



INSURANCE BROKERS ASSOCIATION OF INDIA

Comments on Insurance Laws (Amendment) Bill, 2008

The Bill introduced in Parliament to amend the Insurance Act 1936, the General Insurance Business Nationalization Act 1972 and the IRDA Act 1999 covers a large number of sections on the different legislations. The following comments are for purposes of convenience grouped under subject-wise.

Structure of insurance companies

(1) The amendment seeks to make it compulsory for the insurance companies to be public limited companies. (2) There is a provision to enhance the equity shareholding of a foreign company from the existing 26% to 49%. (3) The bill also proposes to scale down the requirement of capital for health insurance companies functioning on a stand alone basis to Rs.50 crores. (4) A further amendment seeks to permit Lloyd's to establish its presence in India and for a foreign re insurer having a stated net worth to open branches in India. (5) The bill also seeks to do away with the present section 6(A) which seeks to compel an insurer holding more than 26% of the equity in an insurance company to 26% by public sale etc., on a date and at a price to be approved by the IRDA with the previous sanction of the Central Government.

These amendments touch the very structure of an insurance company. The Malhotra Committee which went into the functioning of insurance business in India which led to the establishment of IRDA, clearly indicated in its Report that any new insurer should be a broad based company whose shares are quoted in the Indian stock market. In other words, the new companies would not only be public in character but will also carry the responsibility of accountability and openness in their transactions and would be available to public gaze and scrutiny. In the initial stages due to lack of public support to a new insurance company it was thought that the new insurer could be permitted and its shareholding in a limited manner by one Indian promoter and by one foreign promoter. This did not prevent the Indian promoter or the foreign promoter from bringing on board its associates. However the distribution of equity shares between the Indian and a foreign promoter was restricted to 74% and 26% of the issued capital. While the original bill provided for a divestment of Indian promoter shares from 74% to 26% on completion of six years of

Regd. & Admn. Office :
Maker Bhavan No. 1, 7th Floor,
Sir V. T. Marg, Mumbai 400 020.

Phone :
91-22-2270 0202 / 6631 4949
91-22-6631 4917 / 6631 4950

Fax :
91-22-2262 3747
91-22-2262 5112

E-mail :
inscbrokersasscn@vsnl.net
ibai@ibai.org
jbbmbi@jbbodamail.com

Website :
www.ibai.org

functioning, the Standing Committee in the course of discussion had modified the period from six to 10 years to provide an opportunity to the Indian promoter to cash in on their investment at least at a time when the new insurance company would start making profits. Hence, even in 1999 when legislation to broad base the Indian insurance companies was made, the recommendation of the Committee was not forgotten and there was a provision in the Act for a wide disbursement and holding of the new Indian insurance company's shares. This is why the present Act has stated the definition of an Indian insurer could be a company under the Companies Act.

The present prescription of enhancement of a foreign equity holders interest in an insurance company to 49% from the existing 26% will have its own fallout. The foreign entity could by itself or in association with others can hold 49%, an Indian promoter either by itself or in conjunction with others may not like to hold an holding less than that. This would mean that 98% of the entire shares of a new insurer would be held by two groups and only 2% of the shares would be available to outsiders. The present prescriptions and SEBI regulations etc may not permit such a small holding to be issued through the market where for any company to be listed a minimum of 25% of its issued shares must be held by the members of the public. Listing of company and the obligation of Corporate Governance rules which follows such a listing are essential for public accountability of such insurance companies. This will be the first casualty of the proposed change of enhancing 26% to 49%. Additionally if some Indian joint ventures would not like to hold 49% and holds let us say 10-11% of the issued capital, then between the Indian promoter and the foreign holder 60% of the shares will be held with 40% put in the market. This will result in foreign equity holder to have a greater say in running of the Indian insurance company and by far it would be the largest shareholder in the Indian company, the rest of the holdings being distributed amongst various other people.

If the Indian company shares were thus allowed to be floated in the market, then we will not be in a position to restrict the operations of FIIs etc. They would enter the market and corner the shares of such Indian insurance companies or at least those whose performance has been found to be of highest order. This will result in a position where if we put the FDI and FII holders together at any point of time, the major holdings in a new insurance company would not be Indian. It is not clear whether such a situation is envisaged in the present dispensation.

This will also not be in consonance with the provisions newly stated to be introduced that a new insurer should always be a public limited company. There is no clear explanation in the bill or its supporting documents why such an idle requirement is being prescribed.

