Market Review
January 16, 2012

Sector
Non-Life & Life

Additional Information

2011 Special Report:
India Non–Life & Life
Market Review

Criteria:
Assessing Country Risk

Analytical Contact
Jeff Yeung, Hong Kong
+852 2827 3413
Jeff.Yeung@ambest.com

Researcher & Writer
Yvette Essen, London
+44 207 397 0322
Yvette.Essen@ambest.com

Growth Anticipated for Indian Insurers, but Frustrations Remain

Further growth is anticipated for India's insurance market, although achieving profitability continues to remain a struggle for many insurers. Since the market was liberalised in 2000, total insurance premiums have increased strongly, driven primarily by the life market. Continued economic growth, an expanding middle class and heightened demand for health insurance are resulting in foreign insurers and reinsurers seeking to establish a greater presence in the country. However, while the insurance sector offers prospects for growth, it is also characterised by challenges and frustrations. A.M. Best notes:

• In the long term, India's middle class is continuing to benefit from increased wealth, although a slowdown in the growth of gross domestic product and inflationary pressures could dampen the insurance market's rate of growth.

• While the insurance market is expected to continue expanding, it has been characterised by intense competition and losses emanating from the motor pool. Insurers are hopeful that the dismantling of the third-party motor pool in March 2012 will lead to an improvement in rates.

• Despite these varied challenges, opportunities emerging in the world's second most populated country continue to attract international insurers and reinsurers. However, they face repeated frustrations in attempting to increase their involvement in India, with a lifting of the foreign direct investment limit from 26% to 49% unlikely to occur in the near term.

• The life sector is continuing to adjust to regulations restructuring unit-linked insurance policies, which took effect in 2010. The impact has been significant, resulting in a sharp drop in first-year premium, although companies are adjusting their product mix toward conventional policies.

Indian Insurers Rated by A.M. Best
(USD Thousands, as of March 31, 2011)

	Premiums Written		Best's Ratings*	
Company Name	Gross	Net	Financial Strength	Issuer Credit
General Insurance Corp. of India	USD 2,565,782	USD 2,308,353	A-	a-
New India Assurance Co. Ltd.	2,135,274	1,584,448	A-	a-
Oriental Insurance Co. Ltd.	1,378,705	1,015,931	B++	bbb+
United India Insurance Co. Ltd.	1,566,545	1,127,263	B++	bbb+

For Best's Rating criteria and definitions, visit www.ambest.com. Ratings as of Jan. 4, 2012.
Source: BestLink® – Best's Statement File Global

India's Growing Insurance Market

The Indian insurance market has seen considerable growth since its liberalisation a little over a decade ago. As **Exhibit 1** shows, statistics from the Insurance Regulatory and Development Authority (IRDA) demonstrate that in the year ended March 31, 2011, total premiums increased 11.3% to INR 3.35 trillion (USD 75.45 billion).

Until recently, the life sector has been the driving force for growth in the insurance market. However, over the past year the life sector has been adversely impacted by the restructuring of unit-linked insurance policies (ULIPs) (see **Life Market in State of Change, Page 6**). Life insurance premium as a percentage of gross domestic product (GDP) was 5.21% for 2011, reflecting products being designed to attract India's 1.2 billion inhabitants, who have a strong savings culture. There has been a greater awareness of the benefits of life insurance offerings, while scepticism has surrounded non-life products. Consequently, insurance penetration for the non-life segment reached just 0.78% in 2011.

India's economy expanded by an estimated 10.1% in 2010; information technology, business services and manufacturing were particular drivers of growth. As the country's poverty levels continue to decline, health insurance is expected to be among the fastest growing sectors as more people can afford cover and awareness of its benefits increases. Health represented approximately 23.35% of non-life premiums in 2010-2011, according to the IRDA's latest annual report. A December 2011 report published by the Standing Committee on Finance indicated that health insurance has increased tenfold from INR 6.8 billion in the year 2000-2001, to INR 66.5 billion during 2008-2009.

The health segment is expected to continue to develop strongly. For example, in November 2011, U.S.-based health service provider Cigna signed a joint-venture agreement with Indian consumer goods company TTK Group to sell a range of health, wellness and insurance products.

However, health business tends to be loss-making, as industry participants appear to be writing business at any cost. Some companies are attempting to increase profitability by reducing hospital expenses and administration costs. A group of insurers including United India Insurance Co. are proposing to form a third-party administrator to improve claims experience in the health sector.

