*International Journal of Humanities & Social Science Studies (IJHSSS)*
*A Peer-Reviewed Bi-monthly Bi-lingual Research Journal*
*ISSN: 2349-6959 (Online), ISSN: 2349-6711 (Print)*
*ISJN: A4372-3142 (Online) ISJN: A4372-3143 (Print)*
*Volume-IV, Issue-I, July 2017, Page No. 131-140*
*Published by Scholar Publications, Karimganj, Assam, India, 788711*
*Website: http://www.ijhsss.com*

# Automobile Insurance in India: Need and Impact of the Premium Hike

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***Abstract***

*Non-life insurance industry of a country, effectuating the risk sharing principle, plays appreciable role in patronising the property from loss or damage. A significant hike was initiated in the insurance premium on automobiles in India by Insurance Regulatory and Development Authority of India in March 2017. This study was administered to unearth the need and backdrop for which the premium hike on automobiles was initiated and make much of the micro and macroeconomic impact of the significant automobile insurance premium hike. It was sighted that the motor segment of the non-life insurers in India struggles to find a sustained, positive and substantial net profit. The situation in which insurers have to be generated additional income from non-insurance sector, so to speak income from investment on securities has been subsisting overtime. The premium hike on the commercial vehicles such as buses and goods carriers would have considerable impact on the economy as a whole while the hike on the premium rates on other commercial vehicles as well as private vehicles would have lesser effect on the economy. The study widely used the data accessed from IRDAI. Secondary data was also reaped from National Crime Records Bureau, Ministry of Transport & Highways, and various news agencies and newspapers.*

***Keywords: Non-life insurance, insurance premium, automobiles, commercial vehicles, impact on the economy.***

**1. Introduction:** Motor vehicle population of the world especially the developing world is up surging in recent time. The use of automobiles has become common and more popular unlike the recent past. Earlier, the automobiles were only owned by elite section of the society. Only the elite section by means of wealth, income and power was able to use automobiles though their use was bounded. The use of automobiles up to recent past was highly bridled by immature market, poor market access and bounded technology. So to say, the recent vehicle growth was considerably contributed by the permeability of these factors along with improving standard of living and ascending demonstration effect. Growth of infrastructure should be treated in earnest the effect of vehicles growth rather than its cause.

India tries to expand the road network mainly to accommodate the ascended number of vehicles rather than attract new ones.

The history of compulsory automotive insurance may be traced back to 1930s while the UK passed Road Traffic Act 1930. This ensured that all vehicle owners and drivers had to be insured for their liability for injury or death to third parties whilst their vehicle was being used on a public road. The intention of the above said act, inter alias, was to ensure that funds would be available to compensate the innocent victims of motor accidents (History of Motor Insurance, 2012).

Motor vehicle insurance is a major portion of the Non-Life Insurance in India with almost half of the total non-life insurance industry. The motor segment of the non-life insurance industry will help reduce the financial consequences of the damage or destruction of motor vehicles. The insurer would issue contracts that would promise to pay the owner of a property a defined amount or less than the financial loss if the property was damaged or destroyed during the period of the policy. Although compulsory, automotive insurance, which shares the risk of property loss/damage out of road accidents and robbery, does not assuring refunding the premium after maturity unlike life insurance. Thus the non-life insurers especially the motor vehicle insurers seem to make large profit out of premium amount itself. Motor vehicle insurance law in India is governed by the Motor Vehicles Act, Insurance Act and aspects of insurance contracts which are governed by Indian Contracts Act, Transfer of Property Act and few others (Wikipedia, 2017). As per the Motor Vehicles Act, 1988 it is mandatory for every owner of a vehicle plying on public roads, to take an insurance policy, to cover the amount, which the owner becomes legally liable to pay as damages to the third parties as a result of accidental death, bodily injury or damage to property (The New India Assurance Co Ltd, 2017). The motor insurance is of great relevance in this sense since the number of annual road accidents in India is greater in number and the intensity of accidents is severe for years. This paper was prepared in the background of recent major hike in automotive insurance premium in India. Insurance Regulatory and Development Authority of India (IRDAI) has proposed up to 50 per cent increase in insurance premium for cars, motor cycles as well as commercial vehicles from April 1 (Press Trust of India (PTI), 2017). A study was inevitable on the sideline for which the recent premium hike was initiated in the country and impact on the insured and the economy.

