Life insurers' IPO norms: Right step at wrong time

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To describe 2011 as a forgettable year for the life insurance segment of the insurance industry would be an understatement.

The run-up to 2010 saw the life insurance segment piggyback successfully on unit-linked insurance plans (ULIPs) so as to achieve a robust growth of 40-50%. In 2010, the Insurance Regulatory and Development Authority (IRDA) tightened the regulatory noose around ULIPs by capping commissions of agents and distributors, enhancing risk cover and extending the lock-in period to five years to give ULIPs the features of a long-term savings product.

These changes reduced the short-term revenues of distributors, whose bottom line in the segment is commissions. When stubborn inflation conspired with a choppy equity market in 2011, ULIPs lost much of their steam and sheen. Insurance companies had little room to obtain further investment, and were dogged by poor underwriting and a lack of technical expertise.

The industry lobbied hard for an increase in the foreign direct investment (FDI) limit in the insurance sector from 26% to 49%, and had high hopes for the Insurance Amendment Bill, 2008, which proposed this hike in the FDI cap. However, 2011 saw the parliamentary panel examine and then reject the bill citing, among other factors, the volatile global economic environment, thereby dashing the industry's hopes of tapping into foreign capital in the near future.

Gate opens

Without access to further FDI, insurers had no choice but to continue to trawl in the difficult domestic waters for fresh capital. Then in November, the IRDA threw open the gates of the domestic capital market for life insurance companies by notifying the IRDA (Issuance of Capital by Life Insurance Companies) Regulations, 2011 (IPO Regulations), which allow private life insurers that have completed 10 years of operations to float initial public offerings (IPOs).

The IPO Regulations require a company interested in floating an IPO to obtain the written approval of the IRDA before approaching the Securities and Exchange Board of India (SEBI) for the public issue of shares or any subsequent issue under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations).

The approval granted by the IRDA would remain valid for one year, within which the applicant company must file a draft red herring prospectus with the SEBI under the ICDR Regulations.

Approval process

The IRDA will delve into the overall financial position of the applicant company and investigate whether the company has complied with applicable laws in the past. It will scrutinize the company's track record in policyholder protection and its profitability as showcased in an embedded value report on the company, to be prepared by an independent actuarial expert and reviewed by another independent actuary.

The IPO Regulations state that the IRDA expects the embedded value of the company to be twice its paid-up equity capital.

The approval granted by the IRDA may be subject to the fulfilment of conditions that the insurance regulator deems fit to impose on the applicant company. The IPO Regulations confer wide-ranging discretionary powers on the IRDA, including the power to: instruct the promoters of an applicant company to dilute their shareholding to a certain extent; set the maximum subscription that may be received by the company from any class of foreign investors; and set a minimum lock-in period for the promoters of the company.

In addition to the disclosures to be made under the SEBI norms, the insurance regulator may require the company to make additional disclosures in its offer document, relating to matters such as particulars of the issue and the issuer, risk factors specific to insurance companies and financial statements.

No bread? Eat cake

"Have you Met Life Today?", "You are in Good Hands", "Retire from Work, not Life", "Positively Different": the advertising slogans of life insurance companies cry out to underinsured Indians, who since time immemorial have thought of life insurance as little else besides tax arbitrage.

A recent McKinsey survey suggested that the life insurance sector in India is one of the least profitable in Asia. Industry insiders will readily admit that the tonic that could help the sector recover from a tepid 2011 would be FDI and not IPO.

With the global economy teetering and the Indian capital markets still going through a dry spell, the spirits in the industry are flagging along with the valuations. Although 2012 is expected to be more bountiful than its predecessor, no one is queuing up for the IPO train just yet. No surprises there.

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