Greater personal wealth is also expected to result in continuing growth in car sales. Currently, the motor market represents 43% of non-life premiums. Other lines of business are expected to benefit as India's economic growth continues. Product

Exhibit 1

India Premium – Non-Life & Life

(INR Billions)

	2007	2008	2009	2010	2011
Population* (Millions)	1,142.0	1,158.0	1,174.0	1,190.5	1,206.9
Gross Domestic Product**	INR 41,550.1	INR 44,120.5	INR 47,108.1	INR 51,863.3	INR 55,929.1
Change in GDP**	10%	6.20%	6.80%	10.10%	7.80%
Insurance Penetration (Life)	3.76%	4.56%	4.71%	5.12%	5.21%
Insurance Penetration (Non-Life)	0.62%	0.65%	0.67%	0.69%	0.78%
Insurance Penetration (Total)	4.38%	5.22%	5.37%	5.81%	6%
Insurance Premium (Life)	INR 1,561	INR 2,014	INR 2,218	INR 2,655	INR 2,916
Insurance Premium (Non-Life)	INR 259	INR 288	INR 314	INR 358	INR 438
Insurance Premium (Total)	INR 1,820	INR 2,302	INR 2,532	INR 3,013	INR 3,354
Change in Premium Volume (Total)	43.06%	26.48%	9.99%	19%	11.32%

Notes:
Premium figures are based on calendar years April 1 to March 31.
* Estimates start after 2009
** Estimates start after 2010
Sources: International Monetary Fund; World Economic Outlook Database, September 2011; and the Insurance Regulatory and Development Authority, annual reports 2006-07 to 2010-11

liability insurance is said to be enjoying increased demand, particularly for the pharmaceutical and motor industries, although this is regarded as a high-risk line of business for insurers. There have been recent reports that directors and officers insurance could be made compulsory for listed companies.

Overseas Investors Drawn to India

In principle, the insurance market is attractive to outside insurers, including U.S.-based Berkshire Hathaway. In 2011, Berkshire Hathaway became a licensed corporate agent of Bajaj Allianz policies, and it currently distributes motor and travel insurance via the Internet. It also plans to offer other non-life and life products.

A joint-venture life insurance company was also established last year in India by Japan's Tokio Marine Holdings and India-based financial services company Edelweiss Capital Ltd. The new company began selling products in July and will offer both property/casualty and life insurance. Separately, Japan's Nippon Life Insurance recently took a 26% stake worth USD 680 million in Reliance Life Insurance. Reliance is now reported to be in discussions to sell a 26% holding in its general insurance company.

However, while international insurers and reinsurers remain interested in India for risk diversification and growth, in reality, business can be unprofitable, owing to the market remaining competitive. Premium rates have been inadequate for most lines of business that were detariffed in 2007.

It can also be difficult to bring deals to fruition: in November, energy and materials company Reliance Industries said negotiations to buy Bharti's 74% stake in Bharti AXA Life Insurance Co. and Bharti AXA General Insurance Co. had terminated "as a result of the parties being unable to reach agreement on the long-term vision and joint governance of the ventures."

Lloyd's has previously expressed frustration with the pace at which the Indian market has opened to overseas investment. While it has no current plans to reappoint a country representative, Lloyd's continues to hope that legislation will be passed in some form that allows it and other reinsurers to set up branch operations in India. Lloyd's plans to send a delegation of managing agents and brokers to India in early 2012 to improve understanding of the Indian market. New chairman John Nelson is also expected to visit the country in the spring to foster relations.

Varied Challenges Face Insurers

While the Indian economy is continuing to expand, the rate of growth is slowing, according to India's Central Statistics Office. In the quarter of July to September 2011, GDP grew at an annualized rate of 6.9% over the corresponding quarter of the previous year. In the quarter from April to June, the Indian economy expanded at an annualized rate of 7.7%.

Although growth in GDP has recently decelerated, India's long-term prospects remain positive, with GDP forecasted to have grown 7.8% in 2011, according to the International Monetary Fund.

Under A.M. Best's country risk rating methodology, India has been assigned a "CRT-4" (Country Risk Tier 4). Countries are placed into one of five tiers, ranging from "CRT-1" (Country Risk Tier 1), denoting a stable environment with the least amount of risk, to "CRT-5" (Country Risk Tier 5).

