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EDITORIAL ANALYSIS

# Too Big to Fail: India's Insurance Regulation Needs Deeper Teeth

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# Too Big to Fail: India's Insurance Regulation Needs Deeper Teeth



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## INTERVIEW ANGLE

*"The D-SII framework designates three insurers as systemically important but does not require additional capital buffers — is enhanced governance supervision sufficient, or does India need stronger regulatory tools for insurance systemic risk?"*

## WHY IN NEWS

IRDAI designated LIC, GIC Re, and New India Assurance Company Ltd. (NIACL) as Domestic Systemically Important Insurers (D-SIIs) for FY 2025-26 on April 2, 2026 — the same three insurers designated every year since the framework was introduced in FY 2021-22.

## THE EDITORIAL ARGUMENT

India's D-SII framework for insurance is well-intentioned but incomplete. While designating LIC, GIC Re, and NIACL as systemically important creates reputational and governance incentives, the framework lacks the sharp regulatory tools that make RBI's D-SIB framework effective — particularly capital surcharges and credible resolution mechanisms. As India's insurance sector grows, this gap must be addressed.

## WHY D-SII MATTERS: THE TBTF PROBLEM IN INSURANCE

The 2008 global financial crisis laid bare how insurance companies can amplify systemic risk. AIG (American International Group) required a **\$182 billion US government bailout** — not because of conventional insurance losses, but because of its credit default swap (CDS) portfolio in its non-insurance subsidiary. The failure of AIG would have triggered cascading defaults across the financial system.

India's context is different but the logic applies:

- **LIC** holds over ₹50 lakh crore in AUM — overwhelmingly in government securities. A sudden LIC distress scenario would directly impact sovereign borrowing costs and the broader bond market



- **GIC Re** receives mandatory cession from all general insurers; its failure would leave the entire general insurance market without domestic reinsurance
- **NIACL** underwrites large portions of government insurance schemes (PMFBY, Ayushman Bharat support structures) — its distress would disrupt welfare delivery

## THE GAP: NO CAPITAL SURCHARGE

RBI's D-SIB framework requires designated banks to maintain **additional Common Equity Tier 1 (CET1) capital** — a hard buffer against stress. This forces D-SIBs to be more expensive to operate (funding the extra capital) but more resilient.

IRDAI's D-SII framework requires:

- Enhanced corporate governance (Board Risk Committee, Chief Risk Officer)
- Comprehensive risk management frameworks
- Enhanced regulatory supervision

It does **not** require additional solvency capital over and above the standard 150% solvency margin required of all insurers.

This asymmetry is problematic. LIC's solvency ratio has historically been relatively modest compared to private life insurers — the D-SII designation without capital surcharge provides governance oversight but not financial resilience enhancement.

## LIC'S UNIQUE STRUCTURAL RISK

LIC's implicit government guarantee — which policy holders widely assume exists — creates a classic **moral hazard**. The guarantee makes LIC policies attractive to risk-averse savers but may discourage LIC management from fully pricing risk into its products and investments.

LIC's listed status (post-May 2022 IPO) has introduced some market discipline, but the government retains ~96.5% ownership — effectively keeping LIC in a state-controlled category where market signals are muted.

## WHAT BETTER REGULATION WOULD LOOK LIKE

- 1 **Capital surcharge for D-SIIs:** Even a modest 0.5-1% additional solvency ratio requirement would build buffer while incentivising sound risk management
- 2 **Recovery and Resolution Plans (RRPs) with regulatory teeth:** Currently, RRPs are prepared but not publicly disclosed or stress-tested by an independent body
- 3 **Subsidiary structure requirements:** Where D-SIIs operate non-insurance businesses (LIC's real estate, GIC Re's investment subsidiaries), ringfencing should be mandated

- 4 **Climate risk stress testing:** Insurers with large agricultural (PMFBY) and property portfolios face growing climate-related exposure — this must enter the D-SII monitoring framework

## UPSC RELEVANCE

### GS Paper 3 — Economy

- IRDAI regulation; insurance sector growth; systemic risk in insurance
- D-SII vs D-SIB framework comparison; capital adequacy
- LIC IPO and mixed ownership model

### GS Paper 2 — Governance

- FSDC (Financial Stability and Development Council) coordination: RBI, IRDAI, SEBI
- Regulatory arbitrage and multi-regulator coordination

### Mains Keywords

D-SII, TBTF, IRDAI, solvency margin, capital surcharge, LIC, GIC Re, NIACL, systemic risk, FSDC

#### KEY FACTS

D-SII FY 2025-26: LIC, GIC Re, NIACL (designated April 2, 2026)

D-SII framework: introduced FY 2021-22 by IRDAI

D-SIB framework: RBI, introduced 2014; current D-SIBs: SBI, HDFC Bank, ICICI Bank

AIG bailout (2008): \$182 billion — landmark case for insurance systemic risk

Standard solvency margin (India): 150% of required solvency margin

LIC government ownership: ~96.5% post-IPO (May 2022)

Sources: [Economic Times](#), [IRDAI](#), [RBI](#)

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