A NOTE ON THE ACTUARIAL SOCIETY OF INDIA

The Actuarial Society of India (ASI) established in September 1944, is a collection of individual actuaries and actuarial students mainly working in India. The actuaries were in early days and are substantially even now Members of the UK Actuarial profession; Institute of Actuaries, London mostly and some belonging to Faculty of Actuaries, Edinburgh.

Since 1979 the ASI is a Member of International Actuarial Association and is actively involved in its affairs.

In 1982 the ASI was registered under Registration of Literary, Scientific and Charitable Societies Act XXI of 1860 and also under Bombay Public Charitable Trust Act, 1950.

The Society is headquartered at Mumbai.

In 1985 the ASI started examinations leading to professional qualification of an actuary, till then the accreditation was based entirely on UK Institute examinations.

ASI is a legally constituted body with power to accredit members as fully qualified members at fellowship level with a designation of Fellow, Actuarial Society of India (FASI). The accreditation is by examinations, which test knowledge and understanding of actuarial science and its practice at high standards of level in consonance with the policy of International Actuarial Association.

As of now most of the students are common students of ASI as well as the Institute of Actuaries, London.

The examinations, except at final fellowship level which are India-specific, are common with Faculty and Institute of Actuaries, London (the UK Institutes). This is keeping in view the education strategy of International Actuarial Association, under which the actuarial education is aimed to be common internationally upto generic level latest by year 2005.

ASI is governed by its rules and regulations and Memorandum of Professional Conduct which are legally enforceable and are thus subject to scrutiny of relevant laws.

ASI has Disciplinary Tribunal in place so as to enforce high standards of professional conduct and discipline.

ASI ensures that its members particularly those having signing-off responsibilities in terms of law/regulations have competency to do so by enforcing a system of Certificate of Practice (CoP) and Continuing Professional Development (CPD) programmes.

ASI is governed by Executive Committee of twelve elected members and number of Boards/Committees which report to it.

The ASI currently has 200 + members at the fellowship level and about 2,500 members at the student level. About 80 + fellow members work overseas.

Most of the members of ASI work in Insurance industry, Life and General Insurance both and quite good number are engaged in practice area of retirement benefits such as pensions and gratuity.

The ASI have always been involved in public policy matters of the Government as these relate to insurance, pension, social security and related matters. Specifically the ASI was formally involved in review of the Insurance Act, 1938, in 1951, in 1967 with Administrative Reforms Committee, in 1968 with a Committee to investigate expenses of LIC of India, in 1977 with Direct Tax Laws Committee, 1979 with Era Sezhiyan Committee to review the working of LIC of India and in 1993 with Malhotra Committee on reforms in Insurance sector.

ASI has been actively involved formally and informally with various issues of Insurance Regulation as dealt with by IRDA and currently Mr. Liyaquat Khan, President of ASI is a Member of Insurance Advisory Committee under Section 25 of IRDA Act, 1999.

November, 2002.

ASI due process for response to the Law Commission on "Comprehensive Review of Insurance Laws"

1. Members of Actuarial Society of India are engaged either as employees or as consultants in the business of insurance and therefore the ASI as a professional body of actuaries has stake into the issues relating to insurance business which are addressed through insurance laws.

2. The ASI since its inception has made its services available to the government and its committees addressing regulatory issues in insurance business from time to time. ASI as a matter of due process for submitting its views to the Law Commission on the comprehensive review of insurance laws has constituted a committee of experienced and senior members of ASI as under;

   i. **Shri S P Subhedar**, FASI, a past president of ASI – Chairperson of the Committee
   ii. **Shri Liyaquat Khan**, FASI, current president of ASI
   iii. **Shri R C Rao**, FASI, current Honorary Secretary of ASI
   iv. **Shri Nick Taket**, FASI, CFO & Appointed Actuary of HDFC Standard Life Insurance Company
   v. **Shri David Muiry**, FASI, Actuary of Swiss Re in India
   vi. **Shri A R Prabhu**, FASI, Appointed Actuary of New India General Assurance Company

3. The response document as submitted now is work of the above committee which has had the benefit of views from other members.

4. ASI due process requires such a document to be debated amongst its members, various boards and finally articulated by the Executive Committee which is the governing body of the ASI. The entire due process however, has not been completed yet and the enclosed "ASI Response Document" is to be taken as having gone through "limited due process" only.

5. As the matter progresses, ASI shall endeavor to make its submission after complete due process and therefore it may happen that some of the submissions being made now get refocused, modified or new points added.

Suggested framework for the comprehensive review of Insurance Laws

While appreciating that the need for review of insurance laws is self-evident, it is desirable that a framework is established so as to facilitate the review in a holistic, comprehensive and consistent manner.

It is recognised that considerable work has been done by International Association of Insurance Supervisors (IAIS) and International Actuarial Association (IAA) for laying down guiding principles for prudential supervision of insurance entities. While articulating the framework for comprehensive review of insurance laws it would be desirable to embed the principles initiated by these two bodies to the extent that these are seen to be applicable to India.

The following framework is, therefore, suggested;

1. When laying down insurance laws, **protection of policyholders' interests** while enabling to promote and maintain efficient, fair, secure and stable insurance markets, should be the primary objective.

2. Insurance industries and markets are of fundamental economic and social importance, nationally and internationally and the insurance markets are getting integrated into a global network. The insurance law should therefore **promote competitiveness** in this context.

3. The insurance law should enable **creation of supervisory authority** which should be operationally independent and accountable to the Parliament in the exercising of its functions and should have adequate powers, legal protection and financial resources to perform its functions.

4. The insurance law should provide for **licensing of insurance** and should require that in granting a license the supervisory authority should assess the suitability of owners, directors, and/or senior management, and the soundness of the business plan, which could include pro-forma financial statements, a capital plan and projected solvency margins.

5. The law should require observance of **highest standards of corporate governance** by insurance service providers and should enable the insurance supervisors for setting requirements with regards to ;

   i. the roles and responsibilities of the Board of Directors, the CEO and other defined senior managerial personnel,
   ii. review of internal controls that the Board of Directors and Management approve and apply,
   iii. require the Board of Directors to set standards for underwriting risks and set quantitative and qualitative standards for investment and liquidity management.

6. The law should require **establishment of standards with regards to assets equal to total of provisions for liabilities** and while doing so address issues such as;

   i. diversification by type,
   ii. any limits, or restrictions, on the amount that may be held in financial instruments, property, and receivables,
   iii. the basis for valuing assets which are included in the financial reports,
   iv. the safekeeping of assets,
   v. appropriate matching of assets and liabilities, and
   vi. liquidity.

7. The law should provide for and enable the insurance supervisor to **establish standards with respect to liabilities of insurers** and while doing so the insurance supervisor should be required to consider;

   i. what is to be included as a liability of the company, for example, claims incurred but not paid, claims incurred but not reported, amounts owed to others, amounts owed that are in dispute, premiums received in advance, as well as the provision for policy liabilities or technical provisions that may be set by an actuary,
   ii. the standards for establishing policy liabilities or technical provisions, and
   iii. the amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements with a given reinsurer, making provision for the ultimate collectability.

8. The **requirements regarding the capital to be maintained** by insurance service providers should be clearly defined and should address the minimum level of capital and the capital adequacy requirements should reflect the size, complexity and business risk.

9. The law should **recognise essentially global nature of reinsurance entities** as these aim to spread the insurance risk globally taking away the heat of risk concentration in a particular jurisdiction. The law should, therefore, enable the insurance supervisor;

   i. to take into account the global nature of reinsurance market while setting licensing or registration requirements,
   ii. the amount of credit taken for risks ceded, which should reflect an assessment of ultimate collectivity of the reinsurance recoverables.

10. The insurance law should recognise and require of the insurance supervisor to ensure that **insurance service providers exercise the necessary knowledge, skills and integrity** in dealing with insurance customers and that the insurance service providers;

    i. at all times act honestly and in a straightforward manner,
    ii. act with due skill, care and diligence in conducting their business activities,
    iii. conduct their business and organise their affairs with prudence,
    iv. pay due regard to the information needs of their customers and treat them fairly,
    v. seek from their customers information which might reasonably be expected before giving advice or concluding a contract,
    vi. avoid conflicts of interest,
    vii. deal with their regulators in an open and cooperative way,
    viii. support a system of complaints where applicable, and
    ix. organise and control their affairs effectively.