A.M. Best notes that high inflation – particularly for food and fuel – threatens to erode disposable incomes. According to India's Ministry of Labour and Employment, inflation in October 2011 was up 9.4% over October 2010. The Reserve Bank of India has been steadily tightening monetary policy since March 2010 and has been lifting interest rates to combat inflation.

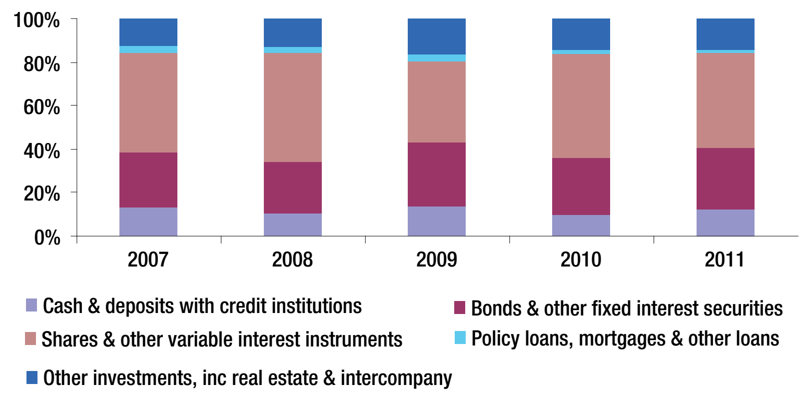
Insurers face other challenges, notably intense competition as the impact of detariffing has made it difficult for companies to prosper. Public sector undertakings (PSUs) – New India Assurance Co., United India, Oriental Insurance Co. and National Insurance Co. in the non-life sector, and Life Insurance Corporation of India – remain the dominant players. Private insurers are finding it particularly challenging to achieve profits, owing to the costs of establishing distribution channels and creating a customer base by offering competitive prices.

Exhibit 2 shows that all non-life insurers, including PSUs, have high exposure to equities, which can make investments volatile. From 2007-2011, the equity component of insurers' assets has been the largest class of investment, representing 37% to 50% of assets. Investment performance has traditionally offset underwriting losses, although in 2011, on the Bombay Stock Exchange, the benchmark Sensex 30 index fell 25%.

A.M. Best's ratings analysis takes into account the risk associated with these equity investments. A.M. Best believes the PSUs that it rates (New India, United India and Oriental Insurance) are well capitalized to absorb volatility in the market and notes their investment portfolios comply with the IRDA's guidelines.

Exhibit 2

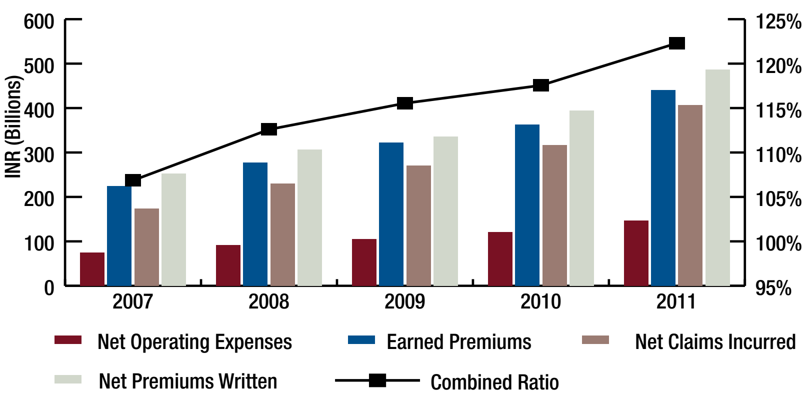
India Non-Life Insurers – Asset Mix (2007-2011)



Source: BestLink – Best's Statement File Global

Exhibit 3

India Non-Life – Aggregated Combined Ratio & Premiums (2007-2011)



Source: BestLink – Best's Statement File Global

Non-Life Insurers' Underwriting Performance

Non-life gross premium written increased 23.8% to INR 330 billion from the beginning of April until the end of October 2011, according to the IRDA's monthly statistics. These data include premiums from the two public specialist insurers – Export Credit Guarantee Corporation of India and Agriculture Insurance Company of India. The IRDA reports its monthly and annual figures for the non-life sector differently; the data recorded in the IRDA's annual report (as demonstrated in **Exhibit 1**) include gross direct premium and exclude these two state insurers.

