Union budget's impact on the insurance sector

April 2021

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(6 min read)

The year 2020, with the onset of the COVID-19 pandemic, was unlike any other. A year that will leave an indelible mark on humanity and a drastic impact on economies, health, businesses, and communities across the globe. The virus outbreak and continuous lockdowns threw India's budgetary calculations entirely out of the line. A slew of fiscal and non-fiscal measures to help the economy recover from the aftermath of the ongoing pandemic became the need of the hour.

India observed a sharp decline in its economic activities since the time it began announcing the gross domestic product (GDP) data in 2020. Compared to most of the other major global economies, India witnessed the steepest drop in GDP[1]. Nearly everyone, including large corporates, small businesses and the common man, expected to see the amendments that the Union Budget would bring with bated breath, owing to its anticipated seminal role in extricating the country out of the economic impasse, which was a fallout of the COVID-19 pandemic. For providing the impetus for growth revival, the Finance Minister (FM) rightly focused on key aspects such as healthcare improvement, infrastructure boost, supports for the micro, small and medium enterprises (MSMEs), skill development, etc. The budget was expected to be aimed at taking the economy out of the chaos.

Key takeaways for the insurance sector

1. Liberalised Foreign Direct Investment up to 74 per cent

On the insurance front, one of the most positive announcements was to liberalise foreign direct investment (FDI) up to 74[2] per cent with overseas possession and control with some precautions. The move is anticipated to allow some of the insurers to gain access to fresh capital. Furthermore, experts assume the decision would also benefit the individual policyholders.

Nearly two decades back, the Government of India (GoI) had permitted foreign companies to own up to 26 per cent in domestic insurers in India's life insurance sector. The sector then got liberalised from 26 per cent to 49 per cent in 2014[3]. Increase in FDI limits from 49 per cent to 74 per cent is expected to serve insurance players raise extra funds to maintain solvency in line with their growing business needs. Moreover, it will help in refining insurance penetration in India. In a nutshell, increase in FDI is expected to augment foreign inflows, encourage more international insurance players to operate in India, help insurance companies achieve tremendous growth through vast pools of capital, and attract best-in-class expertise, technical innovation, and new products for the consumers' benefit.

2. Board of Directors as resident Indians

With the announced amendment, majority of board of directors and key management staff should be resident Indians with at least 50 per cent directors being independent directors and a stated share of profits to be booked as a 'general reserve[4]. The term 'adequate safeguard' has caused some ambiguity and one

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would hope that the conditions highlighted are thorough and no other conditions would be subsequently brought in.

3. Change in taxability of ULIPs

This budget tweaks the taxation of unit-linked insurance policies (ULIPs). Tax exemption available on maturity proceeds of ULIPs under Section 10 (10D) of the Income Tax Act, 1961 (hereinafter 'the Act') will no longer be available if the annual premium payable of ULIPs bought on or after 1 February 2021 (hereinafter 'the date') exceeds INR 2,50,000. ULIPs bought before the date shall be excluded from the proposed budget announcement. If a policyholder purchases multiple ULIPs on or after the date having premium less than INR 2,50,000 then the aggregate of premiums payable for all policies shall be considered and exemption shall be allowed only for those ULIPs whose aggregate premium is within the prescribed limit of INR 2,50,000. However, considering the language used in the proviso this could be prone to different interpretations.

Further, ULIPs shall be considered as a 'capital asset' and gains / losses arising on receipt shall be considered as 'capital gains/ losses' in the previous year in which such amount is received. The tax rate on capital gains shall be as per section 112A of the Act and section 111A of the Act dependent on nature of capital asset i.e. long-term or short-term which is reliant on the period of holding. The tax rate under Long-term Capital Gain ('LTCG') will be 10 percent, which is in par with the equity instruments like listed equity shares and equity oriented mutual funds, if the equity component under ULIPs is minimum 65 percent in case of direct investment in listed equity shares of domestic companies and 90 percent in case of indirect investments through fund of funds. The minimum equity component of 65 percent or 90 percent as the case may be, is required to be satisfied throughout the term of ULIPs in order to be eligible for concessional LTCG rate of 10 percent. Moreover, the Security Transaction Tax shall also be levied on maturity or fractional withdrawal.

Due to above-mentioned changes in the taxability, popularity of ULIPs may decline and thereby adversely impacting the business of the life insurance companies.

4. Privatisation of two public sector banks and one general insurance company

The FM also announced that two public sector banks and one general insurance company will be privatised and initial public offering (IPO) of one of the largest public sector life insurance companies in India will be carried out in FY21–22. The GoI is expected to pick up a substantial volume from this IPO, resulting in the insurer becoming one of the largest in the marketplace. Additionally, it could improve the insurer's transparency, accountability and regulatory capital position, which stood at 165 per cent in September 2020 (exceeds the regulatory minimum of 150 per cent)[5]. The disinvestment target of INR1.75 lakh crore[6] from stake auction in public sector businesses and financial establishments appears practical this time.

Talking of the slips, insurance sector was expectant that few measures would be given green light in this year's budget, including[7]

(i) discrete tax deduction for life insurance premium and mediclaim premium payment,
(ii) deduction in tax on profits and gains of life insurance companies,
(iii) extension of 12 years carrying forward period for business losses.

Similarly, Indian branches of foreign re-insurers were hoping for a special, more reasonable and clear-cut taxation code, but no such announcements were made.

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Overall, the implications of the budget proposals of the GoI are mixed for the insurance sector. However, the proposed amendments related to liberalisation of FDI cap to 74% could strengthen solvency, attract foreign capital, and encourage competition. These could also inspire the global insurers to enter the rapidly growing Indian market. The international insurers, that already have minority stakes in the companies, might also try and improve their ownership. The proposed budget measures are expected to usher in a new growth era for a more developed insurance industry in India.

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[1] Once in a Century Budget: Statement of Fact or Hope, The Wire, January 2021

[2] FM proposes increase in FDI cap in insurance sector to 74%, The Economic Times 01 February 2021

[3] The life insurance sector in India was opened up two decades back after the government had first allowed foreign companies to own up to 26% in Indian insurers in 2000, Mint, March 2021

[4] Union Budget 2021: a booster shot for insurance industry; FDI limit hiked to 74%, Financial Express, February 2021

[5] Budget Proposals Positive for India's Insurance Industry, Fitch Ratings, February 2021

[6] Budget Speech 2021

[7] Budget 2021: Gauging the impact on insurance sector, CNBC TV18, 3 February 2021

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