CHAPTER - I

INTRODUCTION, THE PROBLEM, THE EXISTING LITERATURES AND THE PRESENT STUDY

Introduction:

A life insurance problem is a socio-economic problem. It concerns human being living in a society. Though an individual loves himself the most, he has social bearing on others. He earns for himself as well as for his dependent family members. Thus, there exists a relationship of love and affection as well as a financial obligation among the family-members and the bread-winner. A premature physical or economic death of the bread-winner ceasing his earning capacity may cause to financial crisis to the bereaved family. Because, a family generally depends for its food, clothing and shelter on the income of the bread winner. So long as he lives and earns, the family is secure; but should death occur all on a sudden, the family will be left in misery and stark poverty. It is the uncertainty of death that is regarded as 'risk' which is inherent to human life. This urges upon every rational individual to search for security against future uncertainties. We shall now deal with the problem in detail in the subsequent sections.

1.1 Early History : A Search for Security:

Ever since the beginning of human habitation on this earth, especially in the Neolithic Age of human civilization man has been exposed to innumerable harms and hazards which

urged upon him to search for ways and means to cope with them. A study of the evolution of the Human race reveals that man has continuously sought for security and happiness for himself and his family from times immemorial (LICI, Branch Managers' Training Course, 1964). The switch over from Paleolithic Age to Neolithic Age was a turning point in the anthropology of human civilisation; since at this age mankind first ever came to learn how to light a fire, to plough and sow, to pet the beasts at home and use them as the produced means of product for domestic works as well as a durable food-substitute. Thus, thanks to agriculture, the gypsy mankind stopped wandering, made habitation and formed society in the womb of community with the idea that safety was to be found in the combined strength of many. As time passed, gradually they began to concern about production and conservation of food and maintenance of shelter against unforeseen future contingencies e.g. foul weather, bad harvest or other natural calamities. So, they began to set aside a portion of their present harvest or stock of food for future consumption or for more purposive use; that is, they learnt under the veil of ignorance, to behave economically. This abstinence from present consumption for more consumption or more purposive use in future is, in economic parlance, called saving — an outcome of intertemporal choice. But as the caravan of civilisation was advancing, things were becoming more complicated for reasons more than one and it was felt that singly saving could not afford full protection

against future uncertainty. Thus they had to think for a step further beyond the benevolence of saving and thereby to protect and ensure a secured future life. Down to this line of thought and realisation the very concept of 'insurance' had emerged in an implicit form of mutual risk-sharing.

1.2 Benevolence of Insurance:

The basic principle of 'insurance' is to reduce risk and to provide certainty and security against uncertainty. It eliminates risk but compensates loss. There is no end of risk and therefore, no limit of loss. Death will forge, fire will consume and accident shall occur (Bhattacharya, 1954). By prevention and precaution the probability of their occurrences or the amount of loss therefrom can only be lessened but cannot be avoided. Insurance has nothing to do with their occurrences but may reduce the loss, had the incident occurred, by spreading the total loss amongst the community of insured. Insurance is thus a device to remove the economic consequence of uncertainty. From the point of view of Economists, by diminution of risks insurance evolves an increase in wealth. It lessens social cost of risk, gives tranquility and cheerfulness to the extensive trades (Bhattacharya, 1954).

Let us dwell a bit on how 'ordinary saving' and 'saving through insurance' differ. A rational individual saves with three

motives viz. transactionary, precautionary and speculative ones. While the prime motivational force behind insurance is security against uncertainty. The idea of 'making safe' originates from the urge to ensure, insure or assure oneself of something. Besides life insurance premium is the first charge on the income of the life assured.

The fundamental social, financial, legal and economic aspects of insurance are — that it is a cooperative endeavour where the loss of a few is compensated by many who are exposed to similar risk; that it is a financial arrangement where an individual or a firm contributes according as he or it transfers risk to the common fund; that here one man agrees to take another man's risk of life or business in consideration of certain periodical payments called premia; that by diminution of risks insurance evolves an increase in wealth. It, as stated earlier, also lessens the social cost of risks, gives favourable environment to trades and commerce. All these make businessmen enthusiastic to venture in high-risk trades which are of great benefit to the nation and enable them to lay foundation of credit, to procure on easy terms and bring their goods in the market (Bhattacharya, 1954). Indeed, "the possession of an adequate amount of insurance causes an average policy-holder to eat better, sleep better, feel better and as a result of these, to work better" (Gupta, 1966).

The onset of industrial era gave impetus towards spreading and advancing of insurance business round the globe through moderation, modernisation and orientation. In fact, today, right from the perils of the sea to the risk of loitering in the space, nothing is left out from the folder of insurance cover. But whatever be their number, they all have been deduced from either of the three major branches of insurance viz. Marine, Fire and Life. "The Original trio-type of Marine, Fire and Life business has now in its chain many other types of insurance business e.g. Personal, Accident, Sickness, Employment Liability, Fidelity Guarantee, Burglary, Motor, Aviation etc." (Bhattacharya, 1954). But chronologically, 'Marine' came first, 'Fire' and 'Life' followed the principle of Marine insurance. Of these trio, Life Insurance is mainly concerned with human life or better say, with 'human life value'. Before going to discuss the concept of human life value let us see how life insurance came into being. Marine insurance of modern type originated with the Jews in the 3rd or 4th century and from Jews, the European nations came to know of it. While the great Fire of London in the middle of the 17th century gave an immediate impetus to Fire insurance. But, Benjamin Franklin observed and pointed out a strange anomaly that "men should be careful to insure their houses, their ships, their merchandise, and yet neglect to insure their lives, surely the most important of all assets to their families, and more subject to loss" (Federation of Insurance Institutes, 1984). Thus, being induced

by his argument men became aware of the importance of human life, and thus Life insurance became popular gradually.