## 2. Objectives:

1. To find out the need and background for which the premium hike on motor vehicles in India was initiated
2. To understand the micro and macroeconomic impact of the significant automobile insurance premium hike

**3. Methodology:** The study mainly endeavours to find the background and need for which the premium hike on motor vehicles was initiated. The impact of the rates hike on the economy was also discussed in the paper. The study was prepared on the basis of the data accessed from Insurance Regulatory and Development Authority of India and National Crimes Records Bureau. The data on premium hikes was collected from various reputed news agencies and newspapers. The common statistical tools of ratio, average, growth rate and total were employed.

**4. Profitability of the Motor Vehicle Insurers in India:** It is revealed from the figure 1 that India's motor vehicle insurance industry, a major segment of non-life insurance sector, is experiencing large scale fluctuations in terms of net profit overtime. Although the industry is making positive net profit, ascended rate of instability has hit the segment of motor vehicle insurance hard. But the positive factor for the industry is that it is 2010-11 only when industry was fell in net loss. From 2002-03 onwards, motor insurance segment of India's non-life insurance industry is making net profit with considerable fluctuation. The net profit was steadily increasing from 2002-03 to 2006-07. The motor segment of the industry faced a decline in net profit in the next two years. After a decent performance in 2009-10, the segment went loss of Rs 10,189 million in 2010-11. Among the fifteen private insurance companies, while two companies reported profits, the remaining thirteen incurred losses during 2010-11 (Insurance Regulatory and Development Authority of India (IRDAI) 2011, p.33). The very next few years happened to be the period of revival for the motor vehicle insurance industry in the country. From the loss of more than Rs 10000 million in 2010-11, the segment stage by stage attained the profit of more than Rs 46000 million in 2014-15. The year of 2015-16 faced another setback for the industry with the decline in profit to Rs 32000 million.

