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A CRITICAL STUDY OF INSURANCE SECTOR LIBERALISATION IN INDIA WITH SPECIAL REFERENCE FDI REGIME, IRDAI REGULATORY CAPACITY AND POLICYHOLDER PROTECTION

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ABSTRACT

India's successive liberalisation of foreign equity caps in the insurance sector culminating in a proposed ceiling of one hundred percent proceeds from the assumption that ownership restrictions are the principal impediment to sectoral development. The empirical record challenges that assumption with uncomfortable consistency: insurance penetration has stagnated at approximately four percent of GDP, and FDI inflows have persistently fallen short of legislative expectations, across the very period in which liberalisation was most actively pursued. This paper argues that the binding constraint is not the equity ceiling but the structural inadequacy of IRDAI's regulatory capacity encompassing supervisory reach, enforcement consistency, group level oversight, and institutional independence. Through doctrinal analysis of the governing legal framework, comparative assessment of Singapore, Malaysia, the United Kingdom, and China as models of sequenced liberalisation, and empirical engagement with official data from IRDAI, DPIIT, and UNCTAD, the paper demonstrates that full foreign ownership, in the absence of commensurate regulatory preparedness, exposes policyholders to governance and systemic risks that the existing architecture is ill equipped to manage. Regulatory capacity building is not a consequence of liberalisation to be deferred .it is a precondition upon which the reform's legitimacy depends.

Keywords: Foreign direct investment, insurance regulation, IRDAI, regulatory capacity, FDI liberalisation, policyholder protection, comparative insurance law

1.Introduction

The progressive liberalization of equity limits within India’s insurance industry, including the proposed increase of the FDI limit to 100%, can be considered one of the most important experiments in financial sector liberalization conducted by a major emerging country in recent decades. As part of a more general approach towards capital account liberalization, this process of reform has been predicated on the idea that loosening ownership requirements would lead to greater foreign capital inflows, increased penetration in the insurance sector, and a regulatory regime in line with international standards. However, the reality paints a very different picture, defying expectations at almost every turn: despite the repeated increase in the FDI limit . from 26% in 2000, to 49% in 2015, and then 74% in 2021 . insurance penetration in India continues to be among the lowest in peer countries, while foreign capital inflows have consistently fallen short of statutory projections.

This gap between liberalized process and limited result is the central paradox of this paperPolicy debate surrounding the issue has focused predominantly on the limit imposed on FDI, basing its implicit premise on the idea that equity liberalization in itself could suffice to revolutionize the sector. Such an implicit premise has resulted in extensive discussion about the implications of ownership limits with regard to economic growth. At the same time, however, it has not been paid sufficient attention to the factors that shape and influence decisions about investing. This results in another void left open in the literature since both researchers and policymakers have been paying attention to foreign investment being legally permissible but not necessarily viable.

Liberalization of the foreign direct investment restrictions in the Indian insurance sector is a necessary but wholly inadequate measure. What limits the progress in the sector is not the existence of the still remaining equity caps, but the fundamental inadequacy of the regulatory infrastructure .which comprises the supervisory capacity, independence, sophistication, and consistency of IRDAI. Without the required regulatory capacity, the suggested opening of the market to 100% FDI might result in neither expected level of investments nor anticipated competitive efficiency.

The research utilizes three main approaches. Doctrinally, the legal background of the FDI regime in insurance, which includes among other FEMA, Consolidated FDI policy, and IRDAI regulations, is analyzed in detail to trace the context of liberalization. Empirically, the existing empirical literature, in particular Dunning's OLI framework and institutional distance approach by Claessens & van Horen, is used to analyze FDI inflow data in insurance from theoretical point of view. Comparative approach involves consideration of India compared to four other jurisdictions with similar experiences. Singapore, Malaysia, United Kingdom and China.

2. Research Questions

1. How inadequate has been the liberalization of FDI limits in the Indian insurance industry in generating corresponding market depth, and how do any deficiencies in the market depth generated by such inadequacies reflect either ineffectual limitations on foreign investors' equity interests in such enterprises or deficiencies in the regulatory ability of IRDAI?

2. Is the institutional structure, composed of FEMA, FDI Policy, and IRDAI regulations, capable of managing a regime of one hundred percent FDI in the Indian insurance industry without posing serious risks to policyholder welfare?

3. What can India learn from the experiences of Singapore, Malaysia, and the UK in terms of how to sequence the liberalization of ownership and regulatory capability development, and to what extent is India's trajectory deviating from these models?

4. What can Dunning's OLI paradigm and the theory of institutional distance explain about why there remains a disparity between the legally imposed FDI limits and actual levels of foreign investment in Indian insurance?