1.3 The Concept of Human Life Value:

Drawing heavily from Huebner (1959), the concept of 'human life value' can be expressed in terms of monetary value for which it should be carefully appraised and capitalised. It is said that when a child is born, a life is born. As he grows into an adult, he acquires education, character, initiative, drive, experience — in short, he acquires knowledge and skill which gives him earning power. Through his earning power, he wants to satisfy his needs — present or future. It is this earning power/productive capacity which is his human life value (Huebner, 1959). In life insurance it is taken as the capitalised part of an individual's earning which is spent on support of dependent family members, business associates or others who have insurable interest on his capacity to earn. The basic principle behind the theory of life insurance is that man must die, but when — is uncertain. Death is the only certainty among the uncertainties of future. Man is a social being and can act rationally. In the words of Sir Browne, "Man is a Noble Animal, Splendid in ashes, and pompous in the grave, solemnizing Nativities and Deaths with equal lustre nor omitting ceremonious of bravery, in the infamy of his nature" (Morah, 1955). Hence, he feels obligation to himself, his family and the society he lives in. So, dying too early or living too long — none is free from hazards and none is socially expected and mentally accepted.

Moreover, from cradle to the grave the path is more hazy than death. Therefore, both should be adequately taken care of. In contrast, when a retarded child is born, a life is born but it does not add economic value to itself because knowledge and skill are not acquired. Human life value relates to only earning person. Non-earning person, as a matter of fact, is a burden on the family vis-a-vis on the society. Such a person is almost a parasite on the income sources of the family, who sucks the resources and makes no contribution in return. In case of death of such a non-earner the family's economy is not going to be weakened, rather the maintenance cost on him is saved (Huebner, 1959).

1.4 Human Life Value Approach:

Huebner said, "Human Life Value is the Economic Interpretation of Life Insurance" (Huebner, 1959). The economic value of an individual to his dependants in terms of life insurance can be estimated by following the steps as under:

(i) Estimate the individual's average annual earning from future personal efforts (ignoring return from investments, if any).

(ii) Deduct Income Tax, life insurance premium, personal expenses and cost of self-maintenance etc.

(iii) Determine the working expectancy of the individual which is the difference between the contemplated age of retirement and present age.

(iv) Select a reasonable rate of interest at which future earnings should be discounted to have the present value of his future earnings.

(v) Multiply the amount of earned income devoted to the family by the present value of Re 1=00 payable annually for the working expectancy, utilising the rate of interest selected.

To illustrate the process let us take a numerical example. Name - XYZ, present age - 35 years, contemplated age at retirement - 65 years and annual average income from future personal effort — Rs. 28,000=00. The amount to be deducted are assumed as:

Income Tax	Rs. 1800.00
Personal Expenses	Rs. 3000.00
Self-maintenance cost	Rs. 9000.00
Socio-needs (expenses)	Rs. 1200.00
Life Insurance Premium	Rs. 3000.00
Total	Rs. 18,000.00

Then, working expectancy is 30 years; and income devoted to the family per annum is Rs. 10,000/-. So expected earning over 30 years = Rs. 10,000 x 30 = Rs. 3,00,000/-. The present value of the amount discounted at 4% rate of interest (assumed) will be Rs. 1,73,000.00 and at 5% rate of interest it will be Rs. 1,53,725.00. Thus, the human life value is Rs.3,00,000.00. Life insurance and only life insurance protects this human life value of an earning person

and this is the basis of determining life insurance need and adequacy. Life insurance agents should endeavour to educate the masses of this fundamental principle and to make them accept it ignoring various superstitions, temptation of tax rebate and return from life insurance planning. This alone can place us in lines with the developed nations (Jain, 1987).

Life insurance is a legal contract between the insurer and the insured based on a high degree of mutual good faith popularly known as 'Uberrima Fides' meaning the 'utmost good faith'. Both the parties to an insurnace contract must be ad idem i.e. of the same mind. Broadly speaking, it is said that "a contract of insurance is in its nature aleatory, voluntary, executory, synallagmatic, conditional and personal, and, except as to life and accident that it is one of indemnity" (Insurance Institutre of India, 1988). In life insurance contract, each party must disclose every material fact known to him and on the basis of the facts disclosed by them, assessment of risk and return are made and the contract is effected. Premium is the consideration for the contract. The important factors determining premium are: (a) Mortality; (b) Interest; (c) Expenses and (1) loading for bonus (under participating policies[1]).

---

1. LIC plans are of two types - with-profit and without-profit. Participating policies refer to the with-profit plans, those which can participate in the bonsus-allocation. For this an extra amount of premium is charged as 'loading for bonus'.

The Life Insurance Corporation of India is a milestone on the road to moderation and modernisation of insurance business in India. It has come into existence through nationalization of 243 odd life insurance companies on September 1, 1956. Today, it being the single largest non-banking development finance institute, affects the economy by ways more than one. It finances various socio-economic welfare and infrastructural schemes under five-year plans; helps develop the process of capital formation; induces the growth of the economy; acts as a stabilising force in the stock exchange market and above all, helps upholding the Human Resource Development Programmes by driving away 'worry' the greatest enemy of human work-effort and by providing protection against physical and economic death, disability and old-age hazards.