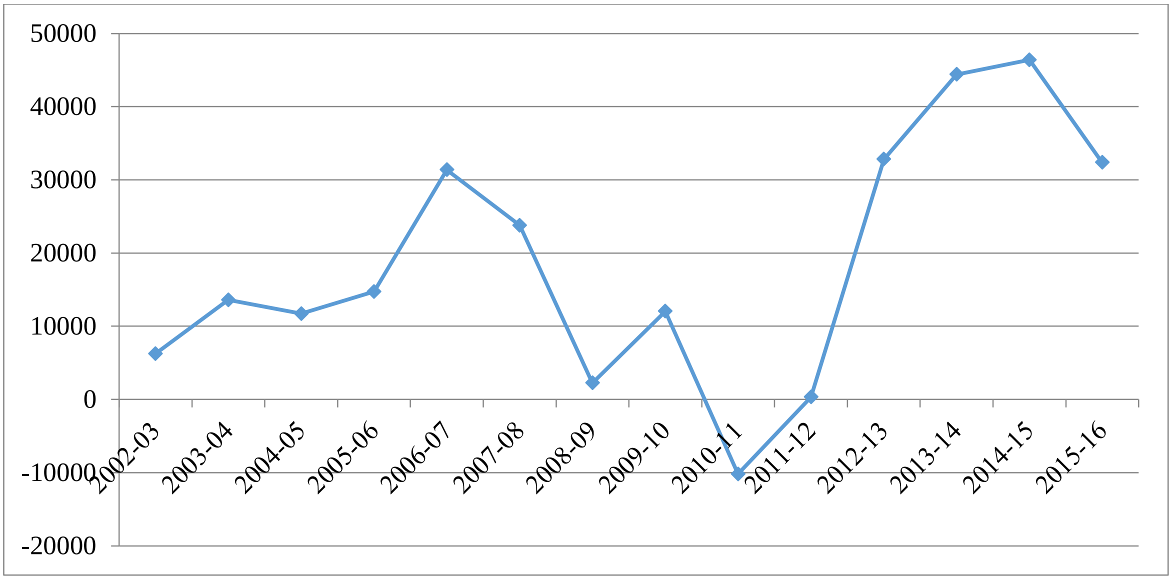


**Figure 1: Net profit of non-life insurers in India (In Rs Million)**
Source: IRDAI Annual Reports

Non-Life Insurers include the insurance companies working in the segments of fire, health and travel, automobile, and marine.

**4.1 Probability of Occurring Undesirable Things:** The institutions for insurance were set up and strengthened on the basis of risk sharing agreement. The risk of loss will be shared by the persons or firms who came up with the agreement with the insurer. Unfortunate few who suffer losses are compensated from funds collected from many policyholders (Das, Davies and Podpiera, 2003). Thus the risk in motor vehicle sector can be insured by paying a nominal insurance premium. Even though the number of undesirable events will be normally lower or manageable, the phenomenal increase of such events would bring the insurers in trouble.

Recently India's roads have witnessed phenomenal growth of motor vehicles. From 50 million registered motor vehicles in 2005-06, the number of vehicles up surged to 127.5 million in 2010-11 and 210 million in 2015-16. The number of vehicles stolen also increased with the growth of vehicle population. From 85000 in 2005-06, it surged to 1.46 lakh in 2010-11 and 1.96 lakh in 2015-16. At once, robbery to vehicle population ratio was subsiding from 0.17 per cent in 2005-06 to 0.11 per cent in 2010-11 and 0.09 per cent in 2015-16. (See Table 1). Even though the occurrence of road accidents was in fact constant despite of the surging vehicle population, the number in between 4.4 lakh to 5 lakh throughout the years from 2005-06 to 2015-16 (Ministry of Road Transport and Highways, 2016). Similar to the robbery to vehicle population ratio, accidents to vehicle population ratio was moving in the same direction. It was declining from 0.88 per cent in 2005-06 to 0.39 per cent in 2010-11 and 0.24 per cent in 2015-16. So to say, the ratio of occurring these risky incidents has also diminished from 1.05 per cent in 2005-06 to 0.50 in 2010-11 and 0.33 in 2015-16. (See Table 1). Similarly the higher severity of the accidents in India (28-29 death per 100 accidents during 2014 and 2015) would also cause for higher burden for the insurers as third party insurance (Ministry of Road Transport & Highways, 2016, p.6).

**Table 1: Ratio of occurring road accidents and vehicle robbery**

| | 2005-06 | 2010-11 | 2015-16 |
|---|---|---|---|
| Vehicle Population (million) | 50 | 127.5 | 210 |
| Road Accidents (In lakh) | 4.39 | 5.0 | 5.01 |
| Vehicles Stolen (In lakh) | 0.85 | 1.46 | 1.96 |
| Accidents to Vehicle Population Ratio (%) | 0.88 | 0.39 | 0.24 |
| Robbery to Vehicle Population Ratio (%) | 0.17 | 0.11 | 0.09 |
| Accidents + Robbery to Vehicle Population Ratio (%) | 1.05 | 0.50 | 0.33 |

Source: IRDAI Annual Reports, NCRB Crimes in India (various issues), Ministry of Road Transport and Highways, and Author's calculations

