The insurance sector needs further assurance

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Following the introduction of the Insurance Laws (Amendment) Bill, 2008, the Insurance Regulatory and Development Authority (the IRDA) has issued a set of corporate governance guidelines for insurance companies.

As insurers in India are yet to be listed, corporate governance requirements prescribed under the listing agreements and regulations issued by the Securities and Exchange Board of India (SEBI) do not currently apply to them.

The guidelines impose corporate governance requirements similar to those applicable to listed companies. Insurers are advised to familiarize themselves with typical corporate governance structures and the regulatory requirements for listed companies, and to initiate steps to facilitate a smooth transition at the time of eventual listing. The IRDA mandates all insurers to implement the provisions of the guidelines by April 2010, leaving little time for insurers to overhaul their present corporate structure.

Additionally, the guidelines impose a lock-in on the transfer of shares of insurers that are held by their promoters, for a period of five years from the date of certificate of commencement of their business. Until now there was no prescribed lock-in period, but the transfer of shares required prior consent of the IRDA under certain circumstances (such as in the case of a proposed transfer of more than 1% paid-up equity capital of the insurer).

While the introduction of the guidelines is laudable, the insurance sector would greatly benefit if some other critical reforms were also implemented.

The Insurance Act, 1938, requires Indian promoters of insurers to divest their shareholding in excess of 26% of the paid-up equity capital, in a phased manner, after a period of 10 years from the date of commencement of the insurer's business. The Insurance Act has left the procedure for divesting the excess share capital to be prescribed by the IRDA, which is yet to do so. Interestingly, though the divestment requirement remains in place, the Insurance Bill proposes to dispense with it.

Several insurers are currently approaching the end of the statutory 10-year period. There are reports that the IRDA is consulting with SEBI to allow the listing of shares by insurers, in order to facilitate the offloading of excess shares held by Indian promoters in the market.

The listing of insurers would bring its own share of complications given that insurers are already highly regulated. The listing guidelines should strike some balance between the insurance industry-specific regulatory framework and the nuances of the capital market.

For instance, the transfer of shares in an insurer beyond certain levels requires prior IRDA permission under the Insurance Act, while shares of a listed company are freely transferable, subject only to takeover and disclosure rules. As the Insurance Bill does not propose to dispense with the requirement to obtain IRDA permission, the listing guidelines should address the manner in which this requirement would need to be satisfied. Additionally, the listing guidelines need to set disclosure standards and clarify valuation norms to create greater transparency. In this direction, IRDA has recently released the "Exposure Draft on Public Disclosures by Insurers", which is broadly in line with the standards on disclosures recommended by the International Association of Insurance Supervisors.

Insurers need regular deployment of capital to meet mandatory solvency requirements. Currently, the raising of capital by an insurer is fairly restricted because insurers may issue only ordinary shares of a single face value. The Insurance Bill proposes to infuse capital in the insurance sector by allowing an increase in foreign direct investment participation (up to 49%), and allowing the issue of such "hybrid capital" as may be specified by the IRDA. The statement of objects and reasons of the Insurance Bill states that insurers would be allowed to raise capital through newer instruments, following the pattern of banks.

It therefore seems that the legislature intends to permit issuance of capital without voting rights (with economic rights only). One would therefore expect that, once insurers are listed, they are allowed flexibility and perhaps a fast-track option to raise capital in order to meet their solvency requirements. Currently, the raising of fresh capital (whether on a rights basis or a preferential allotment basis) by a listed company is often time consuming due to the compliance requirements.

Currently the Insurance Act only recognises two categories of insurers, life and general. The Insurance Bill proposes to allow insurers to operate a health insurance business exclusively, and has reduced the minimum capital requirement to Rs500 million (US$11 million) from the Rs1 billion (US$22 million) required for the life insurance and general insurance businesses. It is expected that the government will also release regulations encouraging the health insurance business, given the urgent need for such services in India.

Given the regulatory complexities that will accompany the imminent 10-year anniversary of the opening of the insurance sector to private participation, policy makers and the IRDA have their work cut out for them in their goal of increasing investor confidence.

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