1.5 Insurance Practice in India:

The early history of Insurance is hidden in the mist of antiquity. Earlier the term of Insurance approximated the Contracts of Bottomery and Respondentia[1] and were somehow similar to the Indian contracts of insurance against loss in journeys (LICI, 1964). According to Dr. C.F. Trenery, the author of "The Origin and Early History of Insurance", 'the earliest form of insurance was some

---

1. In maritime law, a conditional obligation in which the ship or cargo or both are pledged as a collateral for the loan - is called 'Bottomery'. When the cargo alone is pledged as an obligation, it is called 'Respondentia'.

kind of Marine and Land Insurance' (Ray, 1941). In the early days the only commercial mode of communication was the sea and reverine routes. During Mohenjodaro civilisation, India's trade extended to Babilon and beyond. The arrival of the Aryans gave further impetus to the trade carried on by the descendants of the Indus Valley civilisation. At that time men who were engaged in trade by sea most often fell victim to the perils of the sea. Many vessels laden with cargo arrived safely in port while a few suffered loss and the loss was being shared by the others. Thus, they used to spread their collective risk among themselves and subsequently formed merchant guilds. All these associations were formed on the principle of risk-sharing and gradually specialised themselves in managing funds and began to study the rates of loss that occurred in different marine ventures and accredited themselves as 'insurers'.

We have already discussed how life insurance came into being. Now let us draw a brief reference to its antiquity. The dawn of the history of life insurance is foggy. So, no authoritative information as to when did life insurance originate is available. However, the term 'Yogokshema' is found to be used in the Rig Veda suggesting that some form of community insurance was being practised by the Aryans in India over 3000 years ago while the emblem of LICI, 'Yogokshemam Bahamyaham' had been taken from the Gita[1].

---

1. अनन्याश्चिन्तयन्तो मां ये जनाः पर्युपासते।
तेषां नित्याभियुक्तानां योगक्षेमं वहाम्यहम् ॥२२॥ नवम अध्याय

Let thy desires and prosperities be left upon me. But roughly translated as : "Your welfare is my responsibility".

Indeed, life insurance is essentially a product of the west. "Life Insurance business, as it is known today, is a heritage from England" (Ray, 1941) where the first life policy, providing temporary cover for a period of twelve months was issued on the life of Williams Gibbons on June 18, 1583. The early attempts of life insurance were but gambling, since mortality tables, the key basis for risk assessment were practically unknown. Had the incident (death) occurred within a specified period, a lum sum amount as set on a 'bet' (verbal agreement) was only payable, else forfeited. The development of Actuarial Science and Mortality tables is a landmark in the history of life insurance (Ray, 1941). Actuarial Science and mortality rates were made reliable in the year 1755 and for the first time life insurance had been transacted on modern lines in England in 1807 (LICI, Branch Managers' Training Course, 1964) and established itself on firm footing in the wake of industrial revolution in the 19th century.

1.6 History of Nationalisation:

Ever first in India life insurance business was started by the Oriental Life Assurance Company in 1818 in Calcutta and was managed by the Europeans. Following it Bombay Life was started in 1823 and Madras Equitable in 1829. But eventually most of them failed and went into liquidation. The early insurance companies in India issued policies in Sterling on the lives of Europeans who were engaged in the services of the East India Company and later on, in those of the government of India. A few companies who attempted to write business on Indian lives either came to grief

sooner or later or were absorbed by others. The failure of two large English Companies, the European and Albert, around the year 1870, affected a large number of persons in this country who had reposed their faith in them. Consequent upon this, an attempt was made to float Companies in India to underwrite business on Indian lives also (Ray, 1941). Meanwhile, the Swadeshi Movement of 1905 gave fillip to the craze for Indian insurance and banking industries and raised the slogan "Indian money for Indian trade and industry only". As a result, many eminent personalities (like Motilal Nehru, Rabindra Nath Tagore, Pattabhi Sitaramayya) came forward to lend support to the Indian insurance companies and many Indian industrialists took interest in insurance business. Consequently, by 1910, a mushroom growth of a large number of companies, both foreign and domestic, sprang up. But most of them miserably failed and as such 100 closed down within a year of their establishment (Vide Appendix - I & II). Some other companies began to practise unethical actuarial practices and thus were frittering away public moneys. Such being the situation, Government of India began to realise the need for controlling insurance business in India, but was unwilling to shoulder the huge liability. Because, at that time, there was no statistical information regarding average longevity and value of Indian lives.

However, Government took attempts to regulate the activities of the insurance companies and their business from 1912 by passing the Insurance Act, 1912. Under this Act, initial deposit system was introduced to check mushroom growth of insurance companies

and submission of reports and returns was made obligatory. From 1914 Government started publishing the return of the life insurance business underwritten and the corresponding life fund. Furthermore, the Insurance Companies Act, 1928 empowered the Government to collect and publish full statistical information on Life and General insurance business in India. Thereafter, the Insurance Act, 1938 gave comprehensive power to the Government for detail control over the activities of all insurance companies, be Indian or foreign. Thus Government was gradually taking control of insurance business in hand for better interest of the nation.

Inspite of all these measures the insurance industry was going on with its own rhythm. The unethical actuarial practices, lack of trusteeship, poor management, unhealthy competition, discriminating premium and bonus rates, war and lapsation made the life industry almost sick in the later half of 1940's and created a gloom profile for the industry. At this stage, Government took keen interest in life insurance business in India from the early part of 1950's and especially from the year the country entered into the planning era i.e. 1951. Actually, Government made study on the industry over the years from 1912 to 1951 and in conclusion reported that "the industry was not playing the role expected of insurance companies in a modern state and efforts at improving the standards by further legislation, we felt, unlikely to be any more successful than in the past. The concept of trusteeship which should be the corner-stone of life insurance seemed entirely lacking" (GOI, Lok Sabha Debates, 1956).

