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TESTIMONY OF THE

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Introduction

On behalf of the American Insurance Association (AIA), I am pleased to offer this testimony to the U.S. International Trade Commission (ITC).

It is an honor to have been invited to testify again, and I thank you for the interest that the ITC has shown in the insurance sector in India during this investigation and in 2014's investigation.

AIA is the leading property-casualty insurance trade organization, representing approximately 325 insurers that write more than $127 billion in premiums each year. AIA member companies offer all types of property and casualty insurance, including personal and commercial auto insurance, commercial property and liability coverage for small businesses, workers' compensation, homeowners' insurance, medical malpractice coverage, and product liability insurance. AIA members make up some of the most active insurers globally, and AIA members are very interested in India's trade and investment policies.

We appreciate greatly the ITC's undertaking an investigation to follow up on its 2014 investigation into trade, investment and industrial policies in India and their effects on the U.S. economy. As I pointed out in my testimony last year, the ITC has been a leader in highlighting the impact on the U.S. economy of barriers in other countries to trade in investment in the property and casualty insurance sector, notably in its 2009 investigation *Property and Casualty Insurance Services: Competitive Conditions in Foreign Markets*. It was in that investigation that the ITC concluded that U.S. exports would increase by 48 percent if all of the examined countries were to fully liberalize cross-border property and casualty insurance exports, and that U.S.-owned affiliates could increase sales by 28 percent if all examined countries fully liberalized affiliate sales restrictions. That liberalization, the ITC concluded, would lead to job growth here in the U.S. Those jobs would likely pay above average wages, the ITC concluded,[i] a finding that was reinforced two years later by Professor Brad Jensen when he stated that jobs in insurance and other finance industries that are related to international trade pay, on average, more than $20,000 more per year than those jobs in the sector that are not related to international trade.[ii]

The ITC's analysis made it clear that such barriers from any of our trading partners cost the U.S. valuable jobs. Those jobs come from cross-border exports, and in U.S.-based staff that support the operations of affiliates established abroad. Though many jobs related to insurance have to be located in the country where the business is being performed (sales agents, for instance), when a U.S.-headquartered insurance company expands abroad, it will generally perform many services related to its management of the foreign affiliate from its U.S. headquarters. So, as the ITC found, if there were more U.S.-invested insurance companies in India, those companies would create employment in India and here in the U.S. alike.

Status of the Indian insurance market

India continues to present enormous potential for insurers because 1) it is experiencing faster overall economic growth than many developed economies; 2) its large population continues to grow, increasing the number of potential insurance consumers; 3) its insurance sector continues to grow faster than those of many developed economies at 9.3 percent; and 4) insurance penetration remains quite low in the non-life insurance sector, at roughly 0.8 percent, compared to the OECD average of 4.2%.

As Indian corporations grow in size and number, they need to insure their property and products, and protect themselves from liability. And, as India's population continues to grow and become more affluent, the need for personal lines of insurance will continue to grow as well.

Economic and social stability in any country are directly related to the uptake of insurance in that country. Greater insurance coverage means that companies and individuals in India will not need large "rainy day funds" and can instead invest the money that would be in those funds in the expansion of their business, education, or invest it in their communities in some other way. Insurance also guarantees that a bad harvest, isolated act of stupidity from an employee, automobile accident or other unexpected events will not bankrupt a company or push a family into economic ruin. With proper insurance, you are no longer one disaster away from destitution.

The risk mitigation that insurance brings is of course essential for large businesses. But it is even more important to micro, small and medium sized enterprises that do not have the size to withstand economic shocks. India is estimated to have over 26 million of such enterprises, including 15 million small retail outlets.[iii] It is those micro, small and medium sized enterprises that are the bedrock of a growing, entrepreneurial economy like that of India's, and their economic stability is an important national interest.

However, India remains underinsured. As I pointed out last year, the World Economic Forum ranks India 52nd out of 62 surveyed nations in property and casualty insurance penetration.[iv] While its current non-life insurance penetration of 0.8 percent is an improvement from 0.6 percent in 2009[v], it is still far too low. While low insurance penetration and density present opportunities for newcomers to the market, the lack of insurance poses dangers to the overall soundness of the economy.

One reason for the underdevelopment of India's insurance market is that it remains dominated by state-owned insurers. The four public sector non-life insurers hold more than 50 percent of the premium market share, at 425.9 billion rupees. That number is up 10 percent from the previous year.[vi] That means that four public sector insurers hold more of the market than the twenty seven private insurers combined.