Equity & Preference Capital

There is another requirement which the amendment bill seeks to support and that is that the capital structure of an insurance company – considering of shares other than equity shares. There are two issues to be taken note of. Shares other than equity shares carry an explicit cost of servicing. Preferential shares or debt capital carry a stated rate of return to its holders. The servicing of such a debt or subordinate capital will have to come out of the policyholders' interest or the shareholders' interest. The equity shareholders will obviously be reluctant to do this and if the policyholders' become responsible to service the debt, either their bonus eligibility would come down or the pure rate of premium which they are called upon to pay will go up. In other words, companies with non equity base would become less competitive in the market. It is to be examined whether such a possibility should be encouraged.

Permitting Foreign Reinsurers to do business in India through Branch Office

The issue regarding admission of Lloyd's to carry on business in India in its existing status has been hanging for a quite a number of years. Lloyd's is not an insurer. It is a market which offers facility to its members to come together and trade. Lloyd's used to be dominated by individual members with unlimited liability but this entire structure has undergone a change now and there are more number of corporates who are members of Lloyd's than individuals and the unlimited liability of members has been given up. Various syndicates operate in Lloyd's to do business. They maintain some deposits with Lloyd's to act as a buffer or a reserve in case of adversity. It is not clear from the present prescription in the amendment bill where all these syndicates who are underwriting business in Lloyd's would de facto become eligible to become Indian insurer. That would be a short prescription for chaos in the Indian market. We will be encouraging a set of people with no capital and solvency requirement eligible to enter the market to do business in Indian whilst an average Indian businessmen would have to put in a minimum of Rs.100 crores as capital and to be suggested to the Regulator about the continuous existence of the

solvency position. This would mean placing a premium on foreign direct entry as against a well-regulated entry for an indigenous or native operator.

The second corollary is the provision for a reinsurer carrying business outside Indian with a net worth of Rs.5,000 crores to enter India and set up business. The new business could be a branch of a foreign party. Obviously, the new amendment provision would mean that lack of Corporate Governance. The net worth of the association or a body set up outside India with absolutely no interest in India may result in an organisation totally outside the jurisdiction of the Indian Regulator. If the net worth were to suffer, as is possible, in the course of time, what corrective measures could be taken are not clear. It would also mean that such a foreign reinsurer would not be subject to bringing in any capital and the Indian regulation would confine itself to look at the working and trading results of the Indian branch. The foreign reinsurer opening a Branch should be made to put in a bank guarantee or capital equivalent to their liabilities. The present indication in the amending bill about such an possibility would certainly run counter to the interests of the Indian insurance companies which have to go through the regimen of fit and proper, solvency, capital adequacy and a host of other regulatory prescriptions regarding its functioning in India. Perhaps, encouraging a foreign reinsurer to get into India and run the insurance business rather than an foreign insurer coming and joining hands with an Indian party and bringing in FDI. This would be naturally the result because even amongst the present insurers in India where joint ventures exists between Indian party and foreign insurer, almost all those foreign insurers who are joint venture in India having reinsurance business and also have a net worth of the prescribed magnitude. In other words, we would be encouraging joint venture partners to withdraw from the present commitment and come into India in the branch route.

By permitting the foreign reinsurers to operate through the branch office would be to encourage them to deal with insurance companies directly who may or may not have the necessary expertise to handle complicated reinsurance contract. It is feared that such practices if encouraged would prove to be detrimental to the interest of the reinsurance brokers licensed and operating in India.

The Role of an Insurance Intermediary

An intermediary plays a very important role in insurance selling. Both for life and non-life companies, intermediaries like Agents, Brokers etc. are necessary not only to market the products of the

insurance companies but also to carry the message of insurance to the uninsured which will have the effect of deepening the insurance market. Traditionally the insurance market has been functional on the basis that an insurance agent represents an insurer. In other words, the appointment, control and guidance of an agent is exercised by the insurance company though the licensing has been done by the IRDA. On the other hand, a broker has been designated to represent an insured. In other words, he carries to an insurance company the requirements of an insured and tries to get the insured as good a quotation as possible from the competing insurers. The concept of intermediation had not received much of recognition in the Indian market during the period it was totally nationalized. The Life Insurance Corporation had the system of Agency mostly of individuals who were required by LIC to sell a minimum of 12 policies in a year to keep their agency alive. The recognition of a person as an agent was still in the hands of Controller of Insurance though he had surrendered his entire rights of appointing licencing etc. to LIC. In the case of general insurers, the feature was not much of selling of insurance. People were under compulsion to secure a risk cover for their products, because it was required by the lender or the financier, approached general insurance companies and obtained protection which was in currency with these companies. In other words, the general insurance business was carried on in the nationalized days at the mercy of the insurers.

