

INDIA UNION BUDGET 2021: LIFE INSURANCE INDUSTRY IMPACTS

The Indian insurance industry is poised to witness significant activity in the coming years. On 1 February 2021, the Finance Minister, Ms. Nirmala Sitharaman, announced the 2021 Budget of the Government of India. In this e-Alert we discuss the key announcements impacting the life insurance industry, covering foreign direct investment (FDI), changes to the taxation of unit-linked insurance plans (ULIPs) in the hands of consumers, and the initial public offering (IPO) of the Life Insurance Corporation of India (LIC).

FDI cap to be raised from 49% to 74%

After increases in the FDI cap for insurance intermediaries in the 2020 budget, the Government now plans to raise the FDI limit in insurance companies to 74%. Along with this, the erstwhile requirement for Indian management control will be amended, so that a majority of directors and key employees need to be resident Indians, as well as a requirement that at least 50% of directors are independent. There will also be a requirement for a specified percentage of profits to be retained with the company as general reserves, which may limit the extent to which dividends can be paid in the future. These proposed changes could have far-reaching impacts on the industry.

For the first time, foreign insurers will be able to take a majority stake in an insurance operation in India. The 49% limit on FDI and the lack of management control have, in the past, been stumbling blocks for some multinational insurers. Multinationals that have yet to enter India, or those that have pared back their holdings in existing insurers, may now reassess their India strategy.

With the Reserve Bank of India capping bank ownership of insurance companies to 30%, the raised FDI cap also opens the door for a '70-30' shareholding structure. A foreign-owned majority stake in a joint venture with a local banking partner could be an attractive proposition in a market where we estimate that 54% of individual new business premium sold in the private sector in fiscal year 2019 was through the bancassurance channel.

It is not just those multinational shareholders that are eyeing a full 74% stake that will be enthused by the news. Some insurers have multiple domestic promoters, given the previous requirement for at least 51% ownership to rest with Indian shareholders. With the capital-intensive nature of life insurance

business, some domestic shareholders may see this change as a means to facilitate their exit from the sector. We may therefore see some consolidation of ownership. This will be welcome news for some, where the existing wide investor base has created conflict over the strategic direction of the insurer.

The increase in FDI limit may also create opportunities for private equity and sovereign wealth funds seeking to take a larger stake in existing life insurance companies.

More innovative models, including tie-ups with existing insurance brokers as a minority partner or niche distribution models focused on digital strategy, may also become viable, if such specialised insurers from other markets consider the large opportunity offered by India.

Once the exact legislative measures proposed in the budget announcement are published, including the specifics around profit retention, we expect this change to generate significant activity in the sector.

Change to the taxation of ULIPs

One of the key selling points of insurance contracts in India is the tax-exempt status of the policy benefits. The budget outlines Government plans to introduce a cap on this exemption in the case of new ULIP contracts having an annual premium in excess of INR 250,000. For policies exceeding this level, the proposal is to apply a long-term capital gains tax, currently at 10% and similar to that which applies to investments in equity-oriented mutual funds. This is proposed to be applied only upon surrender, maturity and partial withdrawal, however, with payments upon death remaining tax-exempt.

The threshold at which the tax exemption is proposed to be removed is relatively high, and so likely to affect higher-net-worth individuals. As a result, its impact on insurers will be dependent

on their ULIP mix and customer profile. While the beneficial tax treatment of ULIPs vis-à-vis mutual funds is an important part of the sales pitch, other factors such as limits on charges, provision of minimum insurance cover, ability to switch funds without triggering any tax, and lock-in periods also come into play. Nonetheless, there may be a possibility of some adverse impact on ULIP sales to high-net-worth individuals.

It is to be seen whether this change makes other product types, especially the non-participating savings business and the participating savings business, increase in prominence. Some insurers may modify their participating contracts in order to bring them more in line with ULIPs (e.g., by increasing the equity component) to take advantage of the potential tax arbitrage.

LICI IPO

The Government also repeated its intention to list the state-owned life insurer in the forthcoming financial year (FY21-22). In order to enable this, various legislative changes have been proposed in the Finance Bill, to amend the Act governing the LICI to bring its mode of operations closer to that of a private insurance company.

These proposed amendments follow the initiation of a process of appointing consultants to work on various stages of the preparatory work towards the proposed listing.



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