

MALHOTRA COMMITTEE REPORT

- AN ANALYSIS

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1. BACKGROUND

The process of liberalisation initiated by the Government in 1991 was certain to invoke fundamental changes in the financial sector and hence the setting-up of a Committee on insurance sector reform, hardly surprised many, in the insurance industry. Despite the hectic speculation on the possible recommendations of the Committee, there was a general consensus in the insurance circles, regarding the broad premise on which the report would be based. And the conformity of the recommendations with the current economic policy has ratified this consensus.

Thus, speculations apart, the report has come as expected. However, at this juncture, it would be worthwhile to probe into the covert sentiments behind the recommendations, in order to unveil the obscure messages and project the future of the insurance industry of India.

2. PRIVATISATION

As mentioned earlier, considering the prevailing economic logic, recommendations on opening-up of general insurance industry to the private sector were quite imminent. However, the social significance of life insurance and the high profitability as well as financial stability of LIC, have made the same recommendations for life insurance somewhat surprising. The fact that life and general insurance have been treated at par by the Committee on this issue, has proved that social or financial considerations were not the deciding factors behind these recommendations.

Even then, the Committee has attempted to protect the social and financial interests by providing for minimum capital requirements, selective approval of foreign entrance, limits on promoters' and non-promoters' holding, safeguards against inter-locking of funds and the setting-up of a regulatory authority, in the report. In fact, it has felt the need for a regulatory authority ".....even in the present set-up or nationalised insurance market", which means the Committee is not satisfied with existing regulatory mechanism.

3. ORGANISATIONAL REFORMS

As a major capital structure reform, Committee has suggested an increase in paid-up capital of LIC and GIC to Rs. 200 crores and that of subsidiaries of GIC to Rs. 100 crores, as well as reduction in Government holding in them to 50 per cent.

The hike in paid up capital has been advocated on the grounds of capital adequacy in relation to the level of activity. Here GIC and its subsidiaries have an edge over LIC as their huge reserves will be easily available for capitalisation, while for LIC, as it has no reserves other than Life Assurance

Fund, it will have to rely only on fresh issue of shares. In fact, the four subsidiaries of GIC have already hiked their paid-up capital utilising their free reserves.

The most striking recommendation is that of reducing Government holding in LIC, GIC and subsidiaries to 50. It is here that the Committee discloses the real forces which impelled its suggestions on privatisation and disinvestment. Referring to LIC, the report states that its "... operational flexibility and its ability to respond to changing conditions is constrained. Some of the constraints relate to the fact that it falls in the definition of State". It thus tells that State-owned character of insurance companies have made them monotonous and lacking dynamism. It goes further to state that a reduction in Government equity by 49% could have been recommended but even then "... the substantive problems which inhibit their commercial functioning would remain". Hence, the Committee is convinced that constitution of truly "Board-run companies" would not be possible even by keeping the Government holding at 51%. The Government, by holding 50% capital will be enjoying a dominant but not absolute control over the composition of Board of Directors.

The Committee in its report has repeatedly emphasised the need for emergence of truly Board-run companies, with controlling interests equitably divided, which it feels is the key to their professional functioning. As an obvious corollary to the above contentions, the Committee stresses the professionalisation of insurance companies. For LIC the Committee comments that its "... central office should be a compact and highly professionalised establishment". This implies a radical transformation of conventional methods of administration and traditional techniques of management, pursued so far.

The Committee has categorically addressed itself to the problem of over-staffing, which it states, is endemic in LIC and GIC. In fact, the crux of the matter has been the perpetual imbalance in the staffing of the various offices, as a result of which the higher offices continue to remain grossly over-staffed and the offices at the grass root-level, which are the operating units, experience acute staff-shortage. This has impeded efficient customer service and effective business development. A review of organisation of all higher offices and the re-deployment of excess staff so available, at the branch offices, has been suggested "...with a view to strengthen the branches where most of the business is transacted" and "... where the impact of growth of business is immediately felt", with a consequent reduction in number of controlling offices.