3. Research Methodology

This paper adopts a pluralist methodology, combining doctrinal, comparative, and empirical approaches in a manner calibrated to the central argument that equity liberalisation, in the absence of commensurate regulatory capacity, remains an incomplete reform. The doctrinal analysis examines the primary legal instruments governing foreign investment in Indian insurance .including the Foreign Exchange Management Act, the Consolidated FDI Policy, the Insurance Act 1938, and the subordinate regulatory framework administered by IRDAI .alongside relevant judicial and quasi judicial determinations bearing on supervisory authority and policyholder protection. This is supplemented by a comparative analysis of Singapore, Malaysia, the United Kingdom, and China, each selected for the instructive manner in which they have sequenced ownership

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liberalisation alongside institutional capacity building. Finally, the paper draws on a circumscribed empirical analysis, utilising official data published by IRDAI, the Department for Promotion of Industry and Internal Trade, UNCTAD, and cognate institutional sources, to situate doctrinal findings within the observable realities of FDI inflow performance and insurance market development.

4.Scope and Objectives

Scope

This research is limited to the legal and regulatory regime surrounding foreign direct investment (FDI) in the Indian insurance industry, specifically within the time frame between the passing of the Insurance Regulatory and Development Authority Act, 1999, and up until the current day, with specific emphasis on the post-2015 and post-2021 periods when the cap on FDI was amended. The theme of this paper is deliberately narrow; instead of examining the economics of insurance liberalization in general terms, it seeks to examine the factors behind FDI being translated into actual market growth. Comparative reference to Singapore, Malaysia, the United Kingdom, and China is selective and purposive, limited to dimensions of regulatory sequencing directly relevant to India's proposed transition to one hundred percent foreign ownership.

Objectives

The paper seeks to establish that IRDAI's structural limitations .in supervision, enforcement, and governance .constitute a more fundamental barrier to sectoral development than residual equity restrictions; to critically evaluate the legal adequacy of the existing framework in anticipating the risks of full foreign ownership; and to derive from comparative experience a set of regulatory preconditions whose satisfaction must precede, rather than follow, the proposed liberalisation.

5.Hypothesis

The persistent underperformance of FDI inflows and insurance penetration in India, notwithstanding successive liberalisation of equity caps, is attributable primarily to structural deficiencies in IRDAI's regulatory capacity .encompassing supervisory reach, enforcement consistency, and institutional independence .rather than to the residual constraints imposed by ownership ceilings. It follows that the proposed transition to one hundred percent foreign ownership, absent a commensurate strengthening of the regulatory architecture, is unlikely to yield the market development outcomes its proponents anticipate.

Sub Hypothesis I

The legal framework governing FDI in Indian insurance .as constituted by FEMA, the Consolidated FDI Policy, and IRDAI's subordinate regulations .contains material gaps in its capacity to manage the systemic and governance risks attendant upon full foreign ownership, rendering the existing architecture institutionally unprepared for the proposed liberalisation.

Sub Hypothesis II

The comparative experience of Singapore, Malaysia, the United Kingdom, and China demonstrates that jurisdictions achieving sustained improvements in insurance market depth following ownership liberalisation did so by prioritising regulatory capacity building as a precondition, rather than a consequence, of permitting unrestricted foreign control .a sequencing discipline that India's reform trajectory has thus far failed to observe.

3.1 Theoretical Foundations: FDI in Financial Services

The issue of why multinational corporations choose foreign direct investment over mere exports to and technology licensing by foreign companies has been an area of consistent theoretical research since the 1960s. Three specific theoretical models that would be useful in analyzing FDI in the Indian insurance market will now be discussed.

The most prominent theoretical model is the OLI paradigm by John Dunning,[797] which describes the rationale behind the FDI investment decision based on the concurrent occurrence of three factors. The first factor is ownership advantage, whereby the firm needs to have some unique asset that enables it to have an advantage over local competitors in the foreign market. Examples of ownership advantages in the insurance industry could be its experience in a new product category not existing in the host market, risk management processes, and possibly international reinsurance capacity for some firms. The second factor is location advantage, where the nature of the foreign market makes production in the host market better than exporting from home. The Indian insurance market provides strong location advantages due to its large population, fast growing middle class, low level of insurance penetration, and demographics that ensure a continuous rise in the size of the working age population for many years to come. The third condition is an internalisation advantage: the firm must have reasons to exploit its ownership advantages within the firm rather than through arm's length contracts such as licensing or technical assistance agreements. In insurance, the need to maintain product quality, protect proprietary risk pricing models, and control the policyholder relationship typically makes internal exploitation through a subsidiary preferable to arm's length licensing.