The first five-year plan, on the other hand, stated that "the mechanism of finance including insurance, stock exchange and other institutions concerned with investment will have to be fitted increasingly into the scheme of development visualised for the economy as a whole; for it is only thus the process of mobilising savings and utilising them to the best advantage becomes socially purposive" (Government of India, Planning Commission, 1951). By this way, while the process of nationalisation was advancing Government finally announced on the 19th January, 1956 promulgating an Ordinance vesting the management and control of the life insurance business in India in the Central Government under Section 3(1) of the Life Insurance Corporation Act, 1956. On the 29th February, 1956, Government introduced the Life Insurance Bill in the Lok Sabha (Lower House of the Parliament) and while moving the Bill in the Lok Sabha, the then Finance Minister C.D. Deshmukh stated that "Insurance is an essential social service which a welfare State must make available to its people and the State must assume responsibility for rendering this service once it is clear beyond reasonable doubt that it cannot be provided in any other manner. So, while it is the failure of the general run of insurance companies to live upto the high traditions demanded of them that has led the Government to take this step" (GOI, Lok Sabha Debates, 1956). It is stated in the Act that the Corporation will come into existence 'with effect from such a date as the Central Government may, by notification in the Official Gazette, appoint' (Bhattacharya, 1970) and all assets and liabilities appertaining to life insurance business, in India, of all registered insurers and outside India,

of all Indian insurers, were to be transferred to and vested in the Life Insurance Corporation of India from the Appointed Day. At last, the Government announced the 'Appointed Day' to be on the September 1, 1956 by a Gazette notification (GOI, Gazette of India, 1956). Thus the Life Insurance Corporation of India (LICI) came into existence by merging 243 odd life insurance companies with effect from September 1, 1956.

After introducing the bill in the Lok Sabha C.D. Deshmukh spelt out in a broadcast to the nation the Government's view of nationalising insurance business in the country as : "The nationalisation of insurance business is a further step in the direction of people's savings. It is a truism which nevertheless cannot too often be repeated, that a nation's savings are the prime movers of its economic development. With the second plan in the offing involving an accelerated state of investment and development, the widening and deepening of all possible channels of public savings have become necessary. Of this process, nationalisation is a vital part" (GOI, Text of Broadcast, 1956). So, it is obvious that the main intention of the Government behind nationalisation of life insurance business was to connect savings mobilisation with the process of economic development of the country. Accordingly, the broad objectives of nationalisation as stated in Section 6(1) of the Life Insurance Corporation Act, 1956 are as follows:

(1) To provide cent percent security to the policy-holders;

(2) To ensure the use of Life Insurance Funds for nation-building activities;

(3) To avoid wasteful efforts in business completion;

(4) To save the dividends paid to the share-holders of the insurance companies;

(5) To avoid certain undesirable practices adopted by some of the insurnace companies; and

(6) To spread the insurance motto beyond the more advanced urban areas well into the neglected rural areas.

The LIC of India started functioning with the organisational structure comprising a four-tier management system e.g. Board — Chairman - Managing Directors — Executive Directors and a four-tier office-infrastructure e.g. the central office with headquarters at Bombay, four Zonal Offices with their headquarters in the four metropolitan cities viz. Eastern Zone (Calcutta), Western Zone (Bombay), Southern Zone (Madras) and Northern Zone (Delhi); 33 Divisional Offices and 240 Branch Offices.

1.7 The Problem:

Life insurance attracts personal savings of millions of individuals in the form of premiums. After meeting management expenses and policy liabilities etc. accumulates net savings to form the 'Life Insurance Fund'. LIC of India forms another fund specially for investment purposes called 'Controlled Fund' taking into account the funds mobilised in the life insurance business, capital redemption insurance business and annuity certain business. Through mobilisation of funds LICI expected to help capital formation for expansion of business and industry, stabilise market

fluctuations, increase employment opportunity and accelerate economic growth and welfare of the nation. The major problem of a developing country like India viz. capital formation, expansion of investment and enterprise — all are expected to be substantially encouraged by life insurance and thereby expected to help individuals, society as well as the nation as a whole. Therefore, it is worth probing that 'how people's savings are accumulated'; how the funds are formed for investments; who are the contributors to the funds; what are the factors influencing premium rates; what are the restrictions on investments; whether there exists any regional disparity as regards investment of funds; whether there is any correlation between sectoral/zonal contribution to and investment of life insurance funds; whether the objectives of nationalisation are being served duly and effectively; whether there is any need for modification in the modus operandi of the Corporation and so forth. The whole market potential for life insurance is widely dispersed and segmented. So, it is worthwhile to deal with the above problems under stratifications viz. inter-occupational, inter-income groups, inter-regional and inter-zonal attributes to the Life Fund. Similarly, it is also important to look into the inter-sectoral and inter-zonal attributes to the investment of the Controlled Fund and yield therefrom. It is significant to see that the motto of 'people's money for people's welfare' and trusteeship are duly followed by LICI or not. Cost efficiency of the LICI is also an important candidate needing further investigation.

In our present study we shall attempt to focus light on some of the questions raised above and try to analyse and evaluate

the performance of the corporation in the perspective of nationalisation of life insurance business. Attempt will be made to prescribe policy changes or modifications, if necessary for the betterment of the institution and the economy. In this study attempts will also be made to suggest scope for furthering the coverage of life insurance business in India.