11. The insurance law should enable **processes to be established** for;

    i. setting the scope and frequency of reports requested and received from all companies licensed in the jurisdiction, including financial reports, statistical reports, actuarial reports and other information,
    ii. setting the accounting requirements for the preparation of financial statements,
    iii. ensuring that external audits of insurance companies operating in the jurisdiction are acceptable, and
    iv. setting the standards for the establishment of technical provisions or policy and other liabilities to be included in the financial statements.

12. The insurance law should **provide for and empower the insurance supervisor** in respect of the following;

    i. the power to restrict the business activities of a company, for example, by withholding approval for new activities or acquisitions,
    ii. the power to direct a company to stop practices that are unsafe or unsound, or to take action to remedy an unsafe or unsound business practice, and
    iii. the option to invoke other sanctions on a company or its business operation in the jurisdiction, for example, by revoking the license of a company or imposing remedial measures where a company violates the insurance laws of the jurisdiction.

13. The insurance law should deal with **professional secrecy** and provide for and ensure that the insurance supervisor;

    i. is constrained by professional secrecy in respect of information obtained in the course of its activities,
    ii. is required to hold confidentially any information received from other insurance supervisors, except where constrained by law or in situations where the insurance supervisor who has provided the information provides authorization for its release.

14. The **role of the actuary**, both within the insurance entity and in the position of the supervisor, is critical to the maintenance of financially sound insurance entities and therefore the application of actuarial expertise is an important component of the operation of insurance entities, insurance markets and insurance supervisory authorities.

15. The Insurance Law should recognise the **regulatory role of the Appointed Actuary** as a named individual on continuing basis in respect of an insurance entity who under the law is required to carry out an annual valuation of insurance liabilities in respect of insurance entities, determine the surplus available for distribution to policyholders and shareholders in respect of life insurance business and to ensure solvency of the insurance entity at all times.

16. The **roles and relationships of the Appointed Actuary and the external auditor** are enhanced by a clear definition of their rights and obligations under the law, their respective roles vis-a-vis insurers and supervisors and communication arrangements between the Appointed Actuary and the external auditor. The law, therefore, should recognise the role of the external auditor which is to express an opinion as to whether the final accounts of an insurer have been prepared in accordance with the identified financial reporting framework. The regulatory role of the actuary; the Appointed Actuary is to address issues and take responsibility for continuing solvency of the insurance entity and as at the accounting date to value and certify provisions in respect of insurance liabilities. The Insurance Law, therefore, should explicitly define role-boundaries of the external auditor and the Appointed Actuary and set a mechanism for transactions across these role-boundaries.

17. **Provisions of Insurance Law and related Regulations (by IRDA), Rules (by the Government) and administrative orders (by IRDA) should be in harmony** and all subordinate legislations should correspond to enabling provisions of the Insurance law.

18. Insurance law should reflect and set **provisions reflecting philosophy of the Government** of the day in relation to insurance markets and details of administration of the insurance laws should be enabled to be put in place by the authority. However, the Insurance law should enable by rules, the Government to put in place some aspects of its philosophy with the fundamentals provided for in the Insurance law.

Executive Summary

NB - The links are to the para in the ASI response document.

1. The existing principal insurance legislations are (link: Para 1)

   ⇒ **Laws;**
   - Insurance Act 1938 (IA '38)
   - IRDA Act 1999
   - Life Insurance Corporation of India Act 1956 (LIC Act)
   - General Insurance Business Nationalisation Act 1972
   - Marine Insurance Act 1965,

   ⇒ **Rules made by the Government of India under section 114 of IA '38.**
   - Insurance Rules, 1939 (IR '39)
   - Ombudsman Rules, 1998.

2. **Classification of Insurance Business (link: Para 4.1, 4.3)**:
   Insurance business has been classified as Long-term Insurance Business & General Insurance business and a suitable delineation between the two has been suggested. Each has further been classified into defined classes, based on their fundamental risk characteristics, for which a separate account of receipts and payments have to be maintained.
   Registration is suggested either for Long-term Insurance Business or for General insurance business.

3. **Powers to make Rules and Regulations (link: 4.2)**:
   Powers of the Central Government to make Rules shall, inter alia, allow for:
   - Stipulation of minimum capital, and the nature of capital, for an Insurance entity.
   - Maximum foreign equity that can be allowed in an insurance service provider.
   - Transaction of reinsurance business without incorporation as an insurer in India, and
   - Insurance operations in India by a specified entity without incorporation as an insurer.

   Powers of the Insurance Regulator (IRDA) to make regulations shall rest in areas other than where Central Government has powers to make Rules.

4. **Registration of insurers (link: Para 4.3, 4.11):**
   All entities including those established by Central/State Governments for carrying on insurance business, whether a distinct legal entity or Dept of Government, carrying on, or desiring to carry on, insurance business in India have to be registered under the Act.
   Lodgement and maintenance of (security) deposits by insurers, under the existing legislation, have outlived their utility against the minimum capital requirement of Rs.100/200 crores and hence should be removed.
   Reinsurance being a global business, branches of exclusive foreign reinsurers should be allowed registration for carrying on reinsurance business in India. Principal legislation may enable such branches for matching the value of domestic liabilities with the value of domestic assets, maintenance at all times of the solvency margin as specified and submission of annual returns and other information in the prescribed format, with the details to be regulated by the Authority.

5. **Capital and Solvency Margin for insurers (link: Para 4.4)**:
   Existing provisions on Capital and Solvency Margin are satisfactory in terms of general guidelines of the International Association of Insurance Supervisors (IAIS), except that only the minimum level of Margin has been stipulated without a control level; a position below which the Authority can get warning signals of an insurer in difficulties.
   The requirements in respect of co-operative societies have to be spelt out.
   Existing provision for divestment of promoter equity beyond 26% and any hike in the foreign promoter’s equity that is being talked about have to be reconciled when necessary.
   Powers of voting in excess of 2½% or 5% of the paid up equity capital, as the case may be, may require a review.

6. **Prudential Supervision (link: Para 4.6, 4.7):**
   IAIS recognises that the application of actuarial expertise is an important component of the operations of insurers, insurance markets and insurance supervisors. A system of appointment and approval of a named actuary with specified statutory responsibilities (responsible actuary) have been in vogue in many countries and existing IRDA Regulations provide for a similar set up. The role & scope for such an actuary (in India called Appointed Actuary), and also of an independent actuary, required in case of transfer of business have to be enabled in the principal legislation, with the details regulated by the IRDA.
   A clear enablement of the roles and role-boundaries of the Appointed Actuary, independent actuary and the auditor with regard to the prudential governance has to be made in the principal Act.

7. **Regulatory reporting (link: Para 4.5, 4.6, 4.8)**:

The classes of General Insurance business to be accounted on a one-year basis and three-year basis have been identified, to take care of reporting delays about premium- and claim-development in some classes and to get a truer and fairer value of the corresponding business.

The manner in which deficits in each of the policyholders' account are to be dealt with has to be spelt out, against the background of different options available.

Payment of bonus to the life insurance policyholders in the initial years by the shareholders out of capital earmarked for the purpose should be enabled in the current competitive environment.

Investment of Shareholders' funds is not regulated in the manner and to the extent that is now in India, in other jurisdictions. Regulation of investments may extend at best to only a portion of the shareholders' funds that corresponds to the control level of solvency margin, apart from policyholders' funds.

8. **Insurance Association of India and Tariff Advisory Committee (link: Para 4.10):**

In an environment of open market economy there is no need for Insurance Law to mandate the establishment of Insurance Association of India and Tariff Advisory Committee.

9. **Life Insurance Corporation of India (link: Para 4.12):**

Except the provisions relating to Capital and Solvency Margin, all other provisions of the Insurance Law should apply to LIC of India. The provisions in respect of solvency should be required to be applied fully over a period of say 10 years, after which section 37 of LIC Act may be considered to be repealed.

10. **General Insurance Corporation of India (link: Para 4.13)**

The compulsory cession of 20% in respect of general insurance should be abolished over a period of say 5 years and no compulsory cession should be introduced for life insurance. GIC should be capitalised adequately and should be enabled to develop its business capabilities as a re-insurer in a competitive and global environment.

11. **Convergence of Law, Rules and Regulations:**

Within the recommended framework of "Comprehensive Review of Insurance Laws", a number of provisions of the Insurance Laws have to be shifted to Rules (currently under section 114 of the Insurance Act, 1938) and Regulations (currently under section 114A of the Insurance Act, 1938) and some of the provisions of the Rules and Regulations have to be shifted to the principal legislation.

