November 15, 2006

Shri P. Chidambaram
Minister of Finance
Ministry of Finance
North Block,
New Delhi, India

Dear Shri Chidambaram:

The undersigned organizations are pleased to transmit to you the enclosed *aide mémoire* which we believe will help provide arguments for your debate following the proposed introduction of a comprehensive insurance Bill in the winter session of Parliament.

We appreciate that the Government of India has committed itself to raising the existing 26% cap on foreign ownership in insurance firms to 49%, on several occasions. And we are also aware of the reasons why action has been delayed. We believe that India will reap great benefits from implementing this long-promised step in the Bill.

We would also appreciate some clarification on whether the Bill will make any change to the current 10-year disinvestment provision (IRDA Act 1999). This provision currently applies to both local and foreign partners. An insurance company takes about 8 years to break even. If the disinvestment provision is implemented as foreseen in the 1999 Act both Indian and foreign partners would stand to lose after 10 years of patient investment by having to divest down to 26%; and there could be turbulence in the market in insurance company shares. We would be grateful for clarity as to the Government of India's plans for operating this provision.

We are also pleased to note the proposed shift toward a de-tariffed regime in the general insurance sector. An increase in foreign direct investment (FDI) by international joint venture partners will contribute to the promotion of risk-based pricing and loss prevention in India's general insurance market and ultimately help develop a healthy and sustainable insurance market. Moreover, a de-tariffed market will require enhanced data quality and a higher level of human resources to support underwriting and technically correct pricing. To build such an infrastructure, insurers, including JVs, will need a stronger capital base, increasing the rationale for an increase in the FDI cap.

We respectfully submit, however, that delay is not in the interest of India, rather that delay is costly to India's economic growth and prosperity.

Respectfully,

American Council of Life Insurers
American Insurance Association
Association of British Insurers
Australian Services Roundtable

Bankers' Association for Finance and Trade (U.S.)
Canadian Chamber of Commerce
Canadian Life and Health Insurance Association
Canadian Services Coalition
Coalition of Service Industries (U.S.)
European Services Forum
French Insurance Association (FFSA)
Financial Leaders Group
General Insurance Association of Japan
German Insurance Association (GDV)
Insurance Council of Australia
International Financial Services, London
London Market Insurance Brokers' Committee
The Council of Insurance Agents and Brokers (U.S.)
Wellington Regional Chamber of Commerce (New Zealand)
World Federation of Insurance Intermediaries

Annex

Case for Raising FDI for Foreign Investors in Insurance in India from 26% to 49%

The Insurance Regulatory and Development Authority (IRDA) and the Finance Minister have both publicly indicated their support for an increase of the foreign direct investment (FDI) cap on insurance from 26% to 49%. International markets would view raising the insurance FDI cap as a strong re-affirmation of India's commitment to economic expansion, carrying out the promise made by the Finance Minister during his 2004-05 Budget Speech that the FDI limit in insurance would be raised to 49% from the existing 26%. The target of 49% FDI in insurance was also endorsed by the previous BJP-led coalition government, demonstrating that there is an understanding among different political persuasions of the benefits that a more developed insurance market will provide. We are confident that raising foreign direct investment in the insurance sector will be good for consumers, the entire Indian insurance industry, and India's economy. Apart from easing the imbalance in partners' capital holdings, the change would not give a 49% partner any shareholder benefits that were not already available to a 26% partner.

The move would open up fresh investment prospects in India's expanding economy and infrastructure. Foreign insurers and insurance intermediaries have already invested significantly in India's capital markets and contributed to the country's infrastructure development. Given demographic shifts in India, the increase in urbanization and rapid industrialization, significant long-term capital for infrastructure projects will be continue to be needed. Insurance companies by their nature invest in long-term financial assets; and their regulators expect them to do so. Raising the equity cap in the insurance sector will encourage further foreign capital infusion and lead to faster capital market development.

The move would also expand the capacity of the Indian insurance industry to offer cover. India is as prone as any nation on earth to natural disasters, and the last two years have seen earthquakes, floods and a major tsunami. Strengthening India's insurance market will enable a deeper market to offer wider protection against a greater range of risks, and help India's people and businesses to recover and rebuild following a natural disaster. For the full benefits to be reaped, further liberalizing measures, covering all aspects of the supply of insurance and reinsurance in India, could only serve to enhance the range of competitive commercial and personal insurance lines available to Indian businesses and consumers.