1.8 The Coverage:

Our present study will cover a period of two decades from 1970-71 to 1989-90 considering the period from 1956 to 1969-70 as the gestation period for post-nationalisation effects to start. The main reasons for our choosing the particular period are:

(a) That, right from 1970-71 the post-nationalisation effects started to reveal in substantial form;

(b) That, from 1970-71 the LICI started publishing statistical information regularly and in a more comprehensive manner;

(c) That, the C.S.O. and N.S.S. started using the year 1970-71 as 'base year' for compiling various statistical data;

(d) That, the LICI celebrated '1970' as the Centenary year of Indian Life Insurance considering 100 years from the date of establishment of Bombay Life Assurance Society on December 3, 1870.

(e) That, in a major attempt 14 Commercial banks were nationalised in 1970-71 recognising the significance of the Public Sector Undertakings (PSU);

(f) That, most of the studies on LICI were made covering a period upto 1970-71.

(g) That, LICI introduced group insurance business in 1970-71.

1.9 A Review of Existing Literatures:

For a back-drop of the present study let us now present a brief overview of the existing literatures having bearing on our present study.

Desai (1973) dealt with the existence of insurance practices in the old days of Manu, Yagnabalkya, Hamurabi etc. He envisaged that the modern form of life insurance was a heritage from England where the first life policy providing a temporary cover for a period of twelve months was issued as early as 1583 A.D. The primary emphasis of the work of Morah (1955) was on the process and purposes of industrial assurance and its influence on the community during the early days of political upheavals in England around the decade of 1840's. Dickson (1960) expounded the history and experience of the Sun Insurance Office in London and evaluated the insurance habit of the British.

In another book Ray (1941) (which was his doctoral dissertation paper from Bombay University) he attempted to draw the historical outline of the existence of insurance business in India. He had shown the reasons for failure of most of the insurance companies of the country prior to nationalisation.

In his study Bhave (1970) discussed about the security aspect in life insurance and analysed critically the need for securing human life value in the event of premature death, disability and old-age hazards. His study covered a period of hundred years from 1870, the year of establishment of Bombay Mutual Life Assurance Society to the year of its centenary celebration in 1970. Wynn (1975) attempted to look into the major relationships between life assurances on the one hand and several other sectors of the economy including financial institutions, the consumer and Government, on the other. Comparing and analysing the World trend in life assurance business, he suggested a number of changes for Indian life insurance business. Ray (1982) dealt with the Social Security aspect of life insurance and explained how it is important for social welfare of the people.

In his study Sezhiyan (1985) decomposed insurance premium under an endowment assurance plan (with-profit) as Premium = Risk cover + Savings + Management expenses + Bonus loading and had deduced that the premium for risk factor forms a low proportion in the premium rate at a certain age at entry. He enunciated that the savings factor forms the major portion of the premium rate and therefore vital for capital formation. He inclined to see that LIC mobilises funds from household sector and invests them in nation-building activities.

Singh (1974) analysed the Government control over allocation of life insurance funds in regional, sectoral and industry-wise pattern of investments. He showed that LIC's investment

policies pay little heed to profitability of investment and revealed that the object of balanced regional development of the country as prescribed by the Planning Commission had not been followed by the Corporation. He confined his analysis over a period from 1956-1971; being the coverage period of his Ph.D. thesis. Singh (1979) examined the contributions of the Corporation towards the economic growth and problems of the country. Singh (1988) simply discussed about the performance pattern of LIC of India and endeavoured to infer some meaningful conclusions within the traditional framework. His study covered the period 1975-1986. He adopted the historical method of research in his approach to appraise the management of risk and life fund. In his study Joshi (1970) showed how the life insurance funds were being invested in different sectors of the economy and made an evaluation of the rationale behind such investments taking into consideration the early decades of the existence of LIC of India.

Jones' (1968) pre-occupation was with the investment policies and returns therefrom. He deduced that the higher the return from investments, the more the benefits to the policy-holders.

Mishra & Rai (1985) critically examined the income and expense pattern of LICI over the period 1956-1981. They also dealt with sources of income and formation of life insurance funds and suggested some steps for reduction in the premium rate. While Mowbray et al (1961) dealt with the theoretical aspects of insurance business, its relevance in the society and practice of insurance

cover in ordinary life of people.

Vakil (1970) focussed on the socio-economic relevance of insurance in modern life. He tried to elucidate the significance of mobilisation of funds in accelerating economic development of the country.

Ghose (1986) and Kumar (1983) made a review of the welfare activities of the Life Insurance Corporation of India and its participation in rural development programmes. They criticized its small penetration to the rural mass. They also suggested introduction of new plans fit for the rural mass and offer them free insurance cover.

Mishra (1985) made an evaluation of the security pattern of the Corporation's investment policy. In his findings he pointed out that LIC should reduce investments in Government securities for the reason of low rate of return.

Thakur (1985) critically discussed the basic principles of investment of life insurance funds on behalf of the policy holders i.e. security, yield, diversification and liquidity. Saxena (1987) in his study traced the changes in national environment in the 1980's under four major categories viz. population, competition, profits of the consumers and legal and technical environment. He showed on the basis of 1981 Census Statistics that with the growth in the total population, death rate and literacy rate must undergo changes. He enlightened that a tough competitive environment had been raised in the country since 1985 and LICI too faced the threat from NSC, UTI, HDFC etc. The Indian consumers were becoming more

aware of various saving plans and return therefrom. Besides, in the eighties there occurred a substantial change in Indian technology. All these had, according to him, substantial bearing on the life insurance business.