**4.2 Income of the Insurers:** Insurance premium itself is the largest source of income for all type of insurers. The state of affairs of motor insurers is also not transverse. The premium income of the motor insurers grows at the rate of above 10 per cent per annum with some phenomenal growth in a few years. Second largest source of income of the insurers is the income derived from their investment in government securities and other approved securities. It has significant role in ensuring safe and sure income for the non-life insurers as they are staggering from the recent set back of marginal and declining growth of net profit. In 2015-16, non-life insurers have earned the income of Rs 190,900 million up from Rs 58,775.5 million in 2005-06 and Rs 93,818.3 million in 2010-11. A major setback for the non-life insurance industry of India is the steadily declining growth of investment income. From 30 per cent growth rate in 2005-06, it went down to 22.13 per cent in 2010-11, 16.44 per cent in 2014-15 and 14.95 per cent in 2015-16. IRDAI Annual Report 2015-16 (2016, p.24) shows that public sector non-life insurers have managed to make relatively lower growth rate of investment income. They procured 14 per cent and 13 per cent growth rates in 2014-15 and 2015-16 respectively while private sector firms made 22 per cent and 19 per cent growth rates in 2014-15 and 2015-16 respectively. The stand alone health insurer, which is having ascended incurred claims ratio is being concentrated on investment income. They have made tremendous achievement from investment in securities with the annual growth rate of 35 per cent and 36 per cent in 2014-15 and 2015-16 respectively. Since 42-44 per cent of the total premium income of the non-life insurers was bagged by the motor segment, around that much of share might be occupied by motor segment in investment income (Exact data was not available with IRDAI).

**Table 2: Premium income of motor vehicle insurers and investment income of non-life insurers (In Rs million)**

| | 2005-06 | 2010-11 | 2014-15 | 2015-16 |
|---|---|---|---|---|
| Premium income of motor insurers | 87330 | 181805 | 373790 | 423010 |
| Investment income of non-life insurers | 58775.5 | 93818.3 | 166070 | 190900 |
| Growth rate of investment income in respective years (%) | 30.19 | 22.13 | 16.44 | 14.95 |
| Share of motor insurance premium in non-life insurance premium (%) | 42.90 | 42.70 | 44.14 | 43.89 |

Source: IRDAI Annual Reports Note: Income in Rs million

**4.3 Cost of the Non-Life Insurers:** The ascended incurred claims ratio of motor insurers evinces the higher expenses of the motor segment. Motor remains for some years as the second largest segment of the non-life insurance industry in India in terms of incurred claims ratio. Incurred claims ratio is defined as the overall value of the claims that the insurance company has paid divided by the total amount of premium received during a period. The motor insurers paid out the claim on an average of 85 per cent of the total premium (Author’s calculation from Table 3). It is relatively higher as far as the segments of fire and marine are concerned. The ratio is highest among the health insurers since accidents’ claims are significant. The major expenses of the non-life insurers are commission expenses and operating expenses. The commission expenses among the non-life insurers are incurred mostly by the health segment followed by motor, fire and marine

(IRDAI, 2016, pp. 22-23). The commission expenses of the motor insurers rose with some fluctuations. From Rs 5823 million in 2005-06, it has become Rs 17730 million with the average growth 13.26 per cent per annum (Table 3 and author's calculation). Operating expenses constitute the major segment of the cost of non-life insurers. From Rs 50774 million in 2005-06, it has become Rs 2.32 lakh million in 2015-16 with the average growth rate of 16.74 per cent per annum (Table 3 and author's calculation). The major component of operating expenses of a motor vehicle insurer is employees' remuneration and welfare benefits followed by rents, rates & taxes, travel, conveyance and vehicle running expenses, and depreciation (Oriental Insurance, 2017).