The move would expand the Indian insurance sector and employment in it. India's insurance sector has seen remarkable growth since its opening up in 2000, including the creation of over one million jobs (including direct and indirect employment in insurance companies) and the business process outsourcing (BPO) industry. In the short time since foreign investment has been allowed in India's insurance sector, over 700,000 new Indian jobs/opportunities have been created directly and indirectly in the sector. This level is expected to increase to one million by 2006-2007. The insurance industry's labour market is expected to increase to 1.5 m over the next 2-3 years if the FDI cap is raised to 49%. Clearly there is room for further growth, which can be fostered, in part, by raising the current foreign equity ceiling.

We trust all these factors will be considered favourably and that steps will be taken in the Bill towards increasing the FDI cap to 49% for both insurers and intermediaries. **Studies suggest that the incremental FDI from existing investors will be at least US$ 500 million,** with several new players bringing in additional FDI if the cap is raised. Foreign insurers and intermediaries are committed to long-term engagement in the Indian economy and to playing an essential role in financing India's economic development.

Additional points in support of increasing the foreign equity share.

Global insurers investing in India have brought a substantial number of new and innovative insurance products and services to Indian consumers; they have shared global best practices, management skills and product development know-how with local partners. These new business practices have brought strong domestic investment benefits: private insurers in India across all asset classes in the Indian economy have invested over $2 billion of funds. It is well known that insurers invest a large percentage of their premium income in the domestic economy of their host country. Insurance companies are among the largest contributors to investment in infrastructure projects and in debt and equity markets.

In the financial year 2004-05, the private sector insurance companies collected premium of Rs.3557.7 crores on the non-life side and Rs.5500.3 crores on the life side. Hence together they were able to garner Rs.9108 crores as premium (US $ 2 billion). The respective figures for the financial year 2005-06 are Rs.5426.8 crores for non-life and Rs.10252.7 crores for life aggregating Rs.15678 crores (US $ 3.4 billion). These funds have been invested in the Indian market, mainly in government securities. Over the same

period the private companies increased their market share from 20.29 per cent in 2004-05 and 26.63 per cent in 2005-06. With increasing activity, the quantum of funds invested by private companies would continue to rise and contribute significantly to overall long-term investment in the economy.

There have been corresponding benefits to Indian consumers. As a result of foreign insurance businesses gaining entry to India's insurance market, policyholders from many walks of life are benefiting - from urban dwellers seeking financial planning assistance to farmers benefiting from micro insurance. Yet, as foreign insurers participating in insurance joint ventures (and their backers, associates and clients), we are concerned that these obvious benefits will be undercut unless an increase in the equity level is allowed, so as to permit this momentum to continue.

If added investment were permitted, there would certainly be scope for further market expansion. Despite its current growth, India's insurance market lags behind other economies in the baseline measure of insurance penetration. At only 3.1%, India is well behind the 12.5% for the UK, 10.5% for Japan, 10.3 % for Korea, and 9.2% for the US. In view of both the dramatic demographic shifts and the commercial expansion now taking place in India, it is clear that the insurance industry will need to play an increasingly critical role in the future, in both the life/pensions and non-life sectors. This is, perhaps, especially true in the life and pensions field. Currently FDI represents only Rs 827 crore of the Rs.3179 crore capitalization of private life insurance companies. With an increase in the equity limit, many more foreign insurers would be interested in entering the market, resulting in further expansion of the life insurance market along with offering a wider choice of products and services to the customer.

As sales increase, solvency margins requirements may dictate a further infusion of capital. Domestic partners who hold 74 per cent share may find it difficult to contribute and lock-in, for a long time, a corresponding percentage of new capital whenever required. It would be more conducive to the growth of the industry to have a more balanced shareholding ratio of 49:51 rather than 26:74. With a greater stake in joint ventures foreign investors may also feel greater confidence in investing in new areas of insurance development, such as the rural market.

In summation, we feel there are substantive benefits to raising the FDI caps on insurance from 26% up to 49%, expanding the market for such products, boosting the availability of capital for long-term lending for infrastructure, reducing the strain on Indian partners to bear the larger financial burden for expanding the company, developing innovative products for consumers, sharing international best practices for the insurance industry, and by strengthening Indian citizens' ability to manage risk.