A limitation of the studies reviewed so far is that none of them has dealt in depth, with the various aspects of the flow of income generation for forming the Life Insurance Fund and utilisation of the same into various socio-economic and infrastructural schemes forming another fund called the Controlled Fund, in the way we propose to deal with in our study. So, in a sense, ours is a maiden attempt in the field of insurance problems, to deal with both 'the sources and uses' of funds in one frame of study.

1.10 The Present Study: A Conceptual framework:

Premium is the prime source of accumulation of funds of the LIC of India. Capital formation is a major contributing factor to the economic development of a country like ours. Mobilisation of people's savings is the way opened for income generation and capital formation. Savings being not simply a residual income but the abstinence from present consumption through intertemporal choice, it needs motivation. In ordinary savings e.g. savings through banks and post offices simply the rate of interest acts as motivation. But the prime motivational force behind savings through LICI is the protection of human life value, in addition to accrual of bonus on sum assured and I.T. exemption on premia.

The major factors influencing premium rates of the LIC of India are:

(a) Mortality experience of the population i.e. the risk element;

(b) Expected rate of return from investment i.e. the savings element;

(c) Management expenses;

(d) Loading for bonus (under with-profit policies).

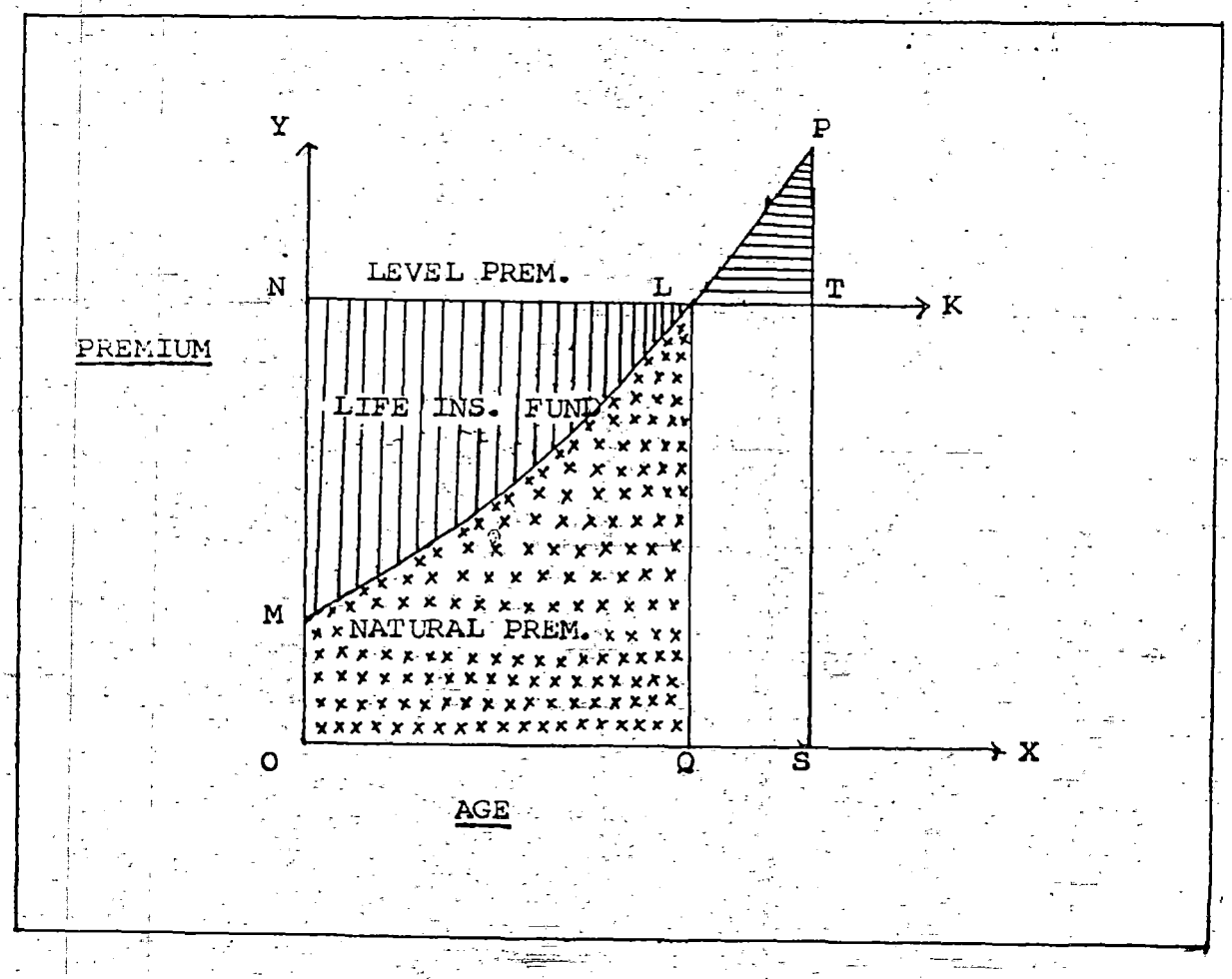
Considering these four factors, premium is charged according as an individual proponent transfers risk to the common fund. It is experienced that risk varies directly with age of the proponent. Accordingly, premium also varies. But under level premium plan as adopted by the LICI, the same rate of premium is charged throuhout the term of the policy though risk increases with the increase in age. So, premium charged in the early years is more than what is actually required and in the later years, it is short of what is required of him. Secondly, the premium for savings element is accumulated throughout the term of the policy or upto the year a policy results into a claim whichever is earlier. Thirdly, that portion of premium which is charged for bonus payment under with-profit policies is also being accumulated throughout the period the policy is kept in force.