Empirical research conducted by Claessens and van Horen into foreign banks entering developing countries[798] is especially instructive in serving as an analytical benchmark for insurance FDI. Their study concluded that foreign entry in the financial services sector usually generates efficiency benefits, such as improvements in competition, reductions in costs of intermediary financial services, and technology transfers, yet that all these benefits depend crucially on the regulatory framework in which foreign entry occurs. More specifically, their study showed that foreign entry in weakly regulated jurisdictions tended to involve cream skimming – that is, foreign firms tended to target only the most lucrative market segments, leaving other market segments untouched – rather than generating efficiency benefits from increased competition. Foreign entry into financially regulated jurisdictions was positively correlated with efficiency benefits, however, in line with expectations. Again, the connection with insurance FDI is evident: instead of asking whether to allow foreign entry into the domestic market (with 100 per cent foreign ownership), the issue to consider here is whether the regulatory regime in India is capable of realising efficiency gains without cream skimming.

The third important framework is the regulatory competition approach, which, in its strong form, implies that light regulation of jurisdiction leads to more foreign direct investment in these jurisdictions, thus creating a competition pressure on those jurisdictions where the regulation is tougher, making them loosen it. In his paper analyzing the effect of foreign direct investment in Indian financial services sector, Saggar[799] finds little evidence for this theory. The reason is simple: the size of Indian market allows attracting foreign investment even if the regulation is stringent. It is an important implication for the reform strategy proposed in this dissertation. It means that India could increase its regulatory standards, thus improving the IRDAI's enforcement mechanism and raising the limit of penalties under the Insurance Act, without deterring foreign investment in Indian insurance sector.

This combination of the three frameworks leads to an important claim in this thesis that is that the result of FDI liberalization in the Indian

[797] Dunning, *supra* note 8, at pp. 79-82 (OLI paradigm: ownership advantages plus location advantages plus internalisation advantages determine mode of international expansion).

[798] Claessens and van Horen, *supra* note 12, at pp. 298-301 (efficiency gains from foreign financial institution entry conditional on robust host-country regulatory framework; cream-skimming predicted in weak-regulation environments).

[799] Mridul Saggar, 'FDI in Financial Services: A Comparative Study,' 18 RBI Working Paper 22, pp. 29-32 (2015)."

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insurance sector at 100 per cent is going to depend not on the statutory cap, but on the effectiveness of the regulatory framework under which such liberalization occurs. Singapore's case is proof, as seen later in this chapter, of the possibility of 100 per cent foreign ownership and superior regulation existing together. India's task is to make sure that it manages to develop its regulatory framework in time with liberalization of the market, rather than after each one of them.

3.2 Policy Framework: FEMA and the FDI Policy

There are two core elements to the legal regime surrounding FDI into the Indian insurance industry. Firstly, there is the Foreign Exchange Management Act, 1999,[800] which acts as the statutory basis for all capital transactions, including foreign direct investment. Section 6 of FEMA gives the Reserve Bank of India, in conjunction with the Central Government, the power to formulate rules relating to the conditions for performing capital transactions. These present day regulations regarding FDI in insurance are formulated under this provision.

The document used to set out the specifics of the FDI limits and other conditions for investments in insurance are found in the Consolidated FDI Policy published by the Department for Promotion of Industry and Internal Trade.[801] Unlike FEMA, the FDI Policy is not a statutory law, and as such can be amended through executive decision alone. This has facilitated the swift liberalization process that has led to raising the FDI limit in insurance from 26 percent in 2000 to 74 percent in 2021. However, it also means that the liberalisation lacks the legislative entrenchment that would make it credibly irreversible. An incoming government with a different policy orientation could, in principle, reverse the FDI liberalisation measures through executive action alone.

FDI Policy conditionalities for insurance have always been conditionalities with the intent to ensure Indian management and control of the insurance companies despite foreign equity in the company. These conditionalities were administratively specified and had evolved in subsequent policy versions. In general, the conditionalities included the Chairperson of the insurer being an Indian citizen residing in India, a certain number of the board members of the insurer being Indian citizens residing in India, the Chief Executive Officer and the Key Management Personnel of the insurer being Indian citizens residing in India, a certain proportion of annual profits of the insurer being retained in India, and a certain percentage of investments made by the insurer in India.

There have always been controversies regarding the legal justification of such conditionalities. Industrial associations, especially those of foreign joint venture partners wanting more control over their Indian subsidiaries, have questioned such administrative specification of conditionalities concerning management and control since they exceed the limits set by statute. A key recommendation of this dissertation is that the current conditionalities be given a more secure legislative foundation through a statutory definition of 'Indian management and control' applicable to insurance companies, enacted as part of the legislative package that implements the 100 per cent FDI proposal.

3.3 Role of DPIIT and IRDAI in FDI Regulation

The regulation of foreign investments in the insurance industry consists of two major bodies that have different yet related roles. First, the Department for Promotion of Industry and Internal Trade is responsible for foreign investment policies for all industries, including insurance. It manages the foreign investment policy and keeps a consolidated record of FDI flows to India by industry. It is also the main point

[800] Foreign Exchange Management Act, 1999 (No. 42 of 1999) (India), s. 6 (capital account transactions including foreign direct investment).