In a circumspect remark, the Committee has pointed out towards the ticklish issue of unfair labour practices "... which constrain efficient and economical functioning of reorganisation at various levels "and wants"... managements

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to eliminate the same as soon as possible with a view to improving productivity and work culture". This calls for some serious thinking, fervid persuasion and courageous decision-making, fervid persuasion and courageous decision-making.

4. BUSINESS POLICY

The comments of Committee on the business policy of LIC and GIC are worth analysing. There was a feeling prevailing in the insurance circles that although LIC passes a major chunk of its profits to policyholders, by way of bonus the revision of premium rates was not seriously pursued. The report recommends a periodic review of premium rates on without profit policies taking into account factors like investment yields, mortality experience, expenses, etc. and utilisation of benefits, if any, accruing therefrom, in reducing premium rates. Revision of mortality table every ten years has also been suggested.

As regards general insurance, on one hand raising of motor premium rates due to heavily adverse claims experience has been recommended, while on the other a progressive reduction of areas under tariff regime has been advocated, particularly for personal insurances. This means that in the long run, the Committee wants every company to determine rates on the basis of its own experience. A favourable claims experience would mean lower rates of premium, more business and vice versa. The translation of this theoretical concept into reality, will make application of loss control measures imperative, for the very survival of the company. However the report is silent on the use of standard policy forms, which is crucial from the point of view of consumers.

The marketing side of business policy has also been deeply examined. The Committee has aptly recognised the significance of agents in the marketing system. The concept of a two-tier agency structure has been put forward. For LIC it advises concentration on improvement of quality of agents, whereas for GIC it wants commission structure to be made attractive. The latter proposal implies a rise in the premium rates. The Committee seems to have taken a serious note of dummy (Benami) agency system, which is widespread and known to all in general insurance industry. The report states that even the existing agents "... should be screened to weed out benami agents". All these recommendations are aimed at building a professional agency force which can withstand competition from private sector.

Development officers, the prime-movers in the marketing machinery and the most privileged class in the insurance industry, have caught attention of the Committee. Effortless rise in the volume of business due to inflationary pressures, without any real increase in its quantum, used to accrue undue benefits to development officers. For this, the Committee feels the need to "... periodically review the service, terms, conditions and benefits of development officers...". Measures like stringent growth and cost norms for receiving incentives, linking of annual increment with a minimum growth percentage and insistence on a balanced portfolio, will go a long way in inculcating a responsible attitude and will bring insurance marketing in line with consumer products marketing. For this purpose, a substantial

change in the approach towards marketing will be required. A more scientific meaning will have to be allotted to the term 'marketing' which was hitherto considered synonymous to 'rise in business'.

The surveyors' profession has been granted the recognition it deserves, by the Committee. The importance of a surveyor in assessment of a loss hardly needs description. The accountability factor involved in the survey work has always warranted the existence of statutorily incorporated institute for surveyors. The Committee recommends setting-up of such an institute and suggests guidelines regarding its constitution, functioning, membership, code of conduct and others incidental matters, which make-up an organised profession. However, it feels that licensing of surveyors should be given-up "... as it has not served any useful purpose".

5. INFORMATION TECHNOLOGY

The concept of management accounting has been recognised as an integral part of modern corporate management. For this the development of information technology in the form of advanced management Information System (MIS) has become need of the hour. The development of information technology is all the more vital for insurance companies, considering their volume of activity and nature of business. This has been acknowledged by the Committee by stressing the need for "... development of better structured and more informative reporting systems". For this purpose comprehensive computerisation has been emphasised, especially for general insurance business. The same has also been recommended for TAC, so that it can perform the vital function of rating more accurately. The Committee also feels that "... computerisation should improve the work environment and job satisfaction within the industry".

Moreover, in a competitive environment where tariff regime is to be kept very limited, accuracy in determination of rates of premium, by each company, will depend on the reliability of data its MIS generates. This will make MIS a prominent item of the corporate agenda in the years to come.