12. **Issues needing debate:**

The ASI response document throws up number of issues which are required to be further debated for appropriate articulation of provisions in the Law. It is suggested that these issues should particularly be facilitated to be debated in various fora. ASI plans to do this in due course. Such issues are;

Issue 1: How the long-term insurance business and General insurance business should be defined in a manner in which both the categories have distinct, non-overlapping and mutually exclusive subject areas. How the insurance risks on human life such as sickness, disabilities and alike should be categorised in to long-term insurance and general insurance business.

Issue 2: All insurance entities, whether companies, co-operatives, state owned (like LIC) or Departments of State/s (like Postal life or Insurance Departments of states) should be registered with IRDA. What would be implication on capital, solvency and structural changes required?

Issue 3: The upper cap on Foreign holding of 26% and divestment to public of promoter holding after 10 years needs examination in depth and whether changes are required in the Law on this count also needs looking into.

Issue 4: For certain classes of business under general insurance category, the reporting for financial statements is three years. There is need to examine whether raison-de-etre for this practice is still valid, particularly keeping in view advances in Information Technology and computing sciences.

Issue 5: Roles, responsibilities and protection of the Appointed Actuary from legal liabilities needs to be debated in the background of those jurisdictions where the Appointed Actuary system is in place for life insurance as well as general insurance, such as Canada and Australia.

Issue 6: Deficit in Policyholders' Fund/s is an issue needing solution keeping in view variety of factors, many of these competing, such as Shareholders' interest vis-à-vis Policyholders' interest. Tax regime has impact and so is the philosophy of Regulations as these relate to the reach and depth of the role of the Appointed Actuary. Convergence of views as between the Industry, Regulator and the actuarial profession is key to an acceptable and sustainable solution.

Issue 7: Roles, role-boundaries and transactions across such role-boundaries of Auditor and the Appointed Actuary needs debate, articulation and commonality of understanding.

ASI Response Document

1. Background:

1.1 The Law Commission of India has undertaken the work of comprehensive review of insurance laws for preparing a consultation paper and, in this regard, has invited the views of the public. The Actuarial Society of India (ASI) being a body of professionals closely involved in the insurance business has considered it necessary to place its views before the Law Commission of India. The submission herein is made in this perspective.

1.2 Currently the principal insurance legislations including Rules made by the Government of India consists of:

i) Insurance Act 1938;
ii) IRDA Act, 1999;
iii) LIC Act 1956;
iv) General Insurance Business Nationalisation Act 1971;
v) Marine Insurance Act 1965.
vi) Insurance Rules 1939; and
vii) Ombudsman Rules 1998

1.3 The comprehensive review will cover these principal insurance legislations.

2. Suggested Approach:

2.1 The insurance legislation in India did not keep pace with the developments in regulatory and insurance business environment in the other jurisdictions for variety of reasons. The opening of insurance business to private sector in Dec. 1999 has changed this situation and it has become necessary to review the insurance legislation in its entirety. In this respect it has been the experience in the other jurisdictions that it is beneficial to include only the general principles and regulatory powers in the principal legislation leaving the details to sub-ordinate legislation to be framed by the regulatory authority (IRDA).

3. Structure of the Principal Legislation:

3.1 Objectives:

i) The following could be put as the regulatory objectives:

- Create an environment of trust for the public in general and the stakeholders in insurance business in particular;
- Promote development of insurance industry on sound lines;
- Protect policyholders' interests; and
- Ensure continued financial viability of insurance industry and of the entities engaged in insurance business on long term basis.

ii) The principal legislation should lay down principles/legally sustainable framework that shall ensure that these objectives are achieved. The principal legislation should be a single legislation so as to embed a holistic and consistent approach.

4. Recommendations:

4.1 Definitions: (link: Section 2 of Insurance Act 1938)

a) *Insurance Business*:

i) The definitions of insurance business need review in the context of the current environment. The definitions suggested are on the premise that the insurance business is divided into two categories,

- Long Term Insurance Business broadly but not entirely what is now defined as life insurance; and
- General Insurance Business, which is generally also called non-life insurance or Property & Liability insurance business in some jurisdictions

ii) These businesses could be divided into classes as follows:

- Classes of Long Term Insurance Business – Section 2(11) of Insurance Act 1938

Number	Description	Nature of Business
A	Life Insurance	Effecting and carrying out contracts of insurance on human life but excluding contracts within Class B herein.
B	Linked long term Insurance	Effecting and carrying out contracts of insurance on human life where the benefits are wholly or partly to be determined by reference to a specified index or value of the underlying assets.
C	Health Insurance	Effecting and carrying out contracts of insurance providing specified benefits against risks of morbidity or of persons becoming incapacitated in consequence of sickness or accident, being contracts that are expressed to be effected for a period of not less than 3 years.
		Effecting and carrying out capital redemption contracts.

D	Capital redemption	Effecting and carrying out contracts of funding superannuation schemes and gratuity schemes and contracts of annuities on human life.
E	Pension, Gratuity and Annuity	Effecting and carrying out contracts of insurance for a period of not less than three years providing fixed pecuniary benefits against risks of the person insured- a) Dying as the result of accident; or b) Becoming incapacitated in consequence of accident. c) Sustaining injury as a result of an accident
F	Accident Insurance	

- Classes of General Insurance Business :- (Link: Secs. 2(6A, 6B, 13A & 13B) of Insurance Act 1938)

Number	Description	Nature of Business
A	Fire Insurance	Effecting and carrying out contracts of insurance against loss of or damage to property – other than covered under classes B to E below – due to fire, explosion, storm, other natural forces, nuclear energy or land subsidence or due to any other event.
B	Goods in transit (Marine cargo)	Effecting and carrying out contracts of insurance against loss of or damage to merchandise, cargo and all other goods in transit irrespective of the form of transport and risks in addition to or as incidental to such transit.
C	Marine Insurance (Marine - other than cargo insurance)	Effecting and carrying out contracts of insurance upon vessels used on sea or on inland waters or upon machinery, tackle, furniture or equipment of such vessels as also against damage arising out of or in connection with use of such vessels, including third party risks and carrier's liability.
D	Motor vehicles	Effecting and carrying out contracts of insurance against loss of or damage to vehicles used on land – including railway rolling stock – damage arising out of or in connection with the use of vehicles on land including third party risks and carrier's liability.
E	Aviation	Effecting and carrying out contracts of insurance upon aircraft or upon machinery, tackle, furniture or equipment of aircraft as also against damage arising out of or in connection with use of aircraft, including third party risks and carrier's liability.
F	General Liability	Effecting and carrying out contracts of insurance against risks of the persons insured incurring liabilities to third parties, risks being other than those covered under classes C to E above.
G	Accident & Health insurance	Effecting and carrying out contracts of insurance, as in classes 3 and 6 of the long-term insurance business, for a period of three years or less.
H	Miscellaneous general insurances	Effecting and carrying out contracts of insurance, which are not principally or wholly of any kind or kinds included in classes A to G above.

Issue 1	This issue of categories and classes of insurance business needs an industry debate.

Explanation: The objective of classification of insurance business into two broad categories and classes of insurance under each category is to achieve homogeneity of issues needing redressal through legislation and regulatory processes. Such homogeneity is achieved by looking at technicalities of insurance business coupled with policyholder/customer perspective issues.

b) ***Financial Service Provider***: shall mean any entity that is regulated by Reserve Bank of India / Securities Exchange Board of India / Insurance Regulatory and Development Authority.

c) ***Financial Year:*** shall mean the period from 1st April of a calendar year to 31st March of the following calendar year for purposes of the provisions of this Act or the Rules and Regulations framed thereunder.

d) ***Insurer:*** [Section 2(9) of Insurance Act 1938] means a legally constituted entity in any one of the following manners:
   i) a Company incorporated under the Indian Companies Act, 1956
   ii) a co-operative society registered under the Indian Co-operative Societies Act for the sole purpose of carrying on insurance business., and
   iii) a legal entity established by Central/State government either by an Act of legislature or under Indian Companies Act for the sole purpose of carrying on insurance business

   Provided however that a Fund, established under a Trust, constituted for the sole purpose of arrangements of pensionary or other employee benefits shall not constitute an insurer under the provisions of this Act,

   Provided further that a reinsurer, incorporated legally in any other jurisdiction for the sole purpose of carrying on reinsurance business, shall not be required to incorporate in India under the provisions of this Act, but shall be registered with the Authority for carrying on reinsurance business in India as a reinsurer,

   Provided further that the Authority may exempt by notification any legal entity established by Central/State Government from specified provisions of the Act or the regulations framed thereunder.

e) ***Jurisdiction***: This refers to a country, state, province or other territory with legally enforceable local insurance laws that relate to the incorporation or operation of insurance companies.

f) ***Non-Proportional Reinsurance***: A reinsurance arrangement where the risk is not shared proportionately between the reinsurer and the ceding insurer.

g) ***One-year accounting***: A basis of accounting that presents at the end of each year of account the estimated underwriting result of business exposed during the year.

h) ***Three-year accounting***: A basis of accounting that presents the estimated underwriting result of business written during a given underwriting year but accounted during a period not exceeding three consecutive one-year. A profit can not be struck until an underwriting year is closed at the end of three years.

i) ***Open year***: A year before an underwriting year is closed under the system of three-year accounting. No profit is removed in an open year, but any identified deficiency should be offset by the use of external funds.

j) ***Proportional Reinsurance***: A reinsurance arrangement where the reinsurer and the ceding insurer share the risk premiums and claims in the same agreed proportions.

k) ***Reinsurance:*** means Insurance purchased by an insurer in relation to its insurance liabilities.

l) ***Reinsurer:*** An insurer providing reinsurance cover.