[801] Department for Promotion of Industry and Internal Trade (DPIIT), *Consolidated FDI Policy, 2020*, para. 5.2.8, p. 67 (Ministry of Commerce and Industry, Government of India, 2020).

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of contact between foreign investors and the Indian government on issues relating to investment policy. Second, the Foreign Investment Promotion Board, which formerly handled approvals for FDI proposals in specific industries, was disbanded in 2017.

Regulatory oversight of foreign insurance investment in the insurance sector is performed by IRDAI. For instance, prior to setting up its own subsidiary, a foreign insurer needs to obtain IRDAI registration in accordance with the provisions of the Insurance Act, 1938, which implies that a prospective insurer should provide evidence of the soundness of financial condition, the fitness and propriety of the promoters, the adequacy of the business plan, as well as the allocation of minimum capital. Accordingly, it would be safe to say that IRDAI registration procedure constitutes a more substantive gateway to foreign entry into the insurance industry. However, IRDAI's supervisory requirements do not specifically address the problems associated with the supervision of foreign subsidiaries of globally integrated insurance companies whose business activities are conducted on the basis of a group structure. Namely, supervising such a wholly owned subsidiary is challenging for reasons of intra group transactions and group capital assessment, as well as data flows across borders. Therefore, IRDAI needs to transition to the principles of risk based supervision and implement a framework for conducting the group capital assessment, as suggested in Chapter 6.

3.4 Liberalisation of Foreign Direct Investment: From 26% to 100%

The liberalisation of FDI in India's insurance sector has been accomplished in four stages within the last twenty five years, as presented in Table 3.1 below. The move from 26 percent to the proposed 100 percent is not only a radical change in the way insurance industry ownership is viewed, but it also shifts it from a predominantly Indian business

where foreigners have a small share to one that is predominantly owned by foreigners, including fully foreign owned entities.[802]

[802] IRDAI, *Annual Report 2023-24*, *supra* note 9, pp. 44-48, Table 2.1 (FDI inflows into insurance sector 2001-2024: cumulative inflows by phase).

Table 3.1: FDI Inflows into Indian Insurance Sector: Phase wise Summary (2001 - 2025)

Phase	Period	FDI Ceiling	Legislative Basis	Estimated Cumulative Inflows
Phase I	2000 2014	26%	IRDA Act, 1999; FDI Policy 2000	Rs. 7,203 crores
Phase II	2015 2020	49%	Insurance Laws (Amendment) Act, 2015	Rs. 14,618 crores
Phase III	2021 2024	74% (intermediaries 100%)	Insurance (Amendment) Act, 2021	Rs. 19,840 crores (est.)
Phase IV (Proposed)	2025 onwards	100%	Union Budget 2025; Insurance (Amendment) Act, 2024	Projected Rs. 35,000+ crore

Source: IRDAI Annual Reports (various years); DPIIT FDI Statistics; Author's compilation.

As evident from Table 3.1, despite consistent rises in cap with each liberalization step, the extent of growth has not been able to live up to expectations created by industrial groups. Such underachievement will be analyzed in detail in Section 3.5.

The first stage of liberalization lasted from 2000 to 2014, during which the groundwork for a private sector insurance market was laid with a cap limit set at 26 percent on FDI. The ceiling had been decided by the Malhotra Committee in order to ensure majority shareholding by Indians, along with the entry of foreign capital in the domestic insurance business. However, in practice, this meant that joint ventures would have to be formed between Indians and foreign firms, leading to many governance problems.

The second stage, which came into effect with the enactment of the Insurance Laws (Amendment) Act, 2015,[803] increased the maximum level to 49%, allowing foreign corporations to have nearly an equal shareholding. The increase in the limit was anticipated to be followed by a flow of fresh investments in the sector from foreigners, which would result in new entries into the market. Although there was an increase in foreign investments and several joint ventures got restructured, the expected influx of new market players did not take place.

In phase three, introduced through the Insurance (Amendment) Act of 2021, this figure was increased to 74 per cent for insurance companies and to 100 per cent for insurance intermediaries. This increase in the ceiling percentage to 74 percent for insurers

[803] *Supra* note 5

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represented a major change in that it would now be possible for foreigners to have a super majority that would give them control of the insurer in India.

The fourth stage, according to the Union Budget 2025 26, will be the removal of the equity condition altogether and allow 100 percent foreign shareholding in the insurance sector. If this is adopted through the legislation that will be necessary for such an undertaking, then the FDI policy in India's insurance sector will be on par with that in Singapore and the UK.