While top-line growth for the non-life sector appears to have remained strong according to the IRDA's monthly statistics, **Exhibits 3** and **4** demonstrate that underwriting has tended to be loss-making.

The two exhibits show that for the past five years, combined ratios have been increasing steadily for the non-life sector, from 106.9% in 2007 to 122.3% in 2011. This reflects increasing loss ratios and competition among market participants.

Motor Key Contributor to Losses

The Indian Motor Third Party Insurance Pool (IMTPIP), which was created in April 2007, has been among the most significant contributors to underwriting losses, as claims inflation has been rising. Losses are distributed to all insurers according to their overall market share of all lines of business. The IMTPIP's loss ratio reached 194.2% for the year 2009-2010, while it maintained reserves at a loss ratio of 126%.

Private insurers in particular have called for the restructuring or abolishment of the pool for years. In late December 2011, the IRDA announced plans to dismantle the pool effective March 31, 2012 in view of factors that include "the alarming increase in the liabilities of the pool." The IRDA further stated that the pool's current framework was "severely affecting the financial viability of the general insurance sector due to alarming capital depletion in the sector," and that policyholders' interests were eroded as there were "huge inefficiencies in claim settlement."

The impact of the changes on the existing IMTPIP is unclear, as it will take months for the total liabilities of current policies to be calculated, with accounts of the pool to be audited by the end of June. However, it is anticipated that rates could rise, as insurers would have greater freedom to set premiums based on claims experience.

The IRDA also announced that a "declined risk pool" would be created to provide third-party insurance for commercial vehicles that are considered uninsurable. GIC Re will act as administrator to the pool, which takes effect April 1, 2012. All general insurers will share claims from the scaled-down pool.

In general, Indian insurers tend to be more focused on domestic risks, although recent catastrophes in the Asia Pacific region are likely to result in some losses. New India has a branch in New Zealand. Some insurers are understood to be facing losses in Thailand, as Indian companies have industrial assets in the flood-ravaged country. GIC Re, India's sole domestic reinsurer, is actively growing its international business.

Separately, the July 2011 terrorist attacks in Mumbai that killed 19 people and injured more than 130 resulted in few claims to the terrorist pool, as there was little damage to properties.

Attempts to Improve Combined Ratios

Some insurers are attempting to improve underwriting performance by introducing stricter underwriting for health and varying discounts on fire policies.

Rates have been lifted marginally for non-third-party liability motor, and engineering risks and fire rates are showing signs of stabilising. Treaty capacity is said to be more restricted, and a greater dependence on facultative reinsurance is said to be resulting in higher deductibles.

GIC Re is continuing to encourage better underwriting standards by implementing more stringent terms and conditions. Insurers are still obliged to cede at least 10% of risks to the state reinsurer. However, GIC Re has recently ceased paying ceding commission to insurers for this obligatory reinsurance. This move is expected to have a negative impact on primary insurers, increasing losses as insurers are asked to return commissions already received from April 1. Non-life insurers oppose the move and are seeking representation from their trade body, the General Insurance Council.

With regard to insurers' overall performance, although loss ratios have been deteriorating, A.M. Best expects gradual improvement of loss and expense ratios in the coming years. Offsetting factors continue to be motor losses (although this could alter depending on the impact of the changes to the motor pool), fierce market competition, high expense ratios and significant exposure to stock-market volatility. Furthermore, to an extent, insurers are unlikely to come under great pressure to focus on capital adequacy, as India has no current plans to shift to a risk-based capital regime.

Regulatory Developments and Foreign Direct Investment

The IRDA has continued to be an active regulator, unveiling a stream of new rules and proposals over the past year. Among the most eagerly awaited are those regarding fundraisings, as insurers seek to fund growth and shareholders look to crystallise their assets.