With the excess portion of premium charged in the early years of the policy-holders (a_e), the portion of premium charged for savings element (b) and the portion of premium charged for bonus loading under with-profit policies (c) the LICI constitutes

a reserve fund in order to meet the shortage of premium in the later years of the policy-holders, to discharge future policy-liabilities and to disburse miscellaneous expenses; supposing that the portion of premium charged for provisional management expenses is just off-set in discharging actual management expenses by the LIC of India. This reserve fund is referred to as the 'Life Insuran Fund'. Thus the Life Insurance Fund (X) may be represented as $(a_e + b + c)$. This can be elucidated by Fig. 1.1

Fig. 1.1

LEVEL PREMIUM & LIFE INSURANCE FUND



In Fig. 1.1, NK represents the level premium[1] which remains constant over the term of the policy; MP represents the cost of insurance which increases with the increase in age i.e. the natural premium[2]. In the early years, the annual premium paid is more than annual cost of insurance, and the balance of the premium left with the insurance company after meeting costs, accumulates in a fund, called Life Insurance Fund (Agarwala, 1956). In Fig. 1.1 it is shown as, MIN = (OQLN - OQLM) i.e. Life Fund = Level Premium - Natural Premium. In the late years natural premium exceeds level premium which means adjustment in Life Fund, which is represented as LFP = (OSPM - OSTM). Let us take a numerical example to illustrate the problem. Suppose, in the late years, say at the age of 50, the life assured pays a premium of Rs. 200.00 annually, but the cost of insurance in that year is Rs. 270=00. Then Rs. 70=00 will be taken out of the Life Fund. Besides, if the life assured dies in the early years, adjustment would have to be made in the Life Fund to pay the claim, because, the Life Fund accumulated by him will fall short of the insured amount and vice versa. It is apparent that the Life Insurance Fund accumulated by a policy-holder is the property of that insured because, (a) it is created out of premiums paid by him and interest realised by investing this Fund, and (b) it is to be applied to meet the excess of cost of insurance over

---

1. Level Premium = Natural premium equally distributed in annual instalment.

2. Natural Premium = Actual Premium needed to justify the risk assured at different age.

premiums in later years and ultimately to pay the claim arising under the policy. The insurance company is merely a trustee for keeping this fund safe and well invested. The insurance company has no right to fritter it away as it lives. If it dissipates this Fund on unworthy objects, the Fund will not be adequate to meet the claim when it arises under the policy, and the insurance company will be declared insolvent. The Fund must, therefore, be of adequate amount. In fact, the adequacy of the Life Insurance Fund is the golden test of financial strength of an insurance company and the safety of policy-holders (Agarwala, 1956). The above words apply to the LIC of India too.

Now, let us see how the life fund expands or contracts. Generally, when total income exceeds total outgo, the fund expands and vice versa. The components of total income are as follows:

(A) Total Premium Income = It considers of first year premium, renewal premium, single premium, consideration for annuities granted, group and group super-annuation premiums. It depends primarily on the volume of business transacted and secondarily on the nature of plan, term and age. But the real indicator of the progress of the Corporation's business is the first year premium and not the renewal premium.

(B) Total Investment Income : It depends upon the rate of return from investment of funds in different sectors of the economy and the size of investment.

(C) Total Income from Bonus Loading : The loading for bonus factor of premium is a special feature attached to the with-profit

policies. It is usually charged @ Re 1=00%. Sum Assured. It depends upon the ratio of with-profit policies to total number of policies and volume of business. Thus, total income (Y) = (A+B+C).

The components of total outgo are stated below:

(E) Payments to policy holders: These include claim by maturity, claim by death, claim by surrender etc;

(F) Total Management Expenses: Management expenses include Commission etc. to agents; salary etc. to the employees; other expenses of management e.g. printing and stationery expenses, publicity and advertisement expenses, postage etc.

(G) 5% of Valuation Surplus payable to the Central Government for its share of Rs. 5 crore only;

(H) Other outgo e.g. taxes transferred to reserves etc.

Thus, total outgo (Z) = (E+F+G+H). Therefore, Excess of income over outgo representing the net accretion to (X) is (Y-Z). Thus,

if (Y-Z) is positive, the Fund expands

and if (Y-Z) is negative, the Fund contracts.

Therefore, the excess of income over outgo is added to the Life Fund. That is, addition to the Life Fund (X) = (Y-Z)[1]. Beside

---

1. Chapter III discusses it in more detail.

Life Fund, LIC constitutes another fund for investment purposes. That investible fund is referred to as 'Controlled Fund'. It means all funds of the LIC appertaining to its life insurance business, capital redemption insurance business, and annuity certain business, but does not include any fund or portion thereof in respect of which the Controller of Insurance is satisfied, or which is regulated by law of any country outside of India. In short, Controlled Fund means all funds relating to Indian Life and allied business of LIC and excluding funds arising out of foreign business (Choudhury & Kulkarni, 1991). As the business of the Corporation moves steadily upward, the sources of income are operative; there shall be a regular flow of income and hence, a regular flow of investible fund. So, we may assume a sustained impact of this flow of funds on the growth and welfare of the economy. The volume of Controlled Fund is usually higher than that of Life Insurance Fund since Life Fund pertains to only life insurance business while Controlled Fund includes capital redemption and annuity certain businesses too. Also, Life Fund equals net liability of the Corporation but Controlled Fund is the interest earning asset of the Corporation.