3.5. FDI inflows: Trends & critical analysis

According to the IRDAI statistics on the cumulative FDI inflows into the insurance sector, there is steady upward growth of the inflows in the period corresponding to all four phases of liberalisation with the speed getting faster with each successive increase in the FDI cap. The first phase of liberalisation (2000 2014) attracted Rs. 7,203 crores; the second phase of liberalisation (2015 2020) attracted an additional Rs. 14,618 crores; and FDI inflows under the third phase through 2024 are expected to be worth Rs. 19,840 crores. This is indeed a substantial amount, reflecting the allure of the Indian market to foreign insurance companies.

The framework of the UNCTAD World Investment Report[804] classifies the determinants of FDI into three categories: policy framework determinants, including the statutory FDI cap and the assurance of investments; economic determinants, including the size of the market, its growth prospects, and human resources; and business facilitation determinants, comprising effective regulations, ease of doing business, and certainty of regulation. India has a compelling score in the economic category and a relatively poor one in the business facilitation category, especially concerning regulatory efficiency and certainty.

The disparities between projected FDI inflows and real FDI flows at different stages of liberalization arise because of the following reasons represented in the business facilitation gap. Firstly, the product approval process, which involves getting pre clearance from regulators for all products in absence of the use and file system introduced in 2022, has led to market entry delays that irritated insurers used to smoother regulatory environments. Secondly, the Indian management and control provisions imposed on investments have resulted in corporate governance challenges in joint ventures, dissuading some investors and causing the restructuring or unwinding of several joint ventures. Thirdly, the dominance of LIC in the Indian life insurance market, protected by its implied guarantee by the government, has placed insurers at a disadvantage against it despite their resources and know how.

In their empirical study[805] on capital movements and the growth of the insurance industry in India, Garg and Verma observed that although an increase in FDI cap was statistically related to an increase in the sum total of insurance premium incomes, the link between FDI cap and insurance penetration as a percentage of GDP was relatively weak. This conclusion corroborates with the hypothesis raised in Hypothesis II of this dissertation: that an increase in FDI cap alone is a necessary but insufficient condition for growth in the insurance industry.

The unique difficulty with the 100 percent FDI policy proposal is that it would allow the creation of completely foreign owned insurance subsidiaries without any need for Indian shareholders. Although this addresses the problem of governance issues that have limited the growth of some joint ventures, it eliminates the structural motivation provided by minority ownership of Indian shareholders, forcing the parent company to interact with the Indian regulatory system and Indian consumers through their local joint venture partner. The issue of managing this transition requires certain regulatory provisions, such as the group capital

[804] UNCTAD, *World Investment Report 2023: Investing in Sustainable Energy for All*, pp. 65-68 (United Nations, Geneva, 2023).

[805] Garg and Verma, "Capital Flows and Insurance Sector Development: Evidence from India," 6 *Ind. J. Econ. and Bus.* 112, 118-121 (2014).

framework and cross border supervision coordination measures outlined in Chapter 6, as a prerequisite for implementing this policy fully.

3.6 International Models for Comparison

3.6.1 Singapore

The regulation of the insurance industry in Singapore, under the jurisdiction of the Monetary Authority of Singapore, is the most pertinent model to draw comparisons with regard to India's liberalisation policy. In 2001, the MAS allowed up to 100 per cent foreign investment in insurance firms operating in Singapore, while India was just beginning to open up its market to private competition through a 26 per cent cap on foreign equity participation. The difference in results since then has been revealing. Singapore has established itself as the primary centre for insurance services in Asia, housing the regional headquarters of most international insurance groups, fostering an advanced reinsurance sector, and attaining insurance penetration of about 7.5 per cent of its GDP. In contrast, India, which enjoys a more extensive market in terms of total premiums, stands at 4.2 per cent insurance penetration.

The regulatory system adopted by MAS for supervision of insurance companies has many lessons for India's move towards risk based regulation. In its Risk Based Capital Mark 2 framework, introduced in phases starting 2018, each company has to maintain capital commensurate with its risk profile under four heads, viz. Insurance Risk based on volatility of the claims experience, Market Risk arising due to the sensitivity of its investment portfolio to market changes, Credit Risk as risk of loss because of non payment by counterparties, and Operational Risk being risk of losses due to systems breakdowns or fraud or other reasons. ORSA is an obligation that has existed in Singapore since 2013 and requires each company to carry out its risk assessment under various stress situations and submit the same to MAS for discussion.

In addition, the MAS example shows that 100 per cent foreign ownership and strong policyholder protection can coexist. Singapore's Financial Industry Disputes Resolution Centre, which is an integrated centre for resolving disputes related to insurance, banking, and investments, ensures policyholders receive effective dispute resolution irrespective of whether the insurer is a foreign owned company or not. The MAS has issued comprehensive conduct of business rules for the sale of insurance products that deal specifically with the mis selling risks associated with the bancassurance distribution channel, and has shown a willingness to impose heavy sanctions against insurers and distribution companies that violate these rules. This comparison with India's consumer protection regime, discussed in Chapter 5, is telling.