In June 2011, draft initial public offering (IPO) regulations for life companies were unveiled. These stipulate that insurers must have

Exhibit 4

India Non-Life – Aggregated Data (2009–2011)

(INR Millions)

	2009	2010	2011
Gross Premiums Written	INR 453,667	INR 533,694	INR 651,947
Yearly Growth in Gross Premiums Written	6.1%	17.6%	22.2%
Net Premiums Written	INR 335,530	INR 394,598	INR 486,286
Yearly Growth in Net Premiums Written	9.6%	17.6%	23.2%
Net Retention Ratio	74.0%	73.9%	74.6%
Capital & Surplus	INR 524,149	INR 873,284	INR 921,244
Change in Capital & Surplus	-29.8%	66.6%	5.5%
Loss Ratio – Non-Life	84.1%	87.0%	92.2%
Operating Expense Ratio – Non-Life	31.4%	30.5%	30.1%
Combined Ratio – Non-Life	115.5%	117.6%	122.3%
Return on Premiums	9.5%	7.6%	1.8%
Return on Capital & Surplus	3.5%	4.1%	0.3%
Net Premiums Written to Surplus	64.0%	45.2%	52.8%
Net Technical Reserves to Surplus	99.7%	68.8%	79.3%
Gross Premiums Written to Surplus	86.6%	61.1%	70.8%

Source: BestLink® – Best's Statement File Global been trading for at least 10 years and meet solvency requirements that include having an embedded value of at least twice paid-up equity capital. Earlier draft guidelines, requiring companies to have been profitable for at least three years before flotation, were removed.

Guidelines regarding mergers and acquisitions were also released in June for non-life private insurers. The guidelines outline the approval process and state minimum solvency margins.

In August 2011, new IRDA guidelines took effect to create a common framework for supervision of life, non-life and reinsurance companies' asset-liability management through stress testing. Other guidelines and regulations published in 2011 include the approval of funds associated with ULIPs and investment in venture funds.

However, the most significant piece of legislation to affect the insurance industry – the Insurance Laws (Amendment) Bill 2008 – has yet to be passed. The proposed change to the foreign direct investment (FDI) limit from the current level of 26% to 49% remains the most contentious point.

Foreign insurers continue to press for a lifting of the FDI limit, as shown by a November 2011 letter from international trade groups, which included the American Council of Life Insurers, the Association of British Insurers, the European Insurance and Reinsurance Federation and the International Underwriting Association. That letter stated in part: "In order to continue

Life Market in State of Change

New regulations that restructured ULIPs in the third quarter of 2010 have significantly impacted the life sector. Data from the regulator show first-year premium of life insurers fell 19% for the first eight months of the 2011-2012 fiscal year to INR 624.3 billion. These figures, which run until the end of November, are solely for first-year premium (regular and single premium) and do not include renewal premiums, which are used in the IRDA's annual reports.

In November, private sector market leader ICICI Prudential said annual premium equivalent sales fell 56% to GBP 73 million (INR 5.8 billion) in the first nine months of 2011, compared with GBP 167 million (INR 13.3 billion) in the same period of 2010. The insurer said it has "significantly diversified away" from linked products to conventional offerings. At the company's third-quarter 2011 results, conventional products contributed to around 40% of incremental new business, up from around 5% previously.

The life market continues to be challenging. Aviva Life Insurance announced in June 2011 that it had made a small profit of INR 290 million for the full year 2010-2011. Since launching in May 2002, it had posted losses, including a loss of INR 3.45 billion in 2009-2010.

India's life sector saw numerous regulatory developments in 2010 and was subject to further rules in 2011. In November 2011, the government unveiled guidelines for unit-linked pension products offered by life insurers. These took effect on Dec. 1, 2011. In November, the cabinet also approved FDI of up to 26% in the pension sector.

Agents remain the dominant distribution force in India, with Life Insurance Corporation of India increasing its work force by employing 100,000 agents in southern central India, taking its total number of agents to 15 million. The sole public life insurer continues to dominate, owing in part to its strong distribution network and government guarantee.

There is an increasing take-up of purchasing insurance products through the Internet, with the IRDA publishing guidelines on Web aggregators in November 2011. These guidelines set a flat fee paid by insurers to Web aggregators and addressed the displaying of products on websites, prohibiting aggregators to carry advertisements or sponsored content.

Bancassurance is also growing in importance. In July 2011, Punjab National Bank announced plans to form a joint-venture partnership with MetLife India, buying a 30% stake in the insurer. The company will rebrand itself as PNB MetLife. In November 2011, the IRDA issued regulations on bancassurance agents, dividing India into three zones and limiting the number of insurance company and bancassurance arrangements.

growing, and to service the widely anticipated acceleration in premium growth in the Indian insurance market, private insurers will need a substantial capital infusion."

However, recent political developments make it appear increasingly unlikely that the FDI limit will be raised in the near term. While international insurers say raising the threshold would provide additional funds as well as greater technical knowledge and expertise, some domestic participants say there is no need for the FDI limit to rise as capacity is available and the market is already competitive.