4.2 Regulatory Authority (IRDA): - (link: IRDA Act 1999)

i) Chapter II – In respect of establishment of the Authority and its set up;

Chapter IV – Duties, Powers and Functions of the Authority;

Recommendations:

- In sub-clause (k) of clause (2) of section 14, the word 'regulating' may be replaced by 'prescribing investment pattern and monitoring of'';
- Sub-clause (o) of clause (2) of section 14 envisages contribution of specified percentage of premium income of the insurers to finance schemes for promoting and regulating professional organizations. In this provision, the 'premium income' may be replaced by 'surplus / underwriting profits';
- In managing its affairs, the regulatory authority must have regard to such generally accepted principles of good corporate governance as it is reasonable to regard as applicable to it.

Chapter V – Finance, Accounts and Audit of the Authority; and

Chapter VI – Miscellaneous – covering Sections 18 to 29 of the Chapter.

Recommendations:

- In clause (2)(b) of section 19, there is a reference to "Controller of Insurance'. This office has been defined under section 2(5B) and 2B of Insurance Act 1938. The words 'Controller of Insurance' may be replaced by "Administrator of Insurance".
- In clause (2) of section 25, accounting and actuarial profession need to be included.
- The need for proviso to section 29 may be examined.

- In the proposed principal insurance legislation, provisions of section 30, 31 and 32 would not be required.
- Powers of the Central Government to make Rules shall, inter alia, allow for
  a) Rules to prescribe minimum capital and nature of capital of an insurance and reinsurance company and an insurance co-operative society;
  b) Maximum foreign equity that can be allowed in an insurance / reinsurance joint venture;
  c) Transaction of reinsurance business without incorporating as a insurer in India; and
  d) Insurance operations in India by a specified entity without incorporation in India or registration as an insurer.

4.3 Registration of Insurers: Section 3 of Insurance Act 1938 and Rule 24 of Insurance Rules1939 -

Recommendations:

i) No person to conduct any category of insurance business – Long-term insurance business or General insurance business - unless the registration to conduct that category of business is obtained under the provisions of this Act. An insurer registered for either category of business shall be entitled to carry on one or more classes of insurance constituting that category.

Explanation: Classes of insurance have been defined, under paragraph 4.1 of this submission, within each category of business. An insurer that has been granted registration by the Authority for transacting either category of business can transact any one or more or all the classes of insurance business constituting that category.

ii) Every entity established by Central/State Government for carrying on or desiring to carry on insurance business shall be registered under the provisions of this Act.

ii) The extent of applicability of the other provisions of the Act and the Rules and Regulations framed thereunder, to the above entity should be enabled in the principal legislation, with the details left to the subordinate legislation.

Issue 2:	**The issue of registration of such entities and the exemptions to be granted needs wider debate.**

iv) (Rule 24 of the Insurance Rules 1939) – The issue of how to allow co-operative societies in the insurance business in the current environment will have to be addressed.

Explanation: section 94A of Insurance Act 1938 specifies that all the provisions of this Act applicable to corporate insurers will equally apply to co-operative insurance companies, save as provided by the Authority. . But the share capital and working capital under sections 95 and 97 of Insurance Act 1938 have to be addressed to.

v) Sections 7 to 9 of Insurance Act 1938 about maintenance of (security) deposits by insurers have outlived their utility and should be removed.

Explanation: Now that every insurance company incorporated in India has to have a minimum paid up capital of Rs.100 crore, the provision for deposit as prescribed in Section 7 may not be considered necessary. The deposit was prescribed when the insurers were not required to have capital or the capital requirements were very low.

vi) Reinsurance being a global business branches of exclusive foreign re-insurers should be allowed to register, under the provisions of the Act, with the Authority under an enabling provision in the principal legislation.

4.4 Capital and Solvency Margin: (link: Sections 6, 64V, 64VA & 95 of Insurance Act 1938 and Rule 57 of Insurance Rules 1939.)

Introduction: The IAIS (International Association of Insurance Supervisors) has released in January 2002 a paper specifying the principles of capital adequacy and solvency. According to this, an insurance company is solvent if it is able to fulfill its obligations under all contracts under all reasonably foreseeable circumstances.

Capital requirements are needed to absorb losses that can occur from technical and other risks. The technical provisions for this purpose have to be adequate, reliable, objective and allow comparison across insurers. Adequate provisions must be made for all other liabilities insofar as they are not included in the technical provisions.

The purpose of solvency margin is to provide a safety buffer against events that may occur outside the expected range of events for which risk reduction measures have been taken.

Capital adequacy and Solvency Margin have to address the extent of matching of assets and liabilities . Assets have to be appropriate, sufficiently reliable and objectively valued.

There should be a minimum level of capital and a control level that will be required. Insurance authorities have to establish a control level, or multiple control levels, that trigger intervention by the authorities in an insurer's affairs when the available Solvency Margin falls below this control level. The principal legislation shall have a framework providing the authorities latitude of action.

Recommendations:

i) The provisions of the Act and the Regulations framed thereunder on the Capital and Solvency Margin requirements are adequate on the above terms except that Section 64VA of Insurance Act 1938 provides for a minimum required Solvency Margin as per a specified formula or Rs.50/100 crores whichever is higher with no control level specified . The Solvency Margin falling below the control level will be a warning signal for the Authority about an insurer in difficulties. The Act should have enabling provisions for the Authority to lay down this control level of Solvency Margin.

ii) Sections 64V and 64VA may be replaced by a new section reading possibly as "An insurer shall, at all times, maintain an excess of the value of assets over the value of his liabilities to policyholders of not less than the higher of a specified minimum amount, or a sum or a percentage of such a sum as a control level, calculated as specified by the Authority, in Regulations to be published in the Official gazette, based on one or more of the technical or mathematical reserves, the sums exposed to risk, the premiums written or earned during the year or the claims paid or incurred during the year, both gross or net of the reinsurance ceded. The authority shall also specify and make rules for determining the value on assets and for quantifying the amount of liabilities for this purpose in the Regulations."

iii) Clause 2(b) of section 95 of the Insurance Act 1938 defines 'Co-operative Life Insurance Society'. This section does not envisage any share capital on which dividend or bonus is payable. However, section 97 of the Insurance Act 1938 envisages working capital of fifteen thousand rupees. These provisions will have to be reviewed in the context of the current environment. (Please see paragraph 4.3(ii) also)

iv) Clause (3) and Clause (4) of section 95 of the Insurance Act 1938 empowers the state government to make rules for registration and governing of co-operative societies for insurance of cattle or crop or both. This provision may have to be reviewed in the context of the experience of the banking industry in respect of the dual control of the Reserve Bank of India and the State Governments on Co-operative banks.

v) It would appear that the provisions of section 6AA (1) of the Insurance Act 1938 are envisaged to be applicable to private insurance companies only and not to the state owned insurance companies or insurance co-operative societies. This may be made clear.

vi) In the context of the recommendations of the N. K. Singh Committee to allow foreign equity in the insurance sector up to 49 % and the inclination of the government, as reported in the press, to allow such increase, the provisions of section 6AA(1) may have to be reviewed. Currently, most of the foreign promoters hold 26 % equity in the insurance joint ventures and if they have to raise their holding beyond the limit of 26 %, they will have to pay premium for acquiring such holding. If thereafter the promoter holding is required to be brought down to 26 % as envisaged in current legislation, it could result in losses for the foreign promoter at the time of divestment. The current thinking about the shareholding of an Indian insurance company after ten years, viz. promoters holding 52 %, 26 % by Indian promoter/s and 26 % by foreign promoter, with balance 48 % to be widely held by the public will have to change. The proposed principal legislation will have to address this issue.