3.6.2 Malaysia

The liberalisation process of the Malaysian insurance sector most closely resembles that of India among Asia Pacific nations. Foreign equity liberalisation took place through a staged process managed by Bank Negara Malaysia[806] during the 2000s, culminating in an increase in the foreign equity limit from 30 percent to 70 percent prior to the introduction of the Financial Services Act 2013, which established the conditions under which a larger level of foreign ownership can be accommodated. In 2009, BNM introduced a risk based capital regime for insurers, which was many years ahead of India.

Among many other systems, the Malaysian Financial Ombudsman Scheme is the most appropriate model of an insurance dispute resolution mechanism for Indian regulators to emulate, since the same system deals with both banking and insurance disputes in one package. The Malaysian Ombudsman scheme deals with a greater variety of disputes compared to India's, such as disputes on the performance of intermediaries involved in insurance and

[806] Bank Negara Malaysia (BNM), *Financial Stability Review 2023*, pp. 44-47 (BNM, Kuala Lumpur, 2023).

disputes related to group insurance policies. The scheme has sufficient funds to employ a competent workforce and resolve cases within defined periods. Its performance statistics, made available every year, offer insights into consumer protection problems studied in BNM's conduct supervision program.

The timing of the Malaysian regulatory reforms vis a vis liberalisation of the markets is worth noting. The adoption of risk based capital by BNM took place in 2009, five years before the gradual enabling of increased foreign ownership within the insurance market started. The final report from IRDAI's Working Group on Risk Based Capital was published in 2023, and the adoption of the entire risk based capital is scheduled for 2027 2028. Assuming the schedule is followed, the adoption of risk based capital will occur after the law allowing 100 per cent foreign direct investment is passed, and perhaps even before certain wholly owned foreign subsidiaries have started their large scale operations in India. From this, one learns that the sequencing in Malaysia would not be appropriate in the Indian case; risk based capital implementation should come first.

3.6.3 United Kingdom

The system of insurance regulation based on the dual regulatory principle applied in the United Kingdom is the most advanced consumer protection mechanism among those analyzed in this dissertation. The supervision of the financial condition of insurance companies is conducted by the Prudential Regulation Authority which operates as a subsidiary company within the Bank of England's structure under the Solvency UK scheme. The regulation of insurance practices belongs to the Financial Conduct Authority.

The regulatory regime of the FCA towards insurance conduct is proactive on a market wide basis, as opposed to an approach where it only responds to individual consumer complaints. In its approach to thematic reviews of market wide conduct issues relating to particular product classes or distribution channels, it has adopted both data analytics and mystery shopping. Whenever there are systemic issues discovered by such thematic reviews, the FCA has not been shy in levying large penalties. The Financial Ombudsman Service deals with all consumer disputes with authorised financial institutions, including insurers, with around 100,000 insurance complaints processed annually. It is well funded, easily accessible, and efficient.

The retail distribution review conducted by the Financial Conduct Authority and introduced in 2013 is the most relevant model that can be used to address the problem of bancassurance mis selling in India. In this case, the use of commission based payment for intermediaries involved in investment and insurance business became illegal and fees paid by the clients became transparent. Such changes were painful to implement in the short term perspective; however, they resulted in better quality of services provided to the clients. Thus, a similar reform in India will be the best option for mitigating the problem of bancassurance mis selling.

3.6.4 China

China's case study stands out as the one that bears the greatest relevance to India as a case of an emerging market economy that had both a large number of state owned insurance companies operating and a process of phased liberalization. Indeed, China started allowing foreign presence in the insurance market in 1992 but through joint ventures alone with no more than a minority share of equity for foreigners allowed. The process of liberalization reached its peak in 2020 when China opened its doors completely allowing foreign subsidiaries of insurers in line with its international obligations.

The Chinese case study further supports two key observations. One, despite the absence of any restrictions on the foreign equity, the three state owned insurers of China remain at the top of the country's insurance market just like LIC does in India. Two, having implemented the risk based capital management regime under the form of the C ROSS Phase II effective from 2022 before full liberalization, China was able to develop its

regulatory system ready for dealing with internationally integrated insurance companies in advance of liberalization.

The parallel drawn from China also shows the significance of supervision by the entire group within a market environment where full liberalisation is allowed. A number of insurance groups in China had established a complicated system of holding companies in the lead up to the process of liberalisation, and they used holding companies outside the country to do their transactions while avoiding the view of the insurance regulator in China. In this regard, the post 2017 actions of the NFRA on the issue of such group structures offer a cautionary approach for IRDAI.

3.7 Regulatory Challenges of the Proposed 100% FDI Scheme

The proposed 100 percent FDI scheme in the insurance sector, if adopted without any corresponding improvement in the regulatory capability of IRDAI, poses five distinct regulatory challenges, which this section discusses.