In December 2011, the Standing Committee on Finance said in its 41st report on the bill "that in the present global economic scenario, any further hike in FDI at this juncture may not be in the interest of the Indian insurance industry." The committee has recommended that the sector's needs to fund growth be met by formulating rules and regulations to enable companies to tap the domestic market, combined with other capital-raising options.

Published by A.M. Best Company

Special Report

CHAIRMAN & PRESIDENT **Arthur Snyder III**

EXECUTIVE VICE PRESIDENT **Larry G. Mayewski**

EXECUTIVE VICE PRESIDENT **Paul C. Tinnirello**

SENIOR VICE PRESIDENTS **Manfred Nowacki, Matthew Mosher, Rita L. Tedesco**

A.M. BEST COMPANY
WORLD HEADQUARTERS
Ambest Road, Oldwick, N.J. 08858
Phone: +1 (908) 439-2200

NEWS BUREAU
830 National Press Building
529 14th Street N.W., Washington, D.C. 20045
Phone: +1 (202) 347-3090

A.M. BEST EUROPE RATING SERVICES LTD.
A.M. BEST EUROPE INFORMATION SERVICES LTD.
12 Arthur Street, 6th Floor, London, UK EC4R 9AB
Phone: +44 (0)20 7626-6264

A.M. BEST ASIA-PACIFIC LTD.
Unit 4004 Central Plaza, 18 Harbour Road, Wanchai, Hong Kong
Phone: +852 2827-3400

Any and all ratings, opinions and information contained herein are provided "as is," without any expressed or implied warranty. A rating may be changed, suspended or withdrawn at any time for any reason at the sole discretion of A.M. Best.

A Best's Financial Strength Rating is an independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations. It is based on a comprehensive quantitative and qualitative evaluation of a company's balance sheet strength, operating performance and business profile. The Financial Strength Rating opinion addresses the relative ability of an insurer to meet its ongoing insurance policy and contract obligations. These ratings are not a warranty of an insurer's current or future ability to meet contractual obligations. The rating is not assigned to specific insurance policies or contracts and does not address any other risk, including, but not limited to, an insurer's claims-payment policies or procedures; the ability of the insurer to dispute or deny claims payment on grounds of misrepresentation or fraud; or any specific liability contractually borne by the policy or contract holder. A Financial Strength Rating is not a recommendation to purchase, hold or terminate any insurance policy, contract or any other financial obligation issued by an insurer, nor does it address the suitability of any particular policy or contract for a specific purpose or purchaser.

A Best's Debt/Issuer Credit Rating is an opinion regarding the relative future credit risk of an entity, a credit commitment or a debt or debt-like security. It is based on a comprehensive quantitative and qualitative evaluation of a company's balance sheet strength, operating performance and business profile and, where appropriate, the specific nature and details of a rated debt security.Credit risk is the risk that an entity may not meet its contractual, financial obligations as they come due. These credit ratings do not address any other risk, including but not limited to liquidity risk, market value risk or price volatility of rated securities. The rating is not a recommendation to buy, sell or hold any securities, insurance policies, contracts or any other financial obligations, nor does it address the suitability of any particular financial obligation for a specific purpose or purchaser.

In arriving at a rating decision, A.M. Best relies on third-party audited financial data and/or other information provided to it. While this information is believed to be reliable, A.M. Best does not independently verify the accuracy or reliability of the information.

A.M. Best does not offer consulting or advisory services. A.M. Best is not an Investment Adviser and does not offer investment advice of any kind, nor does the company or its Rating Analysts offer any form of structuring or financial advice. A.M. Best does not sell securities. A.M. Best is compensated for its interactive rating services. These rating fees can vary from US$ 5,000 to US$ 500,000. In addition, A.M. Best may receive compensation from rated entities for non-rating related services or products offered.

A.M. Best's special reports and any associated spreadsheet data are available, free of charge, to all *BestWeek* subscribers. On those reports, nonsubscribers can access an excerpt and purchase the full report and spreadsheet data. Special reports are available through our Web site at *www.ambest.com/research* or by calling Customer Service at (908) 439-2200, ext. 5742. Some special reports are offered to the general public at no cost.

For press inquiries or to contact the authors, please contact James Peavy at (908) 439-2200, ext. 5644.

SR-2012-310