Issue 3	**This provision has to have a further debate by the insurance industry.**

vii) The restriction on voting rights as envisaged in clause (6) of section 6A of the Insurance Act 1938 onwards may have to be reviewed in the context of present environment. It was reported in the press that the government was considering removal of the ceiling of 10% on the voting rights as it exists in the banking regulations.

viii) An insurer that fails to comply with the minimum solvency margin requirement shall:

a. submit to the regulatory authority a plan for the restoration of a sound financial position;
b. propose modifications to the plan or a previously modified plan, if the regulatory authority considers it inadequate;
c. put into effect any plan accepted as adequate by the regulatory authority.

ix) In order to protect the interests of the policyholders, provisions may be made similar to those of section 52A to 52D of the Insurance Act 1938, except that an administrator could be appointed by the regulatory authority without intervention of the Central Government. In this regard, intervention in the affairs of an insurance entity shall not be guided by the provisions of any other legislation, except the Insurance Act.

4.5 Financial Statements and Accounts: (link: Sections 10-14 of Insurance Act 1938 and Rules 25 to 28 of Insurance Rules 1939.)

Recommendations:

i) The Sections 10 & 11 deal with separation of accounts and funds; preparation of Balance Sheet, Revenue Accounts, Profit & Loss Account and Cash Flow Statements.
To ensure clarity, it should be made clear that accounts are required as follows:
- separation of the accounts of its shareholders and policyholders
- policyholders' accounts to be subdivided for each class of insurance business.
- subdivision for those sub-classes as is specified by the Authority.
- a single Balance Sheet for the entire insurer in the prescribed format.
- Indian companies having operations outside India should report on their foreign operations separately as well as for the total business.

ii) The principal legislation will have to provide for earmarking of the assets separately for each of these policyholders funds for which separate revenue accounts are to be maintained and for the Shareholders' funds.

iii) The existing Section 10(1) of Insurance Act 1938 may be amended as: "where the insurer carries on the business of "miscellaneous general insurance, or motor insurance or marine insurance business, whether alone or in conjunction with general business of another class, he shall keep separate account of all receipts or payments in respect of each sub-class of miscellaneous general insurance business, motor insurance or marine insurance business, as may be prescribed by the Authority in this behalf.:

iv) Each class of general insurance business, for which a separate account is kept of the receipts and payments in terms of this Act, shall be accounted on a one-year basis, except Goods-in-Transit and Marine insurances, Aviation insurance and Non-proportional reinsurance, which shall be accounted for on a three–year basis.
<u>Explanation</u>: It is the practice globally, for a majority of general insurance classes, to follow a basis of accounting that presents at the end of each period of account, the estimated underwriting result of business exposed during the accounting year. But, Marine insurance business, aviation insurance business and Goods-in-transit (transport) business globally follow a three-year accounting. In this three-year accounting, the estimated underwriting result of business written during a given underwriting year is presented. A profit cannot be struck until an underwriting year is closed after three years. This is because information on premiums and claims my take several years to develop. Non-proportional reinsurance also is accounted on this basis. Lloyd's use it for all their syndicates.
The three-year accounts present a better true and fair view of the business than one-year can. This has also to be viewed against the background of technological advances in communication achieved.

v) The principal legislation may provide only for the matters as covered in clause (1A) of section 11 of the Insurance Act 1938 and leave the details to be covered by the sub-ordinate legislation.

v) The principal legislation may provide for the time-frame for submission of the annual accounts.

Issue 4	This provision needs a further discussion by the insurance industry.

4.6 Prudential supervision and Actuarial responsibilities: (link: Section 3(B), 13, 22, 35(d) of Insurance Act 1938)

Introduction: IAIS has brought out a draft guidance paper in April 2002 on the role of actuaries in insurance and the IAA (International Actuarial association has offered its comments in October 2002.

This paper recognises that the application of actuarial expertise is an integral component of the operation of an insurer, insurance markets and insurance supervisory authorities. Actuarial skills include assessing risk and provisions for insurance companies, for example in life insurance, using the combination of discounted cash flows and probabilities. These require a detailed understanding of the probabilities of insurance risks, e.g. mortality and morbidity, claim frequencies and severities, skills in the use of statistical models as a basis of establishing or determining the adequacy of premiums (tariffs), setting the level of technical provisions and understanding volatility and adverse deviation.

The Appointed Actuary system adopted in India through IRDA regulations is on the premise of a named actuary appointed on continuous basis by an insurer, for carrying out laid down functions for life as well as general insurers.

The Appointed Actuary thus is clearly expected to act as a front-line controller of prudential financial management. The link to the insurance supervisor is through the legislative duty to "whistle-blow" if the Board or management of the company insists on pursuing a strategy, which the Appointed Actuary believes may have a serious adverse impact on the company.

The responsibilities of the Appointed Actuary are spelt out in the regulations and by implication this captures those provisions of the IA '38 and IR '39 which are mandated to be carried out by Actuary (but not necessarily the same actuary). These need to be and are supported by a detailed body of professional guidance. This, therefore, requires high levels of actuarial education and professionalism, and demands the active support and involvement of actuarial profession. The role of Appointed Actuary requires him/her to monitor the adequacy of assets to meet the liabilities on a continuous basis. This role includes providing a forward looking report to the Boards of directors on stress and scenario testing of a firm's current and future financial condition and playing a key role in the identification of risk and its successful management. The Appointed Actuary acts as a front-line controller, which makes it possible to reduce the degree of direct supervisory oversight. This is also based on the premise that the degree of comfort achieved this way by the legislator this way would not be achieved if all such functions were carried out within the office of the regulator.

In order to perform his/her functions as a proxy to the regulator, the Appointed Actuary has to monitor, in detail, all aspects which could impinge upon the company's financial position, in particular:

- product design;
- methods of marketing;
- volumes of business;
- premium rates
- options and guarantees;
- surrender values and paid-up values;
- investments held and changes in investment policy;
- current and likely future levels of expenses;
- current and likely future tax bases;
- reinsurance arrangements
- claims handling policy; and
- any contingent liabilities.

The whistle-blowing requirements increase not only the confidence of the Regulator but also the independence of the Appointed Actuary. It has, therefore, to be examined the extent to which the current provisions in the Regulations need to be embed in the Law and the various IA '38 & IR '39 provisions need to be amalgamated together forming the role of the Appointed Actuary. The current regulatory environment in Australia and Canada would appear to be providing a good framework to look at.

Recommendations:

i) The appointment/approval and role of the Appointed Actuary, in general, should be spelt out, for both the categories of insurance, in the principal legislation, with the details to be provided in the subordinate legislation.

<u>Explanation</u>: The scope of actuarial certification of the Actuary in life insurance are prescribed, included in Sections 3(2)(f), 3B, 13, 28, 28A, 40B, 64V(2) and 64VA(7) of Insurance Act 1938 and Rules 10-C, 17C, 25 & 27 of Insurance Rules 1939. There is no such provision for General insurance.

ii) An independent actuary – other than an Appointed Actuary – has been recognised for certain responsibilities both in the principal legislation and the subordinate legislation. The role and scope of an independent actuary should be spelt out in the principal legislation, with the details in the subordinate legislation.

<u>Explanation</u>: An independent actuary is at present required by the Authority to cause an investigation and valuation, if the report submitted by Appointed Actuary does not properly indicate the financial condition of the affairs of the insurer by reason of the faulty basis adopted in the valuation (section 22 of the Insurance Act 1938), in product pricing (subordinate legislation) and in mergers and amalgamations. (Section 35 (3)(d) of Insurance Act 1938). The role and scope of an independent actuary should be spelt out in the principal legislation, with the details in the subordinate legislation.

iii) Protection to the Appointed Actuary from civil and criminal proceedings lodged against him should be enabled in the principal legislation, with the details to be provided in the subordinate legislation.

<u>Explanation</u>: There is no provision at present, in the principal or subordinate legislation, offering protection against any civil or criminal liabilities arising out of responsibilities, obligations and duties of the Appointed Actuary. For example, the Appointed Actuary is to attend all the management or investment committee meetings and Board meetings and will be privy to all sensitive information of the company. It is likely that civil or criminal liabilities arise against him out of areas not directly connected with his responsibilities and duties.

iv) Policyholders Reasonable Expectations: (Paragraphs 8(e)(ii) & 8(g)(viii) of Appointed Actuary Regulations) – The subordinate legislation places the responsibility on the Appointed Actuary for protection of the policyholders' interest, including their reasonable expectations. This emphasis should find place in the principal legislation with the details to be provided in the subordinate legislation.

vi) Approval and removal of Appointed Actuaries: The appointment/approval of an Appointed Actuary has been indicated earlier in i) hereof for principal legislation. The power to remove an existing Appointed Actuary is indirect in that the Authority can only direct the insurer to remove and make a fresh appointment for his approval. The Authority needs to be vested with power to withdraw approval for an existing Appointed Actuary, whether the insurer desires it or not.