**Table 3: Expenses of the non-life insurers**

| Year | Incurred claims ratio of motor insurance (%) | Commission expenses of motor insurers (Rs million) | Operating Expenses of Non-Life Insurers (Rs million) |
|---|---|---|---|
| 2005-06 | 62.71 | 5823.3 | 50774.3 |
| 2006-07 | 84.69 | 5682.2 (-2.42) | 53068.9 (4.52) |
| 2007-08 | 92.31 | 5033.3 (-11.42) | 61352.7 (15.61) |
| 2008-09 | 88.84 | 7881 (56.57) | 73644.3 (20.03) |
| 2009-10 | 84.50 | 8085.7 (2.60) | 83922 (14.00) |
| 2010-11 | 102.54 | 8910.8 (10.19) | 106200 (26.55) |
| 2011-12 | 94.90 | 10982.2 (23.25) | 111780 (5.25) |
| 2012-13 | 88.63 | 14730.4 (34.13) | 135400 (21.13) |
| 2013-14 | 79.54 | 16279.6 (10.52) | 151180 (11.65) |
| 2014-15 | 77.14 | 15874.7 (-2.5) | 202060 (33.65) |
| 2015-16 | 81.18 | 17730.4 (11.69) | 232300 (14.97) |

Source: IRDAI Annual Reports

Figures in brackets show the growth rate in percentage

Insurers should be making consistent-substantial profit so that only they could fulfil their commitment towards the insured. Borsch (1964) warns that if an insurance company consistently makes losses on its operations, the company will sooner or later be unable to fulfil its part of the insurance contracts. Incurred claims ratio of the motor insurers are fairly high that come around from 80 to 90 per cent of the premium income. Operating expenses and commission expenses altogether exhaust a substantial portion of the income. Premium was not at all enough to run the industry since great majority of it was being exhausted by claims. Thus it can be affirmed that a premium hike was necessary to save the motor segment of the non-life insurers as well as the industry.

**5. Micro and Macroeconomic Impact of Motor Vehicle Insurance Premium in India:** Even though the non-life insurers including motor segment are not making super normal profits and are floundering with inconsistent level of net profit and ascended level of costs, the premium hike of the motor insurers can't be blindly justified or seconded.

**5.1 Microeconomic impact:** The impact of significant premium hike by the motor insurers would be severe as it cannot be conceived that a larger portion of the premium holders belong to elite section of the society. Since a great majority of the vehicles registered in India as on 31st March 2012 were two-wheelers, a common man's or middle class' vehicle, impact of the premium hike would not be driblet. Motor insurance has been a matter of necessity or compulsion in many countries rather than choice. All premiums will mature in one year and no refunding is provided after the maturity. Only the undesirable happenings can claim the compensation. Motor Vehicle Act of India bans using motor vehicles on public roads without having insurance policy covering third party risks. Furthermore, no vehicle would get registered without a valid insurance policy. Thus every vehicle owner is liable to take insurance premium not of his choice but out of mere necessity.

Table 4 shows that a great majority of the vehicles registered in India as on 31st March 2012 are two-wheelers (69.33%). More than 10 crores of two-wheelers were among the registered in 2012 in India. This proves that any hike in insurance premium would affect the common man directly since two-wheeler has been considered to be a common man's vehicle. He would be compelled to rearrange his tight family budget. Someone may try to avoid the policy as per the law of demand. As the price of insurance policy increases demand will come down as more people will try to skip the 'policy'. But this can be mitigated by the government or motor vehicle departments through ensuring effective punishment. But IRDAI's recent hike on bike insurance premium is relatively lower. 'In case of two wheelers (up to 75 cc), the premium has been hiked to Rs 569 against Rs 519. For 75 cc-150 cc bikes, it will go up by 15 per cent to Rs 619 and for those in 150cc-350cc category, the premium will rise by 25% (Economic Times, 2017).

Premium hike for other private vehicles including jeeps and cars would have lesser impact on the customers although the hike is 40 per cent for the cars up to 1500cc (Economic Times, 2017). The prime reason for this is that car is fairly a vehicle for convenience or luxury which would be occupied by financially capable persons in general.

Owners of all other public vehicles or commercial vehicles such as taxis, buses and Goods carrying vehicles would be able to transfer the burden of the premium hike on to the passengers or public. Trade unionism would help them bargain with the government for fare or freight hike.