3.7.1 Cross border Supervision and Group Capital

An overseas insurance company operating as a wholly owned subsidiary of an international insurance group in India will be supervised not only by IRDAI under Indian prudential regulation but also by the regulator of the domicile state of the parent company. The main concern here would be the potential transfer of value or risks from the Indian subsidiary to other members within the insurance group through intra group reinsurance, management fees, and capital contribution deals in a manner that IRDAI would find difficult to assess independent of consolidated group accounts. This concern can be dealt with through the International Association of Insurance Supervisors (IAIS) Insurance Core Principle (ICP) 25, which emphasizes supervisory cooperation and coordination. Bilateral supervisory memorandums of understanding have been negotiated with IRDAI as part of ICP 25, although the number of these memorandums is currently fewer than those of MAS Singapore.

3.7.2 Corporate Governance and Composition of the Board

Foreign owned insurance subsidiaries that do not have any Indian shareholders in their equity capital would have their boards comprising mostly of individuals from the parent organization's global management team, with very little, if any, independent representation of Indian policyholders. The corporate governance of such entities needs to be regulated in such a manner that the board can remain free of any interference by the parent organization regarding issues that could potentially impact the interests of Indian policyholders, which include issues relating to prices, claims management, and the transfer of profits. The IRDAI fit and proper criteria for directors and senior management are only partially sufficient for corporate governance purposes, but they do not address the issues arising from the conflict of interest.

3.7.3 Compliances under DPDP Act

Insurers that are wholly owned foreign entities will, because of their global nature, use information systems to process the data of their policyholders which are linked to the data systems of the global entity from which they operate. The provisions of the Digital Personal Data Protection Act, 202362, prohibits any transfer of personal data across borders to a jurisdiction approved by the Central Government. The category of 'significant data fiduciary' that will be imposed upon the insurers under the provisions of the DPDP Act will have further compliance requirements like mandatory appointment of Data Protection Officer, mandatory DPDP impact assessment, and mandatory data breach notification to the Data Protection Board. There is no guidance issued by IRDAI regarding compliance of the DPDP Act in the insurance sector.

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3.7.4 Captive Reinsurance

Large international insurance companies normally rely heavily on the use of captive reinsurance, which involves transferring risks from operational subsidiaries to the reinsurer within the group, in their risk management and capital management processes. The use of captive reinsurance between an Indian insurance subsidiary and its international group parent may result in regulatory arbitrage by enabling the transfer of the profits earned through underwriting operations abroad without taking any responsibility for claims back home in India, thereby putting Indian insurance consumers at a disadvantage. Current regulation in respect of reinsurance transactions does not cover the area of captive reinsurance.

3.7.5 The Indian Management and Control Requirement

The historic rule regarding the necessity for insurance firms to have Indian management control, which has been defined administratively within the scope of both the FDI Policy and the IRDAI registration rules during all stages of liberalization, now poses an insurmountable obstacle under the system of 100 per cent FDI. With the absence of an Indian equity stakeholder in this scenario, there is no guarantee structurally that the higher level management and board of directors posts would necessarily go to resident Indians. Hence, a legislative guarantee for minimum levels of Indian management participation becomes a legal necessity in a situation of 100 per cent FDI.

7. Critical Analysis

The central difficulty with India's approach to FDI liberalisation in the insurance sector is not that it has moved too quickly, but that it has moved in the wrong order. The progressive elevation of the equity ceiling .from twenty six to seventy four percent, with a proposed ascent to full foreign ownership .has proceeded as though ownership structure were the binding constraint on sectoral development. The empirical record does not sustain that premise. Insurance penetration in India has stagnated at approximately four percent of GDP, a figure that has remained broadly unchanged across the very period in which liberalisation was most aggressively pursued. FDI inflows, while incrementally positive, have fallen well short of the volumes that comparable liberalisation measures generated in peer jurisdictions. If the cap were the operative variable, its repeated relaxation ought to have produced correspondingly improved outcomes. That it has not done so compels a reorientation of the diagnostic lens toward the institutional environment within which foreign capital is expected to operate.

IRDAI's structural limitations in this regard are neither peripheral nor incidental .they are constitutive of the problem. The Authority's supervisory architecture remains organised around entity level oversight, rendering it institutionally incapable of monitoring the intra group transactions, related party exposures, and capital fungibility that characterise the operations of large multinational insurers. This is not a resource deficit alone; it reflects a conceptual gap in the regulatory framework that statutory amendment has not resolved. The Insurance Act and IRDAI's subordinate regulations continue to lack a coherent group supervision regime of the kind mandated under the European Union's Solvency II Directive or operationalised by the Monetary Authority of Singapore. In the absence of such a regime, permitting one hundred percent foreign ownership does not merely expose policyholders to heightened risk .it does so in a supervisory vacuum that the existing legal architecture is structurally unequipped to address.