Issue 5:	**Roles, responsibilities and protects of the Appointed Actuary need further debate in the background of those countries where the Appointed Actuary system is in vogue for life as well as general insurance business. Examples are Canada and Australia.**

vii) The principal legislation shall empower the Authority to put in place a **Board for the sole responsibility of protecting policyholders** who may be prejudiced in consequence of the inability of insurers in case of insolvency to meet their liabilities under policies issued by them.

Apart from the existing provisions in the insurance legislation, both principal and sub-ordinate, for protection of policyholders' interest, it may be considered whether the principal legislation should provide for imposition of an industry level levy on the insurers to generate funds when required for restoration, say of 80% or 90%, of the benefits of the policyholders of the company that is declared insolvent, with due weightage for obligations under compulsory insurances.

Explanation: Despite all the efforts of the Government or the Authority, an insurer may have to be declared as insolvent under certain circumstances. The policyholders may require a bail-out in such circumstances by at least meeting their liabilities to the maximum extent possible. In the UK, the Policyholders Protection Act 1975 (PPA 1975) provides for establishment of a statutory body. The main responsibilities of the Board are:

- To administer the protection scheme from the time an insurer is referred to it to the settlement of claims/benefits under the PPA 1975.
- To secure the payment of 90% of any amounts outstanding under long term policies to individual policyholders at the beginning of liquidation. Broadly, the Board is to secure continuity of insurance to 90%, or if this proves impossible, to pay the policyholder a sum equivalent to 90% of the value of his policy.
- To settle 100% of compulsory insurance claims under general insurance policies to individual policyholders and 90% of the claims under other general insurance claims, and to arrange transfer of policy obligations to another insurer, failing which to return the pro-rata premium to all the policyholders.
- To finance its expenditure and the claims of policyholders by levies on authorised insurance companies, and also intermediaries, if so necessary. There are separate levies for general and long term business. The general business levy is raised on companies' net UK premium income for all classes of general business except marine, aviation and transport insurance business and reinsurance. The long term business levy is raised on companies' premium income from the UK long term policies effected after 31st December 1974. Neither levy may exceed 1% of the premium income liable to the levy in any one calendar year.
- To impose a levy only on failure of insurance companies, i.e. to meet expenditure they have already incurred, or which they expect to incur within a year.

vii) The principal legislation may provide for the time-frame for submission of actuarial reports which should be same as prescribed for accounts, as the accounts cannot be completed without completing the actuarial investigation. The principal legislation may prescribe that an actuarial investigation has to be carried out annually. The details may be covered in the subordinate legislation.

viii) The principal legislation may prescribe the manner in which the deficits in the policyholder fund be dealt with, such as – the deficit/s where the shareholders' funds are adequate to meet the deficit and the minimum solvency margin could be allowed to continue / cover up the deficit/s by transfer of the required amount from shareholders' funds to each segregated policyholder fund. The issue of deficit in the Policyholders' fund/s has to be addressed to keeping in view tax regimes besides interest of shareholders vis-a-vis policyholders. Should the laws or regulations need to address this issue or should it be left to be addressed to by the Appointed Actuary within the framework of his role as guardian of the policyholders' interest?

(ix) Clause (1) of Section 49 of the Insurance Act 1938 prescribes that "No insurer,……….,who carries on the business of life insurance………shall, for the purpose of declaring or paying any dividend to shareholders or any bonus to the policy-holders ………..utilize directly or indirectly any portion of life insurance fund or of the fund of such other class or sub-class of insurance business, as the case may be, except a surplus shown in the valuation balance-sheet…..”. In the early stages of a life insurance company when the policyholder fund is in deficit, the shareholders may, despite this, like to declare bonus to policy-holders which is financed by the shareholders. In the context of the provisions of clause (1) of Section 49 cited above, the bonus to the policyholders can be paid only out of the surplus disclosed at the valuation and for payment of bonus to the policy-holders as mentioned herein the shareholders have to transfer such an amount from the shareholder fund to the policy-holder fund as would, after meeting the deficit in the policy-holder fund, facilitate emergence of such surplus as is necessary to declare the desired bonus.

Issue 6	**This issue has to have a wider debate within the actuarial profession, the industry and Regulatory regime.**

4.7 Audit of Accounts: - (link: Section 12 of Insurance Act 1938.)

<u>Introduction</u>: In the IAIS paper referred to in paragraph 4.6, the relationship between actuaries and auditors has also been stressed.

The primary role of an external auditor is to express an opinion as to whether the financial accounts of an insurer have been prepared in accordance with the identified financial reporting framework. This opinion helps to establish the credibility of the financial statements and may be relied upon not only by the supervisor but also by the shareholders, policyholders, rating agencies and tax authorities.

In auditing the accounts of an insurer, the auditor must address the technical provisions established by the insurer. While auditors and actuaries may be subject to different legal frameworks across jurisdictions, the work of an auditor and an actuary are closely linked.

In particular, the relationship between actuaries and auditors is enhanced by:

- Clear definition of the roles of the actuary and the auditor; and
- Arrangements for formal communication between the actuary and the auditor.

In the subordinate legislation in India, the assumptions made in arriving at the technical provisions/liabilities to the policyholders have to be included in the Notes to accounts and the auditor certifies whether the actuarial valuation of liabilities is duly certified by the Appointed Actuary including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the Authority or Actuarial Society of India in concurrence with the Authority. The roles of the auditor and the Appointed Actuary have been made very clear in the legislation.

Recommendations:

i) The principal legislation may have to provide for auditing of the accounts in general with the details laid down in the sub-ordinate legislation. The regulations shall specify the requirements as to qualifications, experience and other matters in respect of auditors as may be required.

ii) The principal legislation should lay down the time limit for filing the audited accounts and leave the details to the subordinate legislation.

viii) A clear enablement of the roles of the actuary and the auditor with regard to the appropriateness of the policyholders’ liabilities has to be made in the principal legislation, with the details to be provided by the Authority.

Issue 7	**This issue of roles, role-boundaries and transaction across role-boundaries of Auditor and Appointed Actuary needs debate and redressal.**

4.8 Investment and asset management: (link: sections 27 to 28B of Insurance Act 1938 and Rules 10A to 10D of Insurance Rules 1939.)

Recommendations:

i) The principal legislation should provide that the policyholders’ funds should be invested, and kept invested, in a manner in which they are most likely to meet the emerging policy liabilities. In support of this, the shareholders’ funds to the extent of the control level of the solvency margin should also be regulated. The balance portion of the shareholders’ funds is not to be regulated.

<u>Explanation</u>: In most jurisdictions, investment of shareholders’ funds is not regulated. As such, the regulations may not prescribe any pattern for investment of shareholders’ funds except as mentioned above.

ii) No insurer shall directly or indirectly invest outside India the funds of the policyholders in respect of or supporting domestic liabilities, without the express permission of the Authority.

iii) The regulatory authority shall make regulations in regard to the investment of assets representing each of the funds constituting policyholder funds and that portion of the shareholders’ fund that is required to meet the control level of solvency margin on the following matters:

- the localisation of such assets;
- the currency of such assets;

- the concentration of such assets;
- the permitted classes of investment for such assets;
- time, manner and other conditions of investment of such assets; and
- information to be provided to the regulatory authority in regard to such assets.

iv) the principal legislation shall require the investment returns, on the assets allocated or deemed as allocated to each general insurance class of business for which separate accounts are maintained, included in each Revenue Account to reflect a true and fair view of each such class of business.

Explanation: At present, there is an invitation to show investment income for each class of general insurance business in the corresponding revenue account but is not consistently being filled up by the industry. The underwriting losses being shown do not represent the true nature of profitability of the class of business, as the income/gains earned on the technical reserves of the policyholders do not get reflected. (In general insurance, investment income is not, under all classes, a factor built into the costing of premiums and so the investment income actually earned is taken to the shareholders' funds. In one way, this positive investment return and the negative underwriting result get netted and the shareholders are responsible to meet the net deficit in each class) This can be ensured through sub-ordinate legislation, provided enablement is made in the principal legislation.

v) "Controlled Fund" has been defined in Section 27A of Insurance Act 1938 and this should be removed to suit the current environment.

