



## An Overview of Life Insurance Corporation of India - Pre and Post Nationalisation

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**ABSTRACT**

Life insurance is a contract that pledges payment of an amount to the person assured (or his nominee) on the happening of the event insured against. The contract is valid for payment of the insured amount during: the date of maturity, or specified dates at periodic intervals, or unfortunate death, if it occurs earlier. Insurance is the outcome of man's constant search for security and finding out ways and means of ameliorating the hardships arising out of calamities. Here, the persons exposed to similar risk contribute some amount periodically and those who actually face the loss are indemnified out of these funds. There are two branches of insurance viz., General Insurance and Life Insurance. General insurance deals with the exposure risks of goods and property where as, life insurance is a way to meet the contingencies of physical death and economic death. In case of pre-matured death of the assured the proceeds of the policy are paid to the beneficiaries and annuities protect the assured against economic death when he lives too long to arrange for his necessities. Life insurance is a contract providing for the payment of predetermined sum of money to the policyholders. It is the function of insurance to safeguard policyholders and their dependents from financial misfortunes.

### KEYWORDS

#### History of Insurance

In India, insurance has a deep-rooted history. It finds mention in the writings of Manu (Manusmriti). Yagnavalkya (Dharmashastra) and Kautilya (Arthashastra). 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 pre-cursor to modern day insurance. Ancient Indian history has preserved the earliest traces insurance in the form of marine trade loans and carriers' contracts. Insurance in India has evolved over heavily drawing from other countries, England in particular<sup>1</sup>.

#### Evolution of Insurance Before Nationalization

History of insurance in India can be broadly bifurcated into three eras: (a) pre nationalization (b) nationalization and (c) post nationalization. Life insurance was the first to be nationalized in 1956. Life Insurance Corporation of India was formed by consolidating the operations of various insurance companies. General insurance followed suit and was nationalized in 1973. Life Insurance in the modern form was first set up in India through a British company called the Oriental Life Insurance Company at Calcutta in 1818. This was followed by the establishment of the Bombay Life Assurance Company in 1823 at Bombay, the Madras Equitable Life Insurance Society in 1829.

Some of the companies that started later did provide insurance for Indians. But, they were treated as "substandard". Substandard in insurance parlance refers to lives with physical disability. In this case, the common adjustment made was a "rating-up" of five to seven years to normal British life in India. Therefore, Indians lives had to pay an ad hoc extra premium of 20 per cent or more. This was a common practice of the European companies at the time whether they were operating in Asia or Latin America. The first company to sell policies to Indians with "fair value" was the Bombay Mutual Life Assurance Society starting in 1870. Insurance business was conducted in India without any specific regulation for the insurance business. They were subject to Indian companies Act (1866). After the start of the "Be Indian Buy Indian Movement" (called Swadeshi Movement) in 1905, indigenous enterprises sprang up in many industries. Not surprisingly, the movement also touched the insurance industry leading to the formation of dozens of life insurance companies along with provident fund companies (Provident fund companies are pension funds).

Comprehensive insurance legislation covering both life and non-life business did not materialize for the next twenty-six years. During the first phase of these years, Great Britain entered World War I. This event disrupted all legislative initiatives. Later, Indians demanded freedom from the British. As a concession, India was granted "home rule" through the government of India Act of 1935. It provided for legislative assemblies for provincial governments as well as for the central government. But supreme authority of promulgated laws still stayed with the British crown.

The only significant legislative change before the Insurance Act of 1938, was Act XX of 1928. It enabled the government of India to collect information of (1) Indian insurance companies operating in India. (2) Foreign insurance companies operating in India and (3) Indian insurance companies operating in foreign countries. The last two elements were missing from the 1912 insurance Act. Information thus collected allows us to compare the average size face value of Indian insurance companies against their foreign counterparts. In 1928, the average policy value of an Indian company was 619 U.S. dollars against 1150 U.S. dollars for foreign companies (source: Indian insurance commissioner's report, 1929, page 23).

The birth of the insurance Act, 1938: In 1937, the government of India set up a consultative committee under the chairmanship of Mr. Sushil C. Sen, a well known solicitor of Calcutta. He consulted a wide range of interested parties including the industry. It was debated in the legislative Assembly. Finally, in 1938, the Insurance Act was passed. This piece of legislation was the first comprehensive one in India. It covered both life and general insurance companies. It clearly defined what would come under the life insurance business, the fire insurance business and so on.