Significant recent developments

Since AIA's testimony in February 2014, some very important developments have occurred in India. On March 12, 2015 the upper house of India's Parliament, the Rajya Sabha, approved the Insurance Laws (Amendment) Bill, making an increase in the foreign investment cap from 26 percent to 49 percent permanent, and opening India's reinsurance market to a significant degree. The passage of that legislation was a very significant moment in the history of India's insurance sector, and a very significant moment for the new governing coalition as well. The government in New Delhi had made it clear from the outset that attracting more investment in India's economy and supporting the economic aspirations of India's citizens were priorities. Pushing the bill through the Parliament is clear evidence of their determination.

In order to sufficiently explain the significance of the passage of the reforms, it is necessary to briefly recall the recent history of India's insurance sector. The Insurance Regulatory and Development Authority Act of 1999 de-monopolized much of India's insurance market. It created the Insurance Regulatory and Development Authority (IRDA) and allowed limited foreign participation through joint ventures with Indian companies. Foreign ownership of those joint ventures was limited to 26 percent, but in 1999 there was an expectation that the foreign investment cap would be increased quickly. Clearly that expectation was overly optimistic.

It was not until 2008 that the government, then led by the Congress Party, introduced legislation in the Parliament to increase the FDI cap to 49 percent. However, to the chagrin of the insurance industry, the legislation languished due to domestic political disagreements.

In the general election of 2014, the Bharatiya Janata Party (BJP) won a decisive victory. Though some non-insurance issues initially prevented the Parliament from considering the insurance legislation, the dedication of the BJP-led government to reform the insurance sector was made clear in December 2014 when the new Prime Minister of India used a rare executive decree called an "ordinance" to temporarily implement the insurance bill.

Once the opposition Congress Party stated that it would support the legislation, it finally seemed likely that the reforms would be made permanent. In the Budget Session of 2015 the Parliament finally voted on the bill. The BJP-controlled Lok Sabha (lower house) passed it on March 4th, and on March 12th the Rajya Sabha approved it. A decade and a half since the initial opening of the market, U.S. insurers can now own 49 percent of a joint venture in India.

The ability of the BJP-led government to build a coalition of support for the bill demonstrates clearly that a new energy has infused the government of India. While the government was swept into power with enormous gains in the Lok Sabha, getting the bill through the Rajya Sabha posed a much greater challenge. By demonstrating its commitment to economic growth through the insurance sector, among others, the government made it clear that they can and will reform India's economy for the benefit of India's citizens. My focus is on the insurance sector so I will leave it to those with more expertise on the greater Indian economy to draw larger conclusions from the government's recent achievements, but it seems to me that the passage of the insurance bill is a symbol of something even bigger than insurance reform.

Foreign investment cap

We expect that the passage of the amendments will have a very positive effect for U.S. insurers, other non-Indian insurers, and the insurance policyholders of India.

It is too early to say with quantitative certainty what the impact of the insurance reforms will be. But early predictions have indicated that it will be big, and it will be good. Predictions from insurance groups and independent economists have put new FDI inflows to India from the investment cap increase anywhere from $2 billion to $10 billion.

Anecdotally, the public expressions of interest from foreign insurers in increasing their stake in joint ventures have been impressive. Despite the challenges in the Indian market – and there are challenges - we expect that those non-Indian insurers that currently have joint ventures in India will increase their stake to 49 percent. Most, if not all, of the non-Indian insurers in joint ventures have contractual rights to increase their stake to the maximum permitted statutory ratio. Currently, 22 of the 24 private life insurers in India, and 18 of the 27 private non-life insurance companies in India, have foreign joint ventures. For the Indian insurance sector, that will not necessarily mean more capitalization since the increased investment would transfer from the non-Indian insurer to the Indian investor. But that transaction will lead to greater investment in the Indian economy overall, since the Indian investor will presumably reinvest the capital in India.

Over time, however, we expect that the increase in the investment cap will also attract new market entrants. For the reasons I outlined earlier in this testimony, investments in the Indian insurance market are valuable, largely due to the great potential for future growth in the expanding but vastly under-insured Indian market. When new insurers enter the market it will increase total capital in the sector. Furthermore, as the Indian insurance sector continues to develop, it is likely that the existing joint venture partners – both Indian and non-Indian – will increase the size of their investments in the joint ventures, increasing the available capital. The increase in capital in the insurance sector will allow insurers to write more policies, expand distribution networks, train and hire talent that must be in-country, and to meet the solvency requirements that are essential to the integrity of the financial system. A well-capitalized insurance sector will have positive dividends for the larger economy, as insurers invest in government bonds, infrastructure development, and other important areas.