4.9 Mergers and Amalgamations and Winding up: (link: Sections 35 to 37A and 53 to 61 of Insurance Act 1938.)

Recommendations:

i) The broad principles of sections 35, 36, 37, and 37A may be retained, except that the powers to approve transfers and amalgamation shall lie with the Court rather than the regulatory authority. The broad principles shall be:

- The principal legislation shall provide that, where it is proposed to carry out a scheme under which the whole or part of the insurance business carried on by one insurer is to be transferred to another, the scheme must receive the prior approval of the Court. Either of the insurers involved may seek the approval of the Court.
- The principal legislation shall provide that the Court shall not consider an application for approval of such a scheme unless the application is accompanied by a report on the terms of the scheme to ensure that the interests of the existing policyholders were not compromised.
- The regulatory authority shall make regulations as to the information that must be provided as part of the application for approval.
- The court must be satisfied that any such scheme does not disadvantage any of the groups of policyholders that are affected by the transfer either directly or indirectly, before it grants approval.
- The Court shall not sanction the scheme unless it is satisfied that the transferee company is, or immediately after the making of the order will be, authorised to carry on the business transferred under the scheme.
- The competent court to pass such order could be the court not lower than the High Court of a state.

ii) Sections 53, 53A, 54, 55, 56, 57, 58, 59, 60 and 61 can be retained broadly but with the following suggested changes:

- Section 53 (2)(a) :Increase the required number of policyholders to 500 and the total value of their policies to be at least Rs.1 crore, with value being defined as surrender value.
- Section 55: The rule contained in the seventh schedule be moved into the main text to give it greater prominence.
- Section 56: An actuary approved by the Court to advise the Court on a variety of schemes to distribute the surplus to the policyholders.
- Section 60: Policy values to be determined by an actuary approved by the Court.
- Section 61: An actuary approved by the Court to advise the Court on a variety of schemes to reduce the benefits of contracts.
- A Board shall be established by the principal legislation for the sole responsibility to protect the policyholders' benefits in the event of winding up of an insurer. Please refer paragraph

4.10 Conduct of insurance business (link: Section 48, 40A, 40B, 40C, 64A to T, 64U to UM):

Recommendations:

'Fit and Proper' Officers

i) Key officers shall mean persons responsible for functions of the insurer, by whatever designation called (such as CEO or Managing Director), and shall include the person in-charge of the Overall management of the insurer, functional heads of actuarial; Marketing, Sales & Distribution; Investment & asset management; Financial Management and person to be appointed as Appointed Actuary.

ii) Without prejudice to the provisions of the Companies Act 1956, the principal legislation may lay down the minimum number of directors that an insurance company shall have;

iii) The directors of an insurance company shall be persons of ability, integrity and standing, shall not have been found guilty of moral turpitude or convicted of any economic offence or violation of any securities laws or Securities Exchange Board of India (Mutual Fund) Regulations 1996 and shall not have been working for or be director of any financial services provider whose registration had been suspended or cancelled any time by the relevant regulatory authority. The appointment of directors shall be with prior approval of the regulatory authority;

iv) The concept of policyholders' director may be dispensed with and instead the concept of independent directors be introduced. The 'independent' status could be defined as not having any association with the promoters or their subsidiaries in any manner whatsoever.

v) The principal legislation shall also lay down number of independent directors in relation to the total strength of the board of directors as also stipulate the absolute minimum number of independent directors;

vi) The key personnel of an insurance company shall not have been found guilty of moral turpitude or convicted of economic offence and shall not have been working for any financial services provider whose registration had been suspended or cancelled any time by the relevant regulatory authority.

vii) The requirements in respect of the CEO and Managing Director may be similar to those provided for in sections 34A and 34B of the Insurance Act 1938.

viii) Every insurer shall appoint an Actuary, designated as Appointed Actuary, as a key officer, in the manner prescribed by the regulatory authority in the subordinate legislation. The regulatory authority may also lay down the functions of the Appointed Actuary who shall carry out those functions in accordance with Actuarial Practice Standards.

***Advertisement and publicity* (link: IRDA regulations):**

ix) The principal legislation may stipulate that regulations may be made as to the form and contents of advertisements. Regulations made, may make different provision in relation to insurance advertisements of different classes or descriptions. For the purpose of regulations "insurance advertisement" shall mean an advertisement inviting persons to enter into or to offer to enter into contracts of insurance, and an advertisement which contains information calculated to lead directly or indirectly to persons entering into or offering to enter such contracts shall be treated as an advertisement inviting them to do so. Any person who, by any statement, promise or forecast which he knows to be misleading, false or deceptive, or by any dishonest concealment of material facts, or by the reckless making, dishonestly or otherwise, of any statement, promise or forecast which is misleading, false or deceptive, induces or attempts to induce another person to enter into or offer to enter into any contract of insurance with an insurance company shall be guilty of an offence;

Intermediaries:

x) In respect of appointment/licensing of intermediaries the principal legislation may lay down the general principles and the details be left to be covered in the sub-ordinate legislation. It may also be considered whether provisions of section 44 should be retained;

xi) It may be considered whether the provisions of section 41 be retained in its present form;

xii) The limitation of expenditure on commission and expenses of management should be retained in the principal legislation;

xiii) The principal legislation may provide for right to withdraw from transaction in respect of long-term insurance policy, i.e. "Free Look" for a specified period effective from the date of receipt of the policy document by the policyholder, the details of which shall be spelt out by the subordinate legislation.

<u>Explanation</u>: Through this provision, the policyholder gets a right to withdraw from the long-term insurance contract, if he so desires. Since the policy document is governed by the Contract Law, a statutory notice has to be issued by the insurer bestowing the right of cancellation for the policyholder within the specified period effective from a date to be specified by the Authority.

xiv) The principal legislation may have provisions similar to those of section 45 of the insurance Act 1938 regarding suppression of material information by the proposer.

Rural and Social Obligations;

xv) Every insurer carrying on long-term insurance business shall in every regulatory reporting year write certain percentage of the total number of policies written by it during that year from the rural area. Such percentages shall be prescribed by the regulatory authority from time to time. The characteristic of the place as 'rural' shall be determined as per the provisions of the latest census report.

xvi) Every insurer carrying on life insurance business shall in every regulatory reporting year provide life insurance cover to such number of lives from the economically weaker sections of the society, by whatever name such sections are referred to, as shall be prescribed by the regulatory authority from time to time.

xvii) Every insurer carrying on general business shall in every regulatory reporting year write such volume of business from the rural area as shall generate premium income that shall bear such percentage to the total premium income of the insurer as shall be prescribed by the regulatory authority.

Criminal Proceedings:

xviii) The provisions in respect of this may have to be in keeping with the current environment. They shall not be guided by the provisions of any other legislation, except the Insurance Act.

xix) The penalties that may have to be in keeping with the current environment.

Insurance association of India:

xx) The Insurance Act, 1938 provides for constitution of Insurance Association of India and its two Councils, Life Insurance Council and General Insurance Council. The setting up these self regulatory bodies should be totally left to the insurers and no provision therefor is considered necessary in the legislation, whether principal or subordinate.

Tariff Advisory Committee:

xxi) The regulator has already announced phasing out of the tariff structure in India. There will be no point in the principal legislation carrying full details of the Tariff Committee and the working norms. The Act may only provide an enablement like "The Tariff Advisory Committee that has been established after the commencement of the Insurance (Amendment) Act, 1968 shall continue to control and regulate the rates, advantages, terms and conditions that may be offered by the insurers in respect of any risk or of any class or category of risks. The Authority may, by notification in the Official Gazette, make regulations about its composition, the functions to be discharged and the procedures to be followed by the advisory Committee, as also about its powers to require information, to impose levies and control and regulate the rates, advantages, terms and conditions that my be offered by the insurers in respect of any risk, class or category of risks for a period to be specified from time to time or to cease such controls and responsibilities after a specified period."

Ombudsman:

xxii) Currently the Ombudsman Rules have been framed by the Ministry of Finance, Insurance Division, in terms of the powers conferred by sub-section (1) of section 114 of the Insurance Act 1938. This was possibly because there is no specific provision in the Insurance Act 1938 enabling establishment of the office of Ombudsman. It would, however, be appropriate to make provision in the principal legislation for framing of 'Ombudsman Scheme' as it is desirable that the scheme is operated under the provisions of the principal insurance legislation. The Financial Services and Markets Act 2000 of the UK provides for establishment of a body by the Financial Services Authority to operate the "Ombudsman Scheme".

4.11 Reinsurance (link: Section 101A to 101C of Insurance Act 1938 and Rule 39(12) of Insurance Rules 1939.):

<u>Introduction</u>: IAIS released a paper in October 2002 on "Principles on minimum requirements for reinsurance supervision". A summary is given below.

Reinsurers contribute to the stability of insurance markets. They can improve the risk profile and the financial soundness of primary insurers by diversifying and limiting territorial accumulations of exposure and consequently creating underwriting capacity. However, to have this stabilizing effect, these entities must be able and willing to meet their obligations as they fall due.

Reinsurers offer cover through traditional means or through alternative risk transfer products. They provide service across borders either directly oe by establishing subsidiaries or branches. Their business has to take account of the location of the risks, types of business or differences in regulation among jurisdictions while they operate on a global basis.

Internationally recognized principles for the supervision of reinsurers are needed because of global nature of business and the expectation that reinsurance business would expand, and because new entrants and expansion of business by existing reinsurers still have to offer acceptable security. Security of reinsurers has to be assessed by primary insurers and supervisors and whether they are subject to effective supervision in their home jurisdictions.

The minimum requirements for the supervision of reinsurers naturally differ from those of primary insurers. Conduct of business rules do not apply, since the policyholders of reinsurers are not customers and do not require the same protection. The supervisors should apply principles reflecting the characteristics of the reinsurance business and the types of business entailed. Regulation should take into account of and reflect best practices in the industry. It should not stifle innovation that would improve the efficiency and stability of the reinsurance market.

Supervisors should take into consideration limitations that reinsurers face. For example, they largely depend on information from primary insurers in establishing technical provisions. As a result, there may be significant delays in receiving claims information. The reinsurers thus have to have adequate systems for establishing provisions for claims incurred but not reported (IBNR) or incurred but not enough reported (IBNER). Higher complications arise for reinsurers in estimating these IBNR and IBNER provisions because of non-homogeneous portfolios, long tail classes or information delays.

Regulation and supervision of reinsurers' technical provisions, investments that also need liquidity and currency matching, capital requirements to take account of higher risk profiles and policies and procedures to ensure effective corporate governance should reflect the characteristics of the reinsurance business. But, for others like licensing, and its withdrawal, fit and proper persons requirement, on-site inspections, sanctions, internal controls and audit and accounting rules applicable to reinsurers should be the same as for primary insurers.

Recommendations:

i) It has been suggested that transaction of reinsurance business may be allowed without incorporation in India. Such entities shall match the domestic liabilities with domestic assets, both valued in terms of applicable regulations and shall maintain at all times a solvency margin as specified and submit annual returns and other information in the prescribed format.

ii) In respect of reinsurance ceded by the direct insurers to reinsurers, the principal legislation may only stipulate that this business shall be transacted as per the norms prescribed by the regulatory authority in the sub-ordinate legislation, including provision of accounting on one-year basis for proportional reinsurances and three-year basis for non-proportional reinsurances.

4.12 Provisions in respect of LIC:

LIC Act may be allowed to continue, but the principal legislation shall provide that the provisions, which are common to all insurers, will be governed by the Insurance Act and Regulations framed there under. The exceptions could be the solvency margin requirement for a period of say, 10 years from now, the power of Central Government to make Regulations specifically for LIC, distribution of surplus, guarantee of the policy benefits in cash by the Central Government, legal protection of members/employees of LIC.

Explanation: The LIC Act serves as a document akin to Memorandum and Articles of the insurer for running long-term insurance business and there should be a level playing field for all long-term insurance players, except:

i) maintenance of the minimum solvency margin for a period of say, ten years over which the Government can build up free resources from the amounts receivable by it as surplus distributed by LIC.

ii) Guarantee for LIC policies for payment in cash. Once the minimum solvency margin is built up, this guarantee can be stopped for fresh policies to be issued thereafter.

iii) Provisions for establishment of LIC, its constitution, functional activities and management of LIC, utilization of business other than long-term insurance, and winding up.

4.13 Provisions in respect of GIC and four state owned companies:

As the new National Re and the four PSU general insurers have been separated in August 2002, no further action seems necessary in the new Act. However GIC as a national re-insurer should not be required to function on the basis of mandated cession (currently 20% for general insurance) and in due course should develop in a open market and competitive economy. No mandated cession of life insurance business should be required.

KEY PROVISIONS OF INSURANCE LAWS

KEY FEATURES	INSURANCE ACT, 1938	INSURANCE RULES, 1939
Definitions	Section 2 (7A)	-
Registration	Section 3	Rule 24
Capital and solvency margin	Section 6, 64V& 64VA	Rule 57
Deposits	Sections 7 to 9	Rules 5 to 10
Financial statements and accounts	Sections 10 to 14	Rule 25, 26, 27 & 28
Actuarial certifications	Section 3(2)(f), 3B, 13, 28, 28A, 40B, 64V(2), & 64VA(7)	Rule 10-C, 17C, 25, & 27
Investment	Sections 27 to 28B	Rule 10-A, 10-B, 10-C & 10-D
Amalgamation and transfer of Insurance business	Sections 35 to 37A	-
Intermediaries and remuneration to intermediaries	Section 42D & 42E	Rules 55, 56, & 56-A
Reinsurance	Section 101A, 101B & 101C	Rule 39(12)

ACTUARIAL CERTIFICATIONS

Section 3(2)(f): At the time of applying for registration, a statement containing the assured rates, advantages, terms and conditions to be offered together with a certificate in connection with life insurance business by an actuary that such rates, advantages, terms and conditions are workable and sound, is to be given.

Section 3B: If it appears to the Authority that the assured rates, advantages, terms and conditions to be offered are not workable or sound, the Authority may require the insurer to make necessary modifications enabling the actuary, appointed by the insurer and approved by the Authority, to certify that the said rates, advantages, terms and conditions are workable and sound.

Section 13: Actuarial report and abstract relating to yearly investigation relating to financial condition of life insurance business along with a certificate by the principal officer that full and accurate particulars of every policy under which there is a liability either actual or contingent have been furnished to the actuary for the purpose of the investigation.

Section 28: Statement of investment of assets required to be submitted to the Authority every year, has to be certified by the principal officer.

Section 28A: Return of investments relating to controlled fund and changes therein, required to be submitted to the Authority every year, has to be certified by the principal officer.

Section 40B: Statements to be furnished to the Authority, in the prescribed form, certified by an actuary on the basis of premiums currently used by him in regard to new business in respect of mortality, rate of interest, expenses and bonus loading.

Section 64V(2): Statement of assets and liabilities assessed in the specified manner required to be furnished to the Authority, has to be certified by an actuary.

Section 64VA(7): Statement relating to required solvency margin maintained by the insurer, in the specified manner, required to be furnished to the Authority, has to be certified by an actuary.

Rule 10-C: Reference Section 28A mentioned above.

Rule 17C: Statement of the basis of premiums in respect of premiums currently used an insurer to be certified by an actuary.

Rule 25: An actuary investigating the financial condition of an insurer is required to furnish additional statements with regard to whether he has taken steps to prevent the policy reserve values from being less than the minimum surrender values and with respect to the proportion of renewal premium income spent in payment of commission and other expenses.

Rule 27: All returns in respect of dividing insurance business, one copy of which to be signed by an actuary who made the valuation.

GLOSSARY OF THE KEY WORDS USED

1. Appointed actuary - Same as responsible actuary.
2. Authority - The Insurance Regulatory and Development Authority (IRDA).
3. Insurance entity - All forms of insurers, insurance intermediary or other intermediary related to the insurance market falling within the purview of jurisdiction of the insurance supervisor.
4. Insurer - Same as Insurance Entity.
5. Insurance Regulator - Same as Insurance Supervisor.
6. Insurance Service Provider - Same as Insurance Entity.
7. Insurance Supervisor - Is the entity created to administer the Insurance Laws.
8. Jurisdiction - A country, state, province or other territory with legally enforceable local insurance laws that relate to the incorporation or operation of insurance service provider.
9. Regulations - Imply contextually laws and regulations or rules or orders issued under provisions of the Insurance Laws.
10. Responsible actuary - Actuary being a named individual appointed on continuing basis in respect of an insurance entity to ensure prudential supervision of insurance entity.
11. Subordinate legislation - Regulations, rules, orders put in place within the framework of Insurance Laws and actuarial practice standards as applicable to the appointed actuary and accounting standards as applicable to the accounting practices of the Insurance service provider.