Insurance & Reinsurance - India

State-owned insurers caught in turbulence

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Introduction

Detariffication has been a topic of debate in the Indian insurance market almost since the market was denationalised at the turn of the millennium. Before detariffication, the rates and terms that could be offered by general insurers were set by the Tariff Advisory Committee. The most common demand was for prices to be set free.

Following detariffication, which took place over a two-year period from 2006, many felt that there were still too many residual restrictions and that the Insurance Regulatory and Development Authority needed to be bolder in relaxing its grip. However, now that detariffication has been present in the Indian market for a few years, there are those who seem nostalgic for the days of the tariff era and wish to see it brought back as a means of escaping the enormous pressure on rates that has been experienced since detariffication. The Ministry of Finance appears to be among that group.

Post-detariffication rate setting

In December 2007 the authority announced that, with effect from January 1 2008, general insurers would be free to set their own rates, provided that they were in line with the rates and rating guidelines that had been filed with the authority in advance. Shortly thereafter, the authority decided that third-party motor insurance risks would be exempt from the new regime, because of legitimate fears that the price for this cover would see dramatic overnight increases. Although the price for the cover needed to increase (and many believe it is still not high enough), the impact of a sudden extreme rate increase could have been difficult to manage, both politically and otherwise. Rates for this class of business would therefore continue to be set by the authority.

In other areas where the prices were arguably set higher than they needed to be, such as the fire industry, the price was freed from regulation. In those classes of business, premiums plummeted as general insurers pushed for a market share. In some cases, the drop in premium was more than 90% from the tariff rate. General insurers were not permitted to increase prices on classes of business where such an increase was needed, and where losses continued to mount. At the same time, prices were cut dramatically in lines of business that had traditionally been profitable.

The state-owned (or public sector) general insurers - New India Assurance, National Insurance, United India and Oriental Insurance - were not immune to these changes. As those with the largest share of the market to protect, the state-owned insurers needed to compete head on with privately-owned insurers. A measure of success has been evident as far as market share is concerned, in that the state-owned insurers continue to hold about 60% of the market in the face of stiff competition, but underwriting losses have continued to grow. Press reports over the last few months suggest that the state-owned insurers collectively reported losses of approximately Rs65 billion (US$1.5 billion) in the last financial year alone, out of which motor insurance accounted for approximately 50% of the losses.

Ministry reaction

Used to seeing these insurers report profits, the Ministry of Finance has reacted. In June 2012 the first reports appeared which suggested that behind the scenes the ministry was questioning whether it was right for profitability to be taking second place to growth. In his speech to the chairmen of the state-owned insurers, the union finance minister said that: "The Ministry has suggested certain welcome steps to curb the unhealthy competition in underwriting premiums and it will help restore sustained business growth."

In subsequent months, the message from the ministry has been more forthright and details of what has been suggested as welcome steps has become a little clearer. State-owned insurers have been asked to:

- stop under-pricing risks in order to increase volumes;
- re-draft their underwriting policies to ensure that risk is adequately priced - state-owned insurers are being encouraged to have a 'common underwriting manual';
- cut down on their expenses, for example, by closing branches that do not report a profit;
- stop competing against each other, and in this context share data with respect to premium and claims experience on major accounts. If a major account resides with any state-owned insurer, then at renewal the other state-owned insurers may not quote a lower price or try to move business without the prior written and explicit consent of the chairman and managing director of the state-owned insurer holding the account.

Although there is no express directive to this effect, there are strong hints that rates need to be raised to a level commensurate with the old tariff rates.

The state-owned reinsurer, GIC Re, has also been asked to refuse business that is not properly priced and to stop paying ceding commissions on mandatory cessions. It is said to be ready to turn away business that it does not believe is properly priced.

Comment

The impact of the changes is being felt far and wide. For example, policyholders are complaining that anti-competitive behaviour is being encouraged, which is bound to lead to sharp premium increases, and the Competition Commission appears to be waiting in the wings. It has recently asked the ministry to justify its instructions and to explain if it is encouraging a cartel among the state-owned insurers. These requests have been made against the backdrop of reports that the commission is preparing to launch an investigation into the matter.

The state-owned insurers are also said to be "seeking clarifications" from the ministry - they are concerned that if they are forced to raise premiums while private insurers are not, it is the private insurers which are going to gain business - including profitable business - at the expense of state-owned insurers.

Industry trade unions, which were previously firmly opposed to any talk of consolidation of the four state-owned insurers to create one state-owned insurer, have now decided that consolidation is the way forward as a means of controlling costs, and thereby theoretically avoiding layoffs.

The state-owned insurers' concern that the ministry's intervention will simply result in accounts transferring to private insurers appears to have a sound basis, but the manner in which the intervention has been made (and its terms) appear to be an open invitation to a commission investigation. The solution might therefore be the formulation of a scheme that involves a system of floor pricing or limited retariffication by the back door.

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