6. INVESTMENT PATTERN

The pattern of investment of huge amount of funds generated by the insurance companies is certainly material to the entire economy. Up till now LIC and GIC were required to invest 75% and 50% of their funds respectively, in Government securities. This limit is recommended to be reduced to 50% and 35% respectively. This is in line with the Government's decision to reduce SLR and CRR in respect of commercial banks. This would also mean that the Government which is confident on slashing its expenditure, will receive less from insurance companies which will now be free to invest a major part of their funds in more lucrative areas and increase substantially their investment incomes. With the limit for investment otherwise than in approved securities remaining unchanged, which is what the Committee has recommended, the surplus funds will be channelised in approved investments, thus making available vital capital for development of various industries.

With the advent of private sector in the insurance field and the liberalisation of investment norms, the obvious possibility of inter-locking of huge funds in private sector, especially in companies under the same management of group as the investing company, cannot be denied. As a guard against this possibility of virtual transformation of insurance companies into investment companies, the Committee has recommended restrictions on quantum of investment in any one company, including the one that "...no insurer...shall invest or keep invested any funds in any manner in its affiliate, whether incorporated or not". Thus care has been taken to ensure that interests of investors and consumers are not jeopardised due to reckless investment.

7. CONCLUSION

Those discussed above and many other recommendations like maintenance of a fixed proportion of rural business, control over management expenses and claims costs, interest penalty for delay in claims settlement, setting-up of the institution of ombudsman, structured compensation for third-party claims, incentives for actuarial profession and other suggestions on technical and administrative reforms are neatly designed for a meticulous reconstruction of Indian insurance industry. This report is a report for change - a change in the entire philosophy governing the insurance sector.

Whenever, in the process of changing economic logic, it is envisaged to shift a sensitive area like insurance, from one ideology to another, the transition has got to be most

scrupulously guided. Such a transition is sure to entice apprehensions in the minds of the masses concerned, on account of the conditioning accumulated over the past. To a certain extent, such apprehensions are justified, as it is a part of basic human instinct to fear the unknown. This when coupled with the bias created by common experience makes the individual reluctant towards accepting a change.

But if adequate measures to vitiate probable hazards of the ensuing change, which is inevitable, are initiated by the sovereign and the masses are properly educated in this direction, these impregnable apprehensions and biases can be wiped out to a great extent. In this context, the report has performed its part in the right earnest. Again it also demands some sort of introspection and awareness on the part of masses concerned.

As stated earlier, while the report is still pending with the Government, implementation of some of its recommendations has already begun. Considering this and the growing awareness in the industry, there seems to be hardly any formidable constraint to the acceptance of the report in toto by the Government.

Summing up this analysis, it can be said that this comprehensive document has been a positive effort towards the qualitative improvement of the insurance industry and can serve as a firm basis for a bright future, if implemented in letter and spirit - at least for the committed well-wishers of the industry.

Miss Universe contest

The spoils of victory

- The glittering gem-studded crown, cash and gold trophy apart, Sushmita Sen is the first Miss Universe to be presented a dazzling diamond signature brooch studded with one hundred sparkling diamonds on 18 kt gold and platinum. An original handmade creation of Hammerman, New York, it is valued at \$20,000;
- \$ 50,000 will come to her from her employment with Miss Universe International Inc;
- A luxury apartment in Los Angeles, California, USA;
- \$ 7,500 cash plus one-year supply of Precisely Right home permanents from Oglvie;
- \$ 7,500 cash, a Master Cam-cordes, a complete 35 mm Maxxum SLR camera outfit and carrying case plus the world's only autofocus binoculars, all from Minolta;
- \$ 5,000 cash plus a collection of Sassaby cosmetics and jewellery in all the latest styles;
- A swanky sportscar of the latest international model;
- A 32-carat diamond jewellery collection consisting of matching earrings for Ms Universe;
- A luxurious full-length Black-glamma mink coat plus sporty mink jacket awarded by the world-famous Flemington Fur Company;
- An extensive assortment of Frederico-Leone shoes in elegant and casual styles;
- A spectacular 18 kt gold and diamond Miss Universe Crown Ring;
- A personal appearance travel wardrobe including luggage from Miss Universe International Inc.