#### Definitions of Various Lines of Business in the Insurance Act of 1938

Section 2(11), Insurance Act, 1938: "Life Insurance Business" means the business of effecting contracts of insurance upon human life, including any contract whereby the payment of money is assured on death (except death by accident only) and the happening of any contingency dependent on human life, and any contract which is subject to payment of premiums for a term dependent on human life and shall be deemed to include

The granting of disability and double or triple indemnity accident benefits, if so provided in the contract of insurance;

The granting of annuities upon human life; and

The granting of superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment or of the dependents of such persons.

Section 2 (6-A), Insurance Act, 1938: "Fire Insurance business" means the business of effecting, otherwise than incidentally to some other class of insurance business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured in fire insurance policies.

Section 2(13-A), Insurance Act, 1938: "Marine Insurance Business" means the business of effecting contracts of insurance upon vessels of any description, including cargoes, freights and other interests which may be legally insured, in or in relation to such vessels, cargoes and freights, goods, wares, merchandise and property of whatever description insured for any transit by land or water, or both, and whether or not including warehouse risks or similar risks in addition or as incidental to such transit, and includes any other risks customarily included among the risks insured against in marine insurance policies.

Section 2(13-B), Insurance Act, 1938: "Miscellaneous insurance business" means the business of effecting contracts of insurance which is not principally or wholly of any kind or kinds included in Section 2 (6-A), 2 (11) and 2 (13-A) of the Insurance Act 1938.

1938 Insurance Act covered deposits, supervision of insurance companies, investments, commissions of agents, directors appointed by the policy holders among others. This piece of legislation lost significance after nationalization. Life insurance was nationalized in 1956 and general insurance in 1973 respectively. With the privatization in the late twentieth century, it has returned as the backbone of the current legislation of insurance companies.

To implement the 1938 Act, an insurance department (that became known as the insurance wing) was first set up in the Ministry of Commerce by the Government of India. Later, it was transferred to the Ministry of Finance. One curious element of classification used was to include automobile insurance in the "Miscellaneous" category. Later in the century, automobiles became the largest single item of general insurance. However, it continued to be included in that category making it difficult to delineate the effects of losses due to pricing that drove this sector. For example, the Tariff Advisory Committee effectively fixed prices for a number of general insurance lines of business. Most premiums were below what would have been actuarially fair (especially for auto). But reporting auto insurance under the miscellaneous category masked this under pricing.

When the market was opened again to private participation in 1999, the earlier Insurance Act of 1938 was reinstated as the backbone of the current legislation of insurance companies, as the Insurance Regulatory and Development Authority Act of 1999 was superimposed on the 1938 insurance Act. This revival of the Act has created a messy problem. The Insurance Act of 1938 explicitly forbade financial services from the activities permitted by insurance companies.

By 1956, there were 154 Indian life insurance companies. There were 16 non-Indian insurance companies and 75 provident fund societies were issuing life insurance policies. Most of these policies were centered in the cities particularly around big cities like Bombay, Calcutta, Delhi and Madras<sup>2</sup>.

### Nationalization of life insurance (1956)

Despite the mushroom growth of many insurance companies per capita insurance in India was merely Rs.8.00 in 1944 (against Rs.2,000 in US and Rs.600 in UK), besides some companies were indulging in malpractices, and a number of companies went into liquidation. Big Industry houses are controlling the insurance and banking business resulting in inters looking of funds between banks and insurance companies. This shook the faith of insuring public in insurance companies as custodians of their savings and security. The nation under the leadership of Pandit Jawaharlal Nehru was moving towards socialistic pattern of society with the main aim of spreading of life insurance to rural areas and to canalize huge funds accumulated by life insurance companies to nation building activities.

### Factors Leading to Nationalization

The genesis of nationalization of life insurance came from a document produced by Mr. H. D. Malaviya called "Insurance Business in India" on behalf of the Indian National Congress. Mr. Malaviya had written a dozen books. This was one of the more obscure ones. In that document, he made four important claims to justify nationalization. First, he argued that insurance is a "cooperative enterprise," under a socialist form of Government, therefore it is more suited for government to be in insurance business on behalf of the "people". Second, he claimed that Indian companies are excessively expensive. Third, he argued that private competition has not improved services to the "public" or to the policyholders. Preventative activities such as better public health, medical check-up, hazard prevention activities did not improve. Fourth, lapse ratios of life policies were very high leading to "National Waste."

Malaviya presents what he called "overall expenses" of insurance business operation in India, USA and UK. His calculations are shown in Table 3.2. He showed that it costs Indian insurers 27% - 28% of premium income for insuring lives whereas in the USA, the corresponding figure is 16% - 17%.

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