[TAPPING THE LIC SOURCE]

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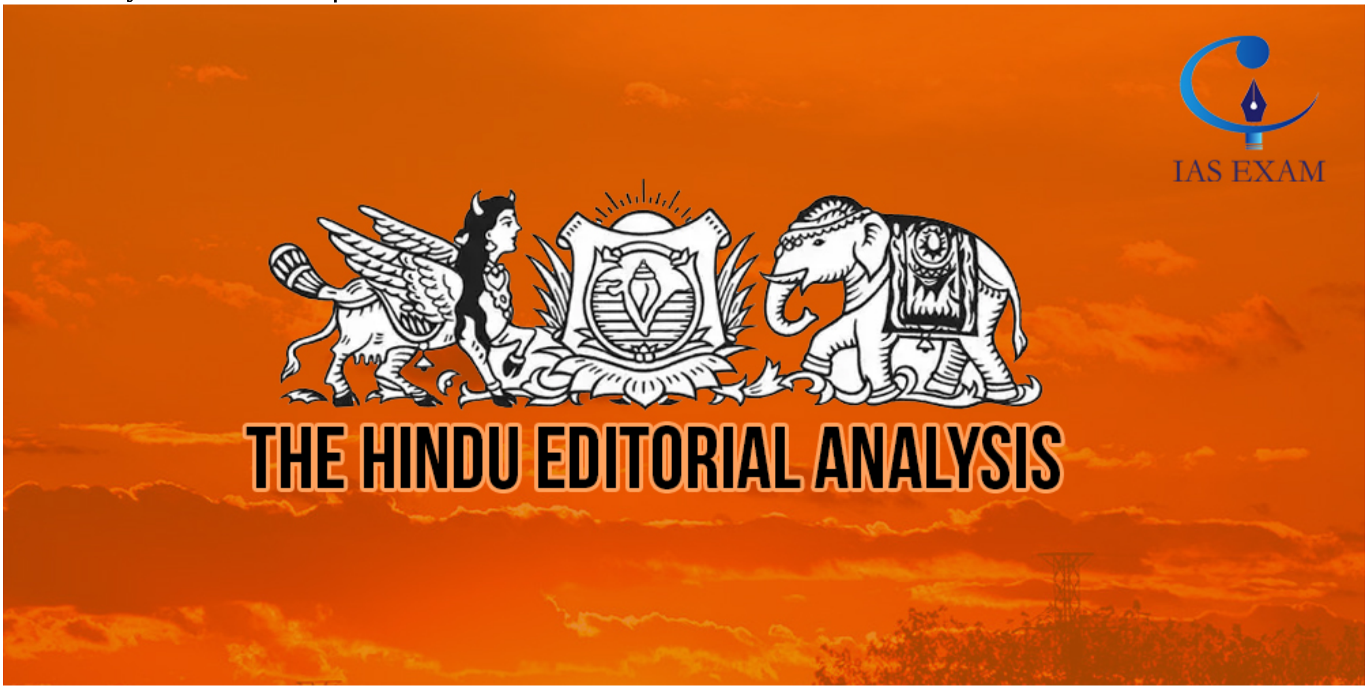

The government should ensure that a fair return is realised from the proposed partial disinvestment

More than 64 years after former Finance Minister C.D. Deshmukh called for the nationalization of insurance, the government is considering partial disinvestment of its holding in the Life Insurance Corporation of India (LIC). It plans to accomplish this in the second quarter of 2020-21.

Why now?

The simple answer is, the partial disinvestment of LIC is a source of income to the public exchequer to make up for the loss in tax revenue over successive cycles of corporate tax cuts, most of which were aimed at spurring domestic industrial development.

Two groups of policies

The policies of LIC can be divided broadly into two groups:

- **Participating** – Participating policies are eligible for not less than 95% of the profits (surplus) emerging each year. Bonus is declared from this profit.
- **Non-participating** – Non-participating policies are not eligible for this bonus. As compensation, the premium rates under these policies are significantly lower.

If Section 28 of the LIC Act, 1956, which prescribes the share of profits to participating policyholders, is not amended to reduce this share, then there will likely be no issues in carrying out disinvestment. However, if the government tries to reduce the percentage of profit going to participating policyholders, there could be a host of problems.

Since rights of existing policyholders cannot be taken away, this amendment can be made applicable only to policies issued in future and not to existing policies. This can create administrative problems. Two books of accounts must be maintained in each branch office: one with respect to old policies and another with respect to new policies. The bifurcation of administrative expenses between the two groups may also be a major problem. We can therefore assume that no change will be made to Section 28 of the LIC Act.

The value of a life insurance company is assessed by finding the present value of future profits generated by the current business, the probable flow of new business in the future, and the present value of profits from this new business. This is a complex and time-consuming process. There is another method known as the Dividend Discount Model. This method is generally applicable only in the case of companies that pay regular dividends. The LIC has a long and uninterrupted history of dividend payments from inception.

Division Discount Method

Under this method, if it is assumed that if the dividend increases by 3% each year, the present value of future dividends will be ₹300,000 crore (₹3 trillion). If the rate of increase of dividends is 4% or more, then the present value of future dividends will be very high and, theoretically, be equal to infinity. The average annual rate of increase of dividend over the last 30 years is 14.32%, so one can imagine what would be the present value of future dividends.

Numerous Products

- The Corporation has a wide range of products. Its agents are reluctant to sell the high profit margin unit linked products since these do not guarantee maturity value. Its portfolio of Group, Pension and Annuity products, which have very low profit margin, is quite substantial. Shareholder’s share of profits is only 5%. It is not even 50% of the share of profits of shareholders of private insurers. Still, its dividend to shareholders is substantial.
- LIC is also introducing unit linked products, which generally have good profit margins. So, its dividends may go up even further. It is my considered view that its value today will be anywhere between ₹3 trillion and ₹5 trillion.
- Its overall cost ratio compares favorably to that of any private insurer. With a capital of just ₹100 crore, it is managing a life fund of about ₹30 trillion and has built up, in the policyholders’ account, a solvency reserve of ₹1.5 trillion. Its million-strong dedicated agency force can be the envy of any insurer. About 96% of LIC’s new business comes from this group.

On every count, it is a dream organisation. The government should ensure that a fair return is realised from the proposed partial disinvestment.

SOURCE: *The Hindu*