F. No: 52/SY/CCP/2012

COMPETITION COMMISSION OF PAKISTAN
GOVERNMENT OF PAKISTAN

7th Floor, ISE Towers,
55 – B, Jinnah Avenue,
Islamabad
Tel:+92-51-9100260-63
Fax: +92-51-9100297

POLICY NOTE

EXCLUSIVE RIGHTS OF NICL TO INSURE PUBLIC PROPERTY

1. The Competition Commission of Pakistan ("the Commission") is mandated under Section 29(b) of the Competition Act, 2010 (the 'Act') to review policy frameworks for fostering competition and to make recommendations for amendments to laws that affect competition in the country. This policy note recommends amendment to Section 166 of the Insurance Ordinance, 2000 which currently prevents competition in the non-life insurance market by extending exclusive rights to National Insurance Company Limited with respect to insurance of public property.

I. Background

2. National Co-Insurance Scheme, a pool of Pakistani insurance companies was constituted in 1955 to help develop smaller Pakistani companies. In 1973, following the Government's decision to nationalize all types of industry, National Co-Insurance Scheme was converted into National Insurance Fund. Thereafter, under the National Insurance Corporation Act, 1976 the National Insurance Fund was converted into National Insurance Corporation in 1976 and became the sole insurer of the public sector enterprises. In 2001 the government changed the legal status of the National Insurance Corporation to National Insurance Company Limited (NICL) under the National Insurance Corporation (Reorganization) Ordinance, 2000. NICL is the only state owned company, under the administrative control of the Ministry of Commerce, which is involved in non-life insurance business in the country. Beside this, there are around 39 private insurance companies involved in non-life insurance business in Pakistan.

3. In pursuance to financial service commitments under WTO financial service agreement in December 1997, the Federal Government opened the insurance market as one of its financial sector reforms. Actual impetus to the reform process came with the promulgation of the Insurance Ordinance, 2000. However, the Federal Government permitted only NICL to underwrite and insure public sector property/liability. Section 166(3) of the Insurance Ordinance, 2000 provides that all insurance business relating to any public property, or to any risk or liability appertaining to any public property, shall be placed with NICL only and shall not be placed with any other insurer. The relevant portion of the section reads:

> *166 (3) Subject to the provisions of sub-sections (4) and (5), all insurance business relating to any public property, or to any risk or liability appertaining to any public property, shall be placed with the Company only and shall not be placed with any other insurer:*

4. Public property has been defined in Section 166(2) of the Insurance Ordinance, 2000 as property which includes moveable or immovable property belonging to the Federal Government, a Provincial Government or a local authority or statutory corporation or any company, firm, undertaking, institution, organization or other establishment which is managed or controlled directly or indirectly by the Federal or a Provincial Government or local authority or statutory corporation.

5. Section 166(4) of the Insurance Ordinance, 2000 states that the Federal Government may by order in writing or notification in the official Gazette exclude any public property which comes under the exclusive domain of NICL. However, NICL has informed that it has not received any such order/notification issued by the Federal Government. Thus, absence of any order/notification to exempt any public property reinforces the statutory monopoly of NICL as envisaged under Section 166(3) of the Insurance Ordinance, 2000.

II. Issue

6. We are of the considered view that the statutory monopoly of NICL as envisaged under Section 166(3) of the Insurance Ordinance, 2000 and in the absence of any order/notification to exempt any class of public property from application of 166(3) restricts competition in the insurance sector for the reasons recorded below.

III. Competition Concerns

A. Statutory protection defeats the tenets of free market

7. Competition is a key to economic growth because it provides more choice, strong incentives for undertakings to be more efficient than their rivals and to reduce their costs and innovate. Where government generates statutory protection in the form of monopoly, whether advertently or inadvertently, it reduces competition. Paradoxically, in such situation the cure (competition) is not allowed to treat the virus (monopoly power), because the government has already rendered the virus immune from the treatment.