On the insurance industry being broad-based in 2000, by the establishment of an independent Regulator and the induction of new insurance companies in the private sector came up, the necessity to broad-base the intermediation agencies was recognized. It was also thought necessary that the entire process of selection of agents or any other insurance intermediary, their training, their licensing and control over their conduct must be vested with a centralized authority. It was thought necessary then that the IRDA would assume this role to ensure a level playing field between the nationalized and the private industry. IRDA had prescribed minimum qualifications which have to be satisfied by a person who would like to act as an agent. The code of conduct was also brought into focus. The process of licensing was continued. A period of training was prescribed which could be carried out either through in house facilities or through recognized outside agencies. All these were meant to inject into the system of agency focus a position of professional attainment and qualifications. Simultaneously, the Regulator also brought into existence the system of insurance broking both direct broking and reinsurance broking. It is not as if the insurance market in the nationalized days did not know of reinsurance brokers. But the fact remains

that those brokers were not licensed by the Controller of Insurance and were mostly acting as the representatives of foreign reinsurers, the procedure brought into existence by the Regulator called for minimum educational qualification, a corporate set up, the presence of qualified professionals in the office of a broker, a minimum capital which a broker's organisation should have, a requirement of a professional indemnity insurance and also a system of a code of conduct. These requirements were implemented through the IRDA Brokers Regulations 2002. The IRDA also recognized the necessity to have reinsurance brokers in the Indian market. Therefore, a distinction was made between direct broking and reinsurance broking and separate qualifications were prescribed though the Regulator also permitted brokers to act as composite brokers when the monetary requirements regarding capital etc. were high. The professionalization of insurance intermediation was therefore set in motion by the Regulator, guided and controlled by it under its performance and the disciplinary authority also vested with the Regulator with regard to the continuance or otherwise of the periodical regulation.

It is now seen from the Amendment Bill that a radical change is being brought into existence in the agency structure of the industry. The proposal delinks the IRDA from the granting of licence. It also clandestinely introduces the removal of distinction between an agent and a broker. It indirectly eliminates the field of operation of an agent and an insurance broker. It also possibly changes the very structure of insurance intermediation where, as pointed out already, the edifice of intermediaries has been raised on the two pillars of an agency and a broking function where an agent is considered to be the extended arm of an insurance company and a broker an independent professional who markets the requirements of a customer in taking an appropriate cover from a right insurance company.

We were being exposed to this sort of a function even in early times during nationalization and pre nationalized days when an agent used to be a subordinate of a business person who had no apparent business qualifications, who had no knowledge of either Insurance Law or its Regulations and who was not receptive to the requirements of a customer or was not serving the customer's interest properly. His sole interest was in the selling of an insurance policy of his employer to benefit the insurance company and not the insured. The system generated dummy agents, benami agents and agents who surrendered their commission totally to their employers. These were the very systemic failures which were sought to be corrected by the professionalisation in insurance intermediation. The Malhotra Committee had also suggested such

requirements to be taken care of in the insurance arena. Thus, the purpose of amendment in the Bill takes us back to those early days where the consumer's rights were forgotten and there were a number of deficiencies in the system which only encouraged malpractice leading to the questioning of the very concept of a risk cover.

We have today a very vibrant system of a Broker force manned by professionals. Even chartered accountants and Engineers who had gone through their professional courses had qualified themselves by going through the specialized training prescribed by the regulations and have made a mark in insurance.

Powers of the Authority for regulating matters related to agency

The proposed Section 42(E) which starts with a non obstante clause gives rise to an impression that all sorts of intermediation in the insurance area will be placed on a same level or pedestal. The distinction so far in the area of intermediation between a broker and an agent will be done away with if Section 42(E) is implemented in its proposed form. The existing Section 42 which prescribes for a special limitation in the functioning of an agent is sought to be removed by the proposed Section 42(E). There will therefore be a contradiction in law if the amendment were allowed to go through.

Another important development by the proposed amendment would be that the system, which is considered to be essential in the interest of consumers, would face the process of elimination. If an individual agent could be enabled to represent a number of insurance companies both on the general and life sides, in his present form and status, the brokers will feel discriminated by a prescription of a traditional training, the necessity to establish themselves in a corporate form, the prescription of a minimum capital, the restriction on the quantum of business to be done through one particular client, the code of conduct prescribed, the professional indemnity bond prescribed etc. will rather become burdens on a broker. All Brokers will be tempted to surrender their licences and convert themselves into insurance agents. There will thus be no regulatory control over insurance intermediation and the Regulator has necessarily to depend on the insurance companies to rein in misbehaving agents. That may not be done in a growing market where an operating theory would be competition and growth of gross premium for an insurer. There will therefore be doors open for unethical practice to be introduced in the Indian insurance market. The IBAI feels that this would not therefore be

the right approach to be adopted by the Government. A second issue which the Committee might consider is that the Regulations and Rules made by the IRDA or the insurance companies would have the effect of overriding and super ceding the basic law of the land. In other words, subordinate legislation will tend to super cede the basic law of the land.