The comparative dimension sharpens this critique considerably. Singapore and the United Kingdom did not liberalise insurance ownership and then construct regulatory capacity in response to the risks that materialised. They invested, over extended periods, in supervisory sophistication .risk based capital frameworks, robust actuarial governance standards, consolidated group oversight .before permitting unrestricted foreign control of systemically

significant financial institutions. Malaysia's experience is particularly instructive: Bank Negara Malaysia conditioned the phased opening of its insurance market on demonstrable improvements in domestic institutional capacity, treating regulatory preparedness as a substantive precondition rather than an administrative formality. India's trajectory inverts this logic. Policy liberalisation has consistently preceded, rather than followed, the institutional strengthening that would render it prudent.

The risks attendant upon the proposed one hundred percent FDI regime are not hypothetical. Cross border supervisory coordination between IRDAI and the home regulators of dominant foreign parents remains institutionally underdeveloped, creating meaningful potential for regulatory arbitrage. The absence of a comprehensive data localisation framework for insurance data compounds these vulnerabilities, as does the inadequacy of existing policyholder protection mechanisms in circumstances where the controlling shareholder is a foreign entity subject to competing jurisdictional obligations. These are not objections to liberalisation as such .they are objections to liberalisation that outpaces the institutional architecture designed to manage its consequences.

What emerges from this analysis is a regulatory governance deficit that FDI cap revision, however expansive, cannot resolve. The mismatch between the ambition of India's liberalisation agenda and the institutional maturity of its supervisory framework is not a temporary asymmetry that market forces will correct. It is a structural condition that, if left unaddressed, will ensure that the proposed one hundred percent FDI regime generates neither the foreign investment volumes nor the competitive market depth that the reform's architects envision. The case for liberalisation is not thereby defeated .but it is fundamentally incomplete without a prior, candid reckoning with the regulatory preconditions upon which its success depends.

8. Recommendations on Research Gap

The existing literature on FDI in India's insurance sector suffers from a persistent and consequential asymmetry: scholarly attention has clustered around the question of how much foreign ownership the law permits, while the prior and more consequential question .whether the regulatory environment is institutionally equipped to govern that ownership .has received comparatively little sustained analysis. This paper has sought to redress that imbalance, but several dimensions of the problem remain underexplored and warrant dedicated scholarly attention. There is, at present, no robust empirical framework for measuring regulatory capacity in emerging market insurance regulators in a manner that permits meaningful cross jurisdictional comparison; the development of such a framework .drawing on supervisory resource allocation, enforcement frequency, rule making responsiveness, and adjudicatory consistency as proxy indicators .would substantially advance the field. Equally, the causal relationship between IRDAI's enforcement activity and actual FDI inflow behaviour has not been subjected to rigorous econometric scrutiny, leaving the central claim of regulatory constraint analytically persuasive but empirically underspecified. The governance structures of wholly foreign owned insurers operating in liberalised jurisdictions, and their implications for policyholder protection and systemic risk, represent a further gap that comparative corporate law scholarship has yet to address with adequate granularity. Finally, the mechanics of cross border supervisory coordination between IRDAI and the home regulators of multinational insurance groups .a question that will acquire acute practical significance under a one hundred percent FDI regime .remains almost entirely absent from the Indian regulatory literature, notwithstanding its centrality to any credible assessment of the proposed reform's prudential viability.

9. Conclusion

In this chapter, the FDI framework in Indian insurance industry has been analysed from four inter related dimensions. These include: theoretical basis for insurance FDI, evolution of policy and legal regime, comparative experiences, and regulatory issues regarding the proposed 100 per cent FDI regime.

The theoretical discussion, which relies on Dunning's OLI paradigm, Claessens and van Horen's empirical approach and regulatory competition theory, indicates that results from the liberalization of FDI are highly contingent upon the regulatory quality of the host country. Empirical discussion on FDI flow shows that insurance FDI in India has always performed lower than expected, and regulatory quality and business facilitation variables are largely responsible for the failure rather than statutory equity cap. Comparative analysis based on Singapore, Malaysia, United Kingdom, and China suggests that 100 per cent FDI and high regulatory quality are compatible and reinforce each other.

Each of the five problems highlighted in Section 3.7, cross border regulation, corporate governance, DPDP Act compliance, captive reinsurance, and Indian management control, necessitates particular legislative and regulatory actions prior to the implementation of the 100 per cent FDI regime. Such actions are outlined in Chapter 6. The discussion presented in this chapter forms the empirical foundation of Hypothesis II of this thesis: Insurance development necessitates FDI cap increases, which by themselves are neither necessary nor sufficient but are secondary factors compared to regulatory quality.

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