8. Choice of creating a statutory monopoly over free competition may have deleterious effects to consumers. It deprives the consumers from the benefits of competition; more choice, better quality and a competitive price. Particularly, in this scenario where NICL's statutory monopoly has been created to insure public property, the government is the direct consumer and is denying itself the benefits of competition such as improved quality of service and competitive premiums.

B. Unbridled discretion to monopolize and harm consumers

9. The statutory monopoly of NICL can be distinguished from situations in which a business may have achieved a monopoly position through organic growth or development as a consequence of a superior product, business acumen, or historic accident. The monopoly position of NICL has emerged not because of business acumen but is the use of government power to monopolize through the creation of statutory barriers to reduce competition. It is important to highlight here that the total Gross Written Premium (GWP) of the non-life insurance sector in 2012 was PKR 57

billion out of which NICL had an approximate market share of 12% i.e. its GWP was PKR 6.84 billion. The total assets of the non-life insurance sector stood at PKR 159 billion with NICL having assets worth PKR 34.98 billion or a share of 22%. NICL therefore had a share in assets of 22% but its share in GWP was only 12%.[1].

10. Market power in conjunction with statutory protection allows for far-reaching negative effects on consumers in two ways. First, monopolist undertaking may act anti-competitively in its own market, where it can restrict output or raise prices. Second, a statutory monopoly for an undertaking can create distortions in another market by anti-competitively cross-subsidizing into product/service in which there is competition.

C. Monopoly

11. The statutory monopoly created under Section 166(3) of the Insurance Ordinance, 2000 in favor of NICL distorts the competitive process in the non-life insurance sector. Such preferential treatment creates de facto subsidies and reduces budgetary constraints on NICL leaving no incentive for NICL to maximize its efficiency.

12. Securities and Exchange Commission of Pakistan (SECP) has made observation in its Insurance Industry Reform Committee Report, 2014 that the law does not restrict NICL from underwriting the private sector property and risks. NICL is registered with SECP as a non life insurer and authorized to transact all classes of non life insurance business. Report further goes on to state that somehow preferential treatment has led to misconception that the role of NICL is restricted only to public property. This is the major reason that since the promulgation of the Insurance Ordinance, 2000, NICL has restricted itself to insuring public property only and that too in certain specific classes of insurance with almost stagnant market share despite having one of the largest asset and gross premium base among the non life insurers. Thus preferential treatment has emerged as a weakness of NICL with no experience in business acquisition.

D. Barrier to Entry

13. Statutory monopoly of NICL limits opportunities for potential businesses to compete because legislative exclusive rights create barriers to entry for the new entrants. These government imposed entry barriers reduce market dynamism as they limit the market's effectiveness in reducing inefficient market power of NICL.

14. While reviewing the other jurisdictions, it has been observed that the countries that made transition from nationalization to de-regulation are enjoying the fruit of liberation by removing or minimizing the impediments in competition. In 1972 non-life insurance sector in India was nationalized and General Insurance Corporation of India (GIC) was created. In 2002 when the Government of India liberalized the insurance sector, it split GIC to form four state-owned companies in the non-life sector who are competing alongside private insurance companies. Similarly, at the time of nationalization in Bangladesh Sadharan Bima Corporation (SBC) was incorporated in 1973. Sector was opened up for private companies in 1984 and today SBC underwrites only 50% of public property.

IV. Recommendations

[1] Page 32-35 Insurance Industry Reform Committee Report, 2014. Published by Securities &Exchange Commission of Pakistan

15. In view of the above, it is strongly recommended that the Federal Government may take measures to amend Section 166 of the Insurance Ordinance, 2000 in order to open insurance of public property to the private sector, excluding public property that is related to national security, which will create a level playing field for all nonlife insurers in the insurance market. This will result in new entrants entering the market which would increase the choice of insurance products and reduce premium costs for the Federal Government. At the same time, NICL would be incentivized to increase its operational efficiency in view of the increased competition. Sectors allied with the non-life insurance sector would also benefit from this increased competition.

ISLAMABAD, MAY 18, 2015