Foreign reinsurance branches

Another very significant development that came from the insurance legislation was the opening of India's reinsurance market to foreign branches. Reinsurance, explained in the simplest terms as insurance for insurance companies, spreads risks and provides protection against major catastrophes, so that stand-alone, separately capitalized insurers are not overwhelmed by losses associated with the risks that they insure. Reinsurance also lowers the ceding company's net retained liability from the policies it underwrites, enabling the ceding company to underwrite more business than its own capital alone could support. Finally, reinsurance enables global companies to manage and diversify risk with the flexibility to deploy capital and to sell coverage to meet market opportunities in different jurisdictions in the world in a timely fashion.

Currently the approximately $2.7 billion Indian reinsurance market is dominated by the single state-owned reinsurer, General Insurance Corporation of India (GIC Re). Troublingly, in line with the government's regulatory objectives to retain more risk through restrictions on cross-border reinsurance, reinsurance premium ceded outside of India is below 10 percent, meaning that more than 90 percent of reinsurance is held within India's borders.

In short, an open and developed reinsurance market is essential for providing price and product advantages to consumers, diversifying risk, and making insurance markets generally more competitive. Permitting foreign reinsurance branches in the Indian market is important to U.S. and other reinsurers who will soon have greater access to India's reinsurance market, and for the stability of India's insurance sector. The IRDA is currently in the process of developing the regulations that will implement the law, and we hope that the regulations will be implemented in a way that maximizes this important opportunity for India.

Enduring challenges in the Indian insurance market

The overall message that I am here today to impart is that India has taken an substantial step toward reducing trade and investment barriers in the insurance sector, and has done so through the impressive dedication of the new government to positive economic reform. I do not want to detract from that message.

However, there are remaining challenges to non-Indian participation in the insurance market that I would like to outline for the ITC. The increase in the investment cap from 26 percent to 49 percent was an important, hard fought improvement to India's insurance regulatory system. However, as I pointed out in my testimony last year, even a 49 percent investment cap is a significant investment barrier, and it remains of the lowest in the region. For illustrative purposes, China, Korea, Taiwan, and Mexico permit 100 percent foreign ownership of property and casualty insurance companies. Even Malaysia and the Philippines permit more than 50 percent foreign ownership.

Furthermore, within India's financial sector, the insurance investment cap remains the lowest when compared with other financial products. Banks, for instance, can be 74 percent foreign owned, and asset management companies can be 100 percent foreign owned.

To be clear, we are far happier at 49 percent than 26 percent, and I do not want to minimize the appreciation that the U.S. industry feels for the recent reform. However, for obvious reasons many of the problems associated with having a joint venture at 26 percent ownership remain with having a joint venture at 49 percent ownership. The minority U.S. insurer still lacks management control over the joint venture, and is limited in its protections as the minority partner. More technical and developmental benefit would flow from the U.S. partner having more control over the company, and the security that comes with being a majority owner would encourage more U.S. insurers to enter the market. Permitting majority or 100 percent foreign ownership would significantly stimulate market participants to inject more capital into the Indian economy, create more jobs, and expand the range of insurance products that are available to consumers.

Getting to 49 percent was a long, politically-fraught process. It is clear that the government of India understands the importance of a more-developed insurance market, otherwise the motivation to pass the insurance bill would not have materialized as it did earlier this year. For the same reasons, 74 percent or 100 percent should be the goal for the benefit of Indian policyholders and U.S. insurers alike. The improvements that we expect to come from the increase to 49 percent will be even greater if insurance companies are permitted to be wholly owned by non-Indian insurers.

Thank you for the opportunity to testify today.

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[i] United States International Trade Commission, *Property and Casualty Insurance Services: Competitive Conditions in Foreign Markets*, (Washington, DC: USITC, March 2009), ix

[ii] Brad Jensen, *Global Trade in Services: Fear, Facts and Offshoring* (Washington, DC: Peterson Institute for International Economics, 2011), 71.

[iii] Indicus Analytics, "The Case for Increasing FDI Caps in Insurance," *Indicus White Paper Series*, January 2013, 7.

[iv] World Economic Forum, *The Financial Development Report 2012*, (Geneva: 2012), 147.

[v] General Insurance Council, *Indian Non-Life Insurance Industry Yearbook 2013-14*, (Mumbai: 2014), 5.

[vi] General Insurance Council, *Indian Non-Life Insurance Industry Yearbook 2013-14*, (Mumbai: 2014)