**Table 4: Category-wise distribution of motor vehicles in India during 2012**

| | Two-wheelers | LMV (Passenger) | Jeeps | Cars | Taxis | Buses | Goods | Others |
|---|---|---|---|---|---|---|---|---|
| Number* | 104249 | 4243 | 3900 | 17570 | 2011 | 1297 | 7658 | 9436 |
| Percentage share (%) | 69.33 | 2.82 | 2.59 | 11.68 | 1.34 | 0.86 | 5.09 | 6.27 |

Source: Ministry of Surface Transport, GoI
* Number of vehicles in thousands

**5.2 Macroeconomic impact:** The premium hike would have some overall impact on the economy besides the specific and direct impact. The premium hike for the public or commercial vehicles such as taxis, buses, auto-rikshaws and goods carriers would make significant effect on the economy as a whole. Any how this indirect impact would have severe effect on the economy.

**5.2.1 Inflationary pressure:** For commercial vehicles, Irdai has proposed up to 50 per cent hike in premium rates for different categories of CVs. Tractors rated up to 6 HP can now attract Rs765 insurance premium, up from Rs510. Irdai has also planned to increase premium rates for e-rickshaws. (Firstpost, 2017). The premium hike for the commercial vehicles, which carry goods or fare-paying passengers, such as taxis, buses and goods carriers likely to bring rise in fares and frights. It would make the life of the commons distressing since public vehicles are accessed generally by this non-elite section of the society. The standard of living of the commons will be affected. The bus fare might be hiked by each state government depends on the protests and demand from the part of the owners. Even though the share of buses among the total number of vehicles in India during 2012 was negligible (0.86%), the number of people resorting to the buses is huge. Thus the impact of premium hike on buses would be on the masses rather than on owners. The owners will be able to transfer the incidence of premium hike on to the passengers. Thus the impact would be severe as it is the common man’s vehicle.

The other issue that may rises with the inflationary pressure after the premium hike on the goods carrying vehicles is also grave. It would bring up the general level of prices since the premium will cause for rise in freights that makes the life of the commons miserable. It would affect their purchasing power and consequently their spending on leisure might be also affected. Even though Indian Railways occupies a unique role in the interstate transportation of goods and services, road network has been a common and easiest mode of transportation. Behera (n.d, pp.44-45) notes that currently around 60 per cent of the freight come from the road transport as per the estimates. He reviews that inter-state movement of goods is over-dependent on National Highways. Furthermore, great majority of the intra-state transportation of goods and passengers are done through road transportation due to its easy access and suitable for small scale operations.

Premium hike on taxis and auto-rickshaws would also have some inflationary pressure as the owners will demand for fare hike. Relatively it would have lesser effect on the economy as the passengers solely will be compelled bearing burden of the fare hike unlike on the commercial vehicles’ categories of goods carriers and buses.

**6. Concluding Remarks:** The motor segment of the non-life insurers in India struggles to sustain a decent level of net profits although having positive net profits over the last few years except one. High deflection was found in the profit level over the last decade. This was emerged after the ascended incurred-claims ratio, and towered magnitude of operating and commission expenses. The insurers in India including non-life insurers were required find income other the sources than insurance premium since income from the main product was insufficient. The insurers were drawing larger level of income from the investment in financial market of the country. The long-standing ascended motor vehicle accidents in the country with higher severity enhance the committed expenses. Thus the paper argues that the premium hike initiated by IRDAI was in right time and necessary to save the industry. At once, the hike could have been optimal as the significant rise in premium rates would have severe impact on the economy.

Even though the hike could be justified on the ground of higher incurred-claims ratio, dishevelling net profits and ascended severity of the accidents, the micro and macro economic impact of the premium hike should not go unnoticed. The premium hike on commercial vehicles especially goods carriers and buses would be instigated for higher incidence on the commons as the price level might be scaled up in future. This would happen due to the fare and freight hikes which may be resulted by the side of. Living standard of the commons would be deeply affected and they might be compelled to rearrange the tight family budget. The hike on other commercial vehicles and private vehicles would have relatively lesser impact on the economy as only the selective users would have to bear the burden.

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