance sector was nationalised.
- Subsequently, the General Insurance Corporation (GIC) was incorporated.
- Foreign markets, primarily British and Continental.
- **In 1956**, the Indian Reinsurance Corporation was incorporated, which consisted of general insurers and received premium cessions from the member companies.
- **In 1961**, statutory cessions were introduced that stipulated the amount that every insurer was required to cede under different categories of insurance.
- A ceding company is an insurance company that transfers the insurance portfolio to a reinsurer.
- The insurer however is liable to pay the claims in the event of default by the reinsurer.
- The purpose behind introducing mandatory cessions was to retain premiums domestically as much as possible, and the binding cessions **from direct insurers to GIC remained at 20% until 2006-07.**
- Later, this limit was lowered to **15%, in 2007-08 and then to 10%, in 2008-13.**
- The obligatory cessions, at present, are at 5%.
- In the post-liberalisation era, the Insurance Regulatory and Development Authority Act, 1999, came into effect.
- Under the Act, an amendment to GIBNA was introduced, which ended the exclusive privilege enjoyed by the GIC and its subsidiaries.
- The supervisory role of the GIC on its subsidiaries was removed, with renotification of the GIC as a national reinsurer.
- With the **General Insurance Business (Nationalisation) Amendment Act, 2002**, that came into force from March 21, 2003, the GIC ceased to be a holding company of its subsidiaries.

- The Government of India took over the ownership of the four subsidiaries and GIC, which left the insurance industry in charge of arranging its own reinsurance cover.
- GIC Re, the sole national reinsurer, provides reinsurance to insurers in India as well as abroad.
- It is the recipient of statutory cessions on every policy issued by domestic general insurers, subject to certain limits and leads almost all treaty and facultative programmes of these companies.
- From the earlier confinement of the reinsurance market to only the public sector reinsurer GIC Re, the market has in due course been opened up to private reinsurers as well, as branches of foreign reinsurers.
- At present, the reinsurance market comprises 1 national reinsurer and 10 other reinsurers, including Foreign Reinsurers' Branches (FRBs) and Lloyd's India.
- This transition from the monopoly of GIC Re to 11 reinsurers has rendered the market relatively more competitive.
- Additionally, there are several cross-border reinsurers in the market.

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