Concept of Penalties

The proposed Bill enhances the quantum of penalties that to be levied on insurers, insurance intermediaries etc. for breach of law and regulations. The quantum proposed in many cases running into crores does not seem to be particularly relevant to the type of breach which is sought to be controlled. Very often, the proposed Bill mentions quantum at Rs.10 crores, Rs.25 crores, Rs.50 crores etc. which in many cases would be a significant portion of the capital of insurance company itself and in case of insurance intermediaries many times the capital they are required to bring in. Therefore, the IBAI requires the Committee to look into this aspect and see that the quantum of penalty has some relevance to the breach of law supposed to be controlled.

Business from SEZ

Section 2(CB), proposed to be inserted in the Act, tries to make exception in the case of special economic zone where various insurers have been permitted to extend covers. This provision would go against the principle that no insurance company can carry on business in India without recognition from the IRDA. This would mean that the proposed insurer must get it's constitution recognized by the authority, it's products to be distributed in the market to be approved by or the File & Returns principle and it's function being subject to the supervision of the authority. Minimum requirements of capital and solvency perhaps would be not thought of in the proposed situation. This also will run counter to the new provision being sought to be introduced in the Insurance Act which is available under GIBNA now proposed to be eliminated from that Act and to be introduced under the Insurance Act stating that no Indian property would be offered for insurance to a non Indian insurer. There should not be any discrimination between insurance companies in offering their products in normal and special economic zones. An incidental issue would be where a foreign insurer fails to carry out his obligations in terms of a policy, whose jurisdiction will be invoked by the client to take care of his interest.

Definition of Health Insurance Business

New definition of health insurance business is proposed to be added to the Insurance Act by the Bill. The IBAI feels that such fractionalization of the total business of insurance into distinct varieties in an Act or Legislation could be avoided since the definitions add to a definite mess. There are so many features which apply commonly to the different classes of insurance and therefore to put these different types of policies to be granted by an insurer in a strait jacket might lead to practical difficulties in implementation of such provisions. In the case of the proposed definition, health insurance business is defined to include overseas travel insurance and personal accident insurance.

These are covers which are today extended to a large number by general insurers and as an add on by the life insurers. So, this proposed definition would therefore cut into the existing business of these companies. This may have an indirect effect on the intermediaries as well. Different classes of business carry different rates of compensation to the insurance intermediaries. Classifying some business which are today carried on by general insurers under health insurance would mean normally a shrinkage in the commission or brokerage payments to insurance intermediaries. This will affect therefore the quality of insurance intermediation and affect the growth of the market.

Powers of SAT

The conferment of appellate powers under the Insurance Act, the IRDA Act etc. on the Securities Appellate Tribunal, it is felt must be available to all interested parties viz. Consumers, intermediaries, insurers etc.

The IBAI would like to suggest the introduction of a new section in the Insurance Act 1938. All enactments that deal with the levy of a cess or a tax contain a provision for refund of excess money collected by the service organisation. They also provide for payment of interest on delayed issues of refunds. This feature is available in the Income Tax Act 1962 as well. The IBAI feels that a similar liability on the part of an insurance company must be built into the system where there is an inordinate delay in refunding excess premium and not settling claims properly within the prescribed period etc. Today, Insurance Law and Regulations do not provide for a time window within which period a claim has to be settled. Indications of this are however available in the code of

conduct introduced by the IRDA. To ensure the uniform approach and to recognize the legal obligation, these provisions must be incorporated in the Law itself so that there is a uniform procedure for implementation of such customer friendly measures.

Representation in the Life and General Insurance Councils

In our submission, we have clearly indicated that the role of a broker in insurance intermediation is as important as that of an agent if not more. A Broker has a professional approach in his dealings with his customers and the regulator. In fact, the Insurance Brokers Association of India is the only body of insurance brokers in India recognized by the IRDA. In such circumstances, the IBAI feels disappointed that its representatives are not made eligible to become Members of the General Insurance Council and the Life Insurance Council, based on their own standing and strength.

The new Section 64(F) mentions Agents, Third Party Administrators, Surveyors, Policy Holders etc., but omits to mention Insurance Brokers who are as important as the others. This deficiency may be kindly corrected by the Committee.

Conflict of Interest

The proposal in the Act envisages that a Director in an insurance company should not be a Director in a Broking Company or be an Intermediary. The IBAI feels that provision should also be made in the Law to prohibit majority shareholders or shareholders having substantial holdings in an insurance company be prohibited from promoting/floating outfits as insurance broker, corporate agents or agents as the case may be.