We have so far discussed in brief, how the funds are being generated and expanded with the growth of business and investment. Now, we shall deal with how the funds are being utilised. The Life Insurance Corporation of India acts as a custodian and trustee of individual savings of millions of policy-holders deposited with it in the form of premium. Life insurance being a long-term contract,

the probability of policies resulting into claims in the early years of the policy-terms is very small. Hence, LIC or the insurer has to preserve the savings by forming funds in order to meet future policy-liabilities. But to keep the funds idle will be a failure on the part of the corporation since such funds will fall short of the policy-liabilities. So, it is expected that the Corporation should keep the funds invested on behalf of the policy-holders, provided safety of the funds is ensured. As such, investment of funds is necessary so as to cope with the inflationary pressure on the real-value of policy proceeds. On the other hand, funds being required for implementation of various socio-economic welfare and development programmes taken under the five-year plans, it will be against the national interest as well as the interest of the policyholders, if the Corporation does not effectively invest funds available with it. Now, let us see how LIC invests its funds. Investment of the funds by a life-insurer is subject to two-fold limitations:

(i) Legal limitations: These limitations are in favour of more investment in gilt-edged securities like Government bonds, debentures and mortgages and less in shares, land and buildings etc. Such limitations are also imposed against dissipations of funds through inter-locking of funds among insurance Companies and financial and non-financial concerns.

(ii) Self-imposed limitations: These limitations reflect the investment policy of the insurance companies. It is influenced by the tradition and outlook of management, the Comparative avail-

ability of various instruments of investments, the current investment needs of the national economy, and the volume of the investible funds at the disposal of the insurer (Gupta, 1966).

Notwithstanding these limitations, investments of the Life Insurance Fund are guided by certain principles. Following A.H. Bailey, an actuary of the London Assurance Corporation, who had stated the investment principles in his paper in 1862, we can summarise the said principles as under:

(1) Security of Capital : It is very essential for the fiduciary nature of the insurer-insured relationship.

(2) Profitability of investments: Despite the negative correlationship between high security and high profitability, investment of funds should be made in such a way that the highest possible interest earning can be ensured.

(3) Liquidity of investments: It is necessary for making unexpected payments like surrender-values, loans, or claims far in excess of the expected number in a particular year.

(4) Diversification of investments : The funds should be invested in diverse sectors of the economy so that risk of capital can be minimised. Diversification can be made in three dimensions viz. (a) Class-wise, (b) industrial character-wise and (c) geographical location-wise. Thus, with diversified investments, if the insurer suffers losses at one place, they may be compensated by making gains elsewhere (Gupta, 1966). Bailey's principles are still valid today, only they are tobe interpreted

in the light of present-day conditions.

Besides, Section 27A of the Insurance Act 1938 put some rigorous restrictions on the investments by the insurers in India. It requires that the Life Insurance Corporation of India shall invest, and at all times keep invested, 25% of its Controlled Fund in Government securities and a further sum equal to not less than 25% of the Controlled Fund in Government securities or approved securities; and the rest of the Fund except to the extent of 15% are to be invested in the following approved securities (Bhattacharya, 1954).

(i) Debentures or other securities issued with permission of the State Government by any municipality in a State or debentures secured by a first charge or any immovable property, plant of equipment of any company satisfying certain other stipulations or debentures, issued by a Co-operative Society;

(ii) Comulative preference shares of a company which must satisfy certain stipulated conditions;

(iii) Ordinary Shares of a company, should they satisfy certain stipulated conditions regarding its past dividend record or ordinary shares of a Co-operative Society;

(iv) Immovable property in India or in other country where the corporation is carrying on insurance business, provided the property is free from any encumbrances;

(v) First mortgages and immovable property in India and loans to any authority or Co-operative Society for housing purposes subject

to certain criteria being satisfied and certain other miscellaneous investments.

Further, Corporation can invest upto 15% of the Controlled Fund in investments such as shares of a new undertaking. But every such investment must have secured a unanimous recommendation of the Investment Committee or support of more than 3/4 majority of the Board.

There are certain restrictions stipulated under Section 27A of the Insurance Act 1938 which requires:

(a) That investment in equity shares of one company will not be more than 30% of the subscribed equity share capital of the company except with prior permission of the Central Government;

(b) That no investment in shares or debentures of a Private Ltd. Company is permissible except with prior permission of the Central Government. Besides, the LIC of India is not allowed to act as a speculator in the Stock Exchange market but when circumstances warrant it may sell during period of boom and buy during periods of depression so that the Corporation may gain and in the process may act as a stabilizing factor in the Stock Market.

1.11 The Research Qeustions:

Having the problem stated and a brief conceptual framework of our study furnished, let us now try to choose and identify some specific questions which will be taken up as the main foci of our present study. We will attempt to address the following questions

while studying some aspects of the sources and uses of funds of the Life Insurance Corporation of India.

1. Why is the Life Insurance Fund important? What are the underlying forces that act behind generation of the Fund and how? What has been the temporal behaviour of the Life Insurance Fund and why?

2. What are the components of income and expenses? How do they act on the Life Insurance Fund and on the Controlled Fund?

3. Do the sources of income and pattern of expenses as prevalent in the LICI correspond to our national economic policy and to the objectives of nationalisation of life insurance business in India? How did the components of income and expenses behave temporally as well as specially?

4. What are the underlying factors that influence the distribution of funds amongst different sectors of the economy?

5. Has the distribution pattern of funds of the LICI been conducive to the objects of our national plans and compatible with the investment policy of the LICI?

6. Which are the sectors as well as regions of the economy that have received priority in the distribution of funds and why?

7. At a more general level we will also attempt to address some important questions : Has the expansion of services of the LICI over time been cost efficient? How did the indicators of efficiency behave?