August 2013
IMF Country Report No. 13/265

India: Financial Sector Assessment Program—Detailed Assessments Report on IAIS Insurance Core Principles

This paper on India was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on February 22, 2012. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of India or the Executive Board of the IMF.

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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

INDIA

IAIS INSURANCE CORE PRINCIPLES

DETAILED ASSESSMENT

AUGUST 2013

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

THE WORLD BANK
FINANCIAL AND PRIVATE SECTOR DEVELOPMENT
VICE PRESIDENCY
SOUTH ASIA REGION VICE PRESIDENCY

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GLOSSARY

AFTR	Asian Federation of Insurance Regulations
ALM	Asset Liability Management
AUM	Assets Under Management
BCG	Boston Consulting Group
C&AG	Comptroller and Auditor General of India
CRORES	100 lakhs, a unit in the Indian numbering system equal to 10 million
FATF	Financial Action Task Force
FRBM	Fiscal Responsibility and Budget Management
FICCI	Federation of Indian Chambers of Commerce and Industry
FSAP	Financial Sector Assessment Program
FSDC	Financial Stability and Development Council
FY	Indian financial year (April through March)
GAAP	Generally Accepted Accounting Principles
GIC	General Insurance Corporation of India
HUDCO	Housing and Urban Development Corporation
IAIS	International Association of Insurance Supervisors
IAA	International Actuarial Association
IAI	Institute of Actuaries of India
IASB	International Accounting Standards Board
ICAI	Institute of Chartered Accountants of India
ICP	Insurance Core Principles
IFRS	International Financial Reporting Standards
IMTPIP	Indian Motor Third Party Insurance Pool
INR	Indian Rupees
IRDA	Indian Regulatory and Development Authority
JVs	Joint Ventures
LIC	Life Insurance Corporation of India
MAT	Marine Aviation and Transit
MCEV	Market Consistent Embedded Value
MMOU	Multilateral Memorandum of Understanding
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MTPL	Motor Third Party Liability
NHB	National Housing Bank
NUCC	National Uniform Claims Committee
OD	Own damage motor insurance
P&C	Property and Casualty
PML	Probable Maximum Loss
PSU	Public Sector Undertaking
RBC	Risk Based Capital
RBI	Reserve Bank of India

SAARC	South Asian Association for Regional Cooperation
SCODA	SEBI Committee on Disclosures and Accounting Standards
SIRF	South Asia Insurance Regulators Forum
SOM	Share of market
SRO	Self Regulating Organizations
TAC	Tariff Advisory Committee
TPA	Third Party Administrator
ULIP	Unit Linked Insurance Plan
USD	United States Dollar

I. Overview, Key Findings, and Recommendations

A. Introduction

1. **This assessment of India's compliance with the International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP) was carried out as part of the 2011 Financial Sector Assessment Program (FSAP).** Although this is the second FSAP for India, this is the first external assessment of India's compliance with the ICPs.

2. **The Insurance Regulatory and Development Authority (IRDA) has principal responsibility for insurance regulation and supervision in India, although the central government also has some reserve supervisory powers.**

B. Information and Methodology Used for Assessment

3. **This assessment is based upon information made available to the assessor in preparation for and during the June 2011 FSAP mission.** IRDA contributed its 2009 self-assessment and a detailed update thereof at the individual criterion level. Further sectoral information (including responses to a questionnaire sent out in advance) was provided before and during the mission. Required documentation, including all relevant laws, regulations, and circulars was available on IRDA's web-site and in the Insurance Act Manual, a copy of which was provided to the assessor by IRDA management.

4. **The assessment has also been informed by discussions with regulators and market participants.** The assessor[1] met with staff from the IRDA headquarters in Hyderabad, insurance companies, reinsurers, industry bodies and the actuarial and accounting professions (mainly in Mumbai), and the relevant officials in the Ministry of Finance in Delhi. The assessor is grateful for the full cooperation extended by all and, in particular, for the outstanding logistical support provided by IRDA.

5. **The assessment employs the 2003 version of the IAIS Insurance Core Principles and Methodology and is based on the essential criteria (EC) listed in that document.** The assessment also took into account IAIS standards and guidelines, and reference was made to peer review opinions where the methodology did not support a clear finding. A more comprehensive sectoral overview than normal has been included with this assessment, given the significance of the Indian insurance market and the fact that an accompanying technical note has not been produced.

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[1] The assessment was carried out by Rodney Lester, Consultant.

C. Institutional and Market Structure—Overview

6. **While income level and structural factors are highly predictive, certain policy variables also affect insurance sector development.** They include financial capacity, industry structure, distribution development, the level of government control, regulatory constraints, level of development of financial sector infrastructure and institutions (including securities markets, key professions and the rule of law), and consumer education and protection.[2]

Size, growth, and significance

7. **The insurance sector in India has a relatively large footprint relative to other forms of financial intermediation given India's income level.** This is particularly apparent when measured in terms of assets under management (AUM) – Table 1. The AUM quantum mainly reflects the balance sheet of the Life Insurance Corporation of India (LIC)[3] and, in part, reflects the long-established role of that entity in the intermediation of retirement savings[4] and provision of an annuity facility. LIC was formed by explicit legislation as a state-guaranteed monopoly by merging and nationalizing 245 insurers in 1956.

Table 1. India: Financial System Comparatives[5]

(In billions of Indian rupees - End 2010)

	Term Deposits	Mutual Fund Assets	Life Insurers AUM (Investible)[6]	Market Cap. Stock Exchange	GOI Bonds*	Other Bonds
	44,706	6,140	13,757	60,799	22,534	8,259
Percent GDP	71.7	9.9	22.1	97.6	36.2	13.3

Sources: RBI, IRDA, and SEBI.

[2] Feyen and others, 2010, What Drives the Development of the Insurance Sector? World Bank Working Paper.

[3] Insurance assets are less than 10 percent of GDP in most developing and many emerging markets – see Footnote 2.

[4] Possible other explanations include the fact the central government CG has allowed the institution to be run professionally—for example, its chairperson typically is an insurance professional with many years of experience in the sector.

[5] There will be some double-counting of insurers and fund managers AUMs.

[6] LIC's investment assets (securities and investment property) alone equate to more than 16 percent of GDP.

8. **The life AUM to GDP figure of 16.8 percent (84 percent of which is contributed by LIC) puts India in the same general range as a number of industrial countries, although underlying drivers vary (Table 2).** In China, most savings are intermediated through the banking sector, and in the United States and Australia pension savings tend to be channeled to managed funds. The U.K., South Korean and Japanese models provide better indicators of the long-term potential for life insurance intermediation in the absence of a viable stand-alone pension mechanism. In India's case, the development of a specialized voluntary supplementary pension has been planned for many years and the basic infrastructure is in place (i.e., the New Pension System or NPS), however the current business model is seriously flawed.[7] With modifications, the NPS still has an opportunity eventually to become a serious competitor for the life insurance sector.

Table 2. India: Life Insurer AUM Comparatives

Country	India	U.K.	Rep. Korea	PRC	Japan	Australia	USA
Life assets as percent GDP 2010	19.2	105.7	32.1	8.1	61.4	22.0	19.7

Source: AXCO Reports.

9. **The life insurance industry has been registering healthy growth in premiums with real compound annual growth rates (CAGRs) of 13.4 percent for life over the 2005/6 to 2010/11 period.** However, **despite a real CAGR of 6.8 percent nonlife,** penetration has remained relatively static (i.e., has only being growing as fast as GDP) due to price competition following the removal of premium tariffs for nonmandatory insurance products in 2007 (Table 3).

10. **Growth in life premium has been high since 2005, largely driven by stock market performance and the popularity of unit-linked, single-premium contracts.** More recently, growth has been slowed by the impact of the global financial crisis. The authorities have taken steps to encourage life insurers to re-focus their core business of providing financial protection (Table 4).

[7] A key issue is that expense loadings do not allow for required marketing and sales costs.

Table 3. India: Comparative Real Nonlife Density and Penetration Trends[8]

(In percent)

	PRC		Brazil		India	
2010 Premium $US million	71628		30847		10562	
2010 density $US	52.9		157.7		8.7	
	Density Index	Pen. %	Density Index	Pen. %	Density Index	Pen. %
2010	267	1.3	128	1.5	147	0.7
2009	210	1.1	120	1.5	131	0.6
2008	175	1.1	120	1.6	127	0.6
2007	157	1.1	112	1.6	130	0.6
2006	131	1.0	107	1.6	125	0.6
2005	112	0.9	102	1.7	109	0.6
2004	100	1.1	100	1.6	100	0.7

Sources: Swiss Re. Sigma, World Bank analysis.

Table 4. India: Comparative Real Life Density Index and Penetration Trends

(In percent)

	PRC Mainland		Brazil		India	
2010 Premium $US million	142,999		33,246		67,810	
2010 Density $US	105.5		169.9		55.7	
	Density Index	Pen.	Density Index	Pen.	Density Index	Pen.
2010	276	2.5	166	1.6	220	4.4
2009	221	2.3	149	1.6	222	4.6
2008	193	2.2	129	1.4	199	4.0
2007	141	1.8	121	1.4	201	4.0
2006	120	1.7	105	1.3	188	4.8
2005	112	1.8	96	1.3	119	2.5
2004	100	2.2	100	1.4	100	2.5

Source: Swiss Re. Sigmas.

11. **India is a clear out-performer in terms of expected life insurance penetration, and is broadly in line with expectations in the nonlife sector (Figures 1 and 2).**

[8] Density for 2004 (premium per capita) is indexed as 100and subsequent densities at 2004 values.

Figure 1. India: Actual vs. Expected Life Insurance Penetration[9]

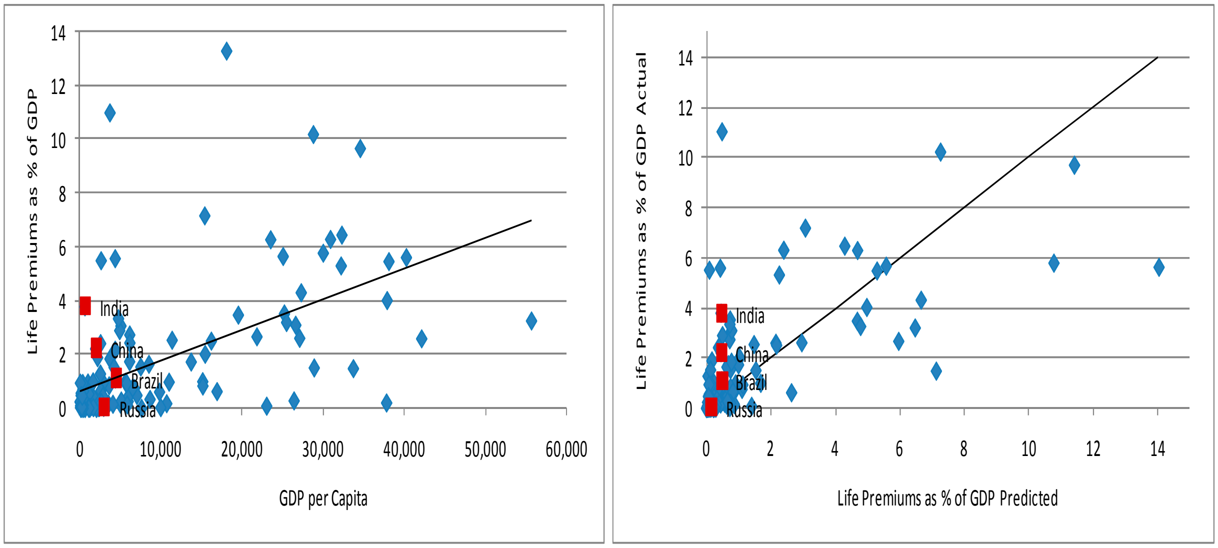
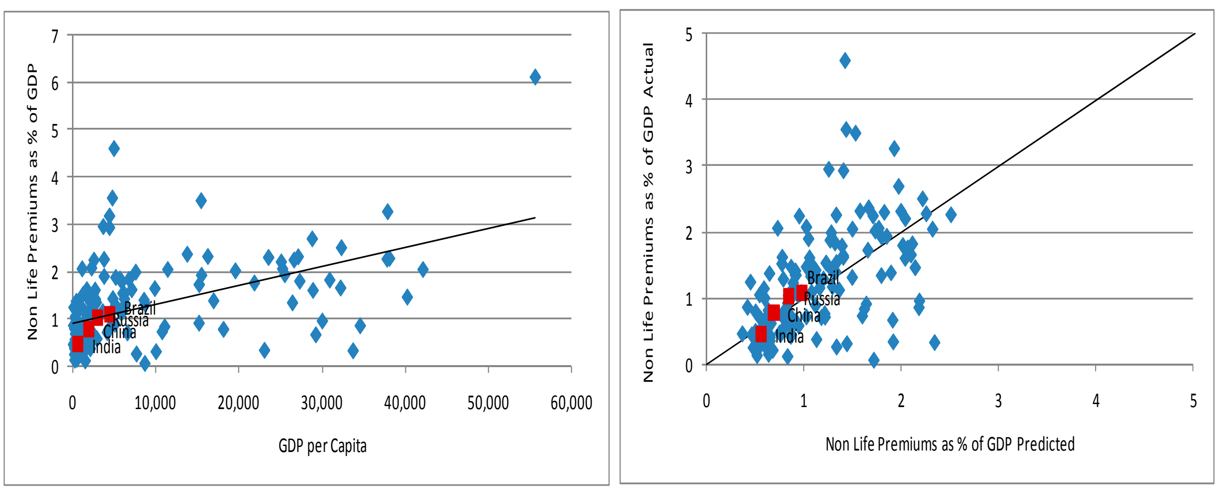


Figure 2. India: Actual vs. Expected Nonlife Penetration



Source: World Bank analysis.

12. **The insurance sector employed 139,000 people in the life sector and 61,000 in the nonlife sector at the end of FY10/11.** A little over half held some form of relevant vocational or academic qualification. Slightly less than 10 percent had formal insurance-related credentials. At the time of the assessment, there were 415 individuals with actuarial qualifications (including 82 IAA accredited Fellows) and approximately 5,700 accountants active in the insurance industry. More than 10,000 surveyors and loss adjusters are also

[9] The first chart shows insurance penetration regressed against income levels. The second shows actual versus expected penetration based on income levels and other structural geographic and demographic factors.

employed in the sector. There is a need to increase the number of insurance professionals significantly due to rapid local growth. India is also a major supplier of skilled personnel to the emerging Middle Eastern markets.

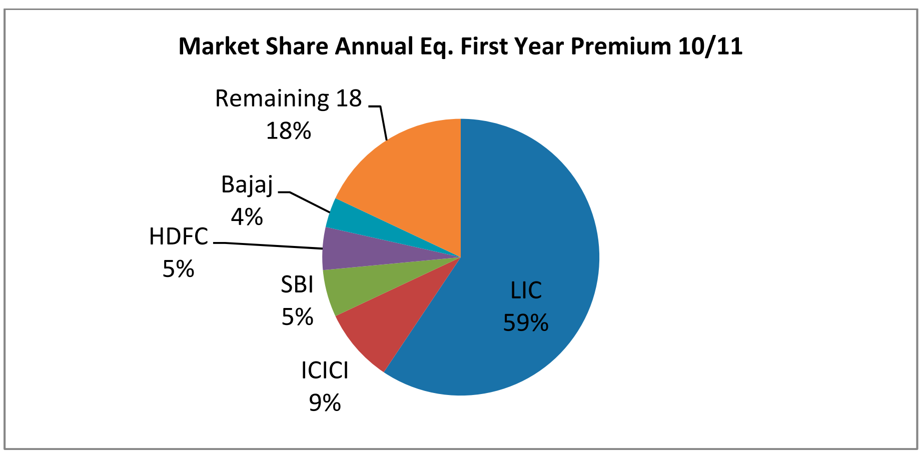
Sector composition and growth

13. **As at the time of the assessment there were 23 life insurers operating in India, including the state-owned LIC.** All the privately owned life insurers began operations after the Indian insurance industry was opened up in 2001. Under the current Insurance Act, insurers are subject to caps on foreign shareholdings of 26 percent of issued equity. Two private life insurers are 100 percent owned by domestic interests. Approximately half of the private life insurers are making accounting losses, partly reflecting the costs of establishing adequate scale, but also in some cases a problematic business model,[10] which IRDA has recently taken steps to address.

14. **LIC continues to dominate the market.** This arises from its enormous distribution capacity and balance sheet strength, supported by an explicit government guarantee under S.37 of its Act (Figure 3).

Figure 3. India: Share of Annual Equivalent First Year life Premiums

(FY 2010/11)



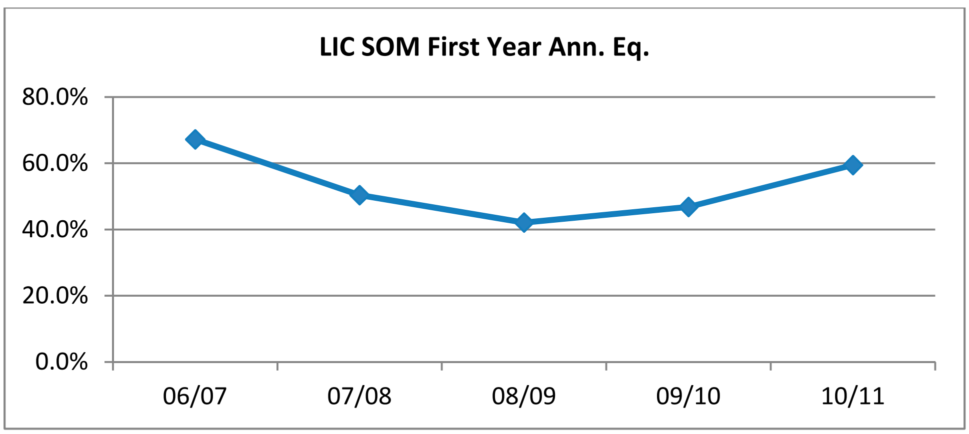
Source: IRDA.

[10] This involved creating poor value for consumers by selling single premium unit-linked and variable insurance products through expensive insurance agency distribution structures. Business models have been significantly modified following IRDA's intervention.

15. **Research on insurance market efficiency[11] points to an equilibrium Herfindhal-Hirschman index[12] of approximately 2,200 for the life sector.** The index for India of 3,704 highlights the very concentrated nature of its life insurance industry, with LIC holding nearly 60 percent on an annual equivalent[13] basis and 70 percent based on actual premium flows. The life sector's concentration has recently increased, reflecting a reversal of the reducing market share trend (to 2009) for LIC (Figure 4).

16. **After a period in which a broadly level playing field has applied to the life insurance sector, largely arising from the aforementioned focus on short-term market returns, there now appears to be a tilt in favor of LIC.** This situation may partly arise from changes to the product rules covering ULIP pension products (see discussion below in paragraphs 27 through 29); however, the government guarantee is also likely to be a useful sales aid during a time of global uncertainty. Ideally, the guarantee should be removed, but given political and industrial realties, an alternative would be to require LIC to include the modeled value of this guarantee in its product pricing.[14]

Figure 4. India: LIC Share of Market—First Year Ann. Eq. Premium



Source: IRDA.

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[11] Where efficiency, defined on an input-output basis, is seen as the result of an optimal trade-off between scale and competition.

[12] This is the sum of the squares of insurers individual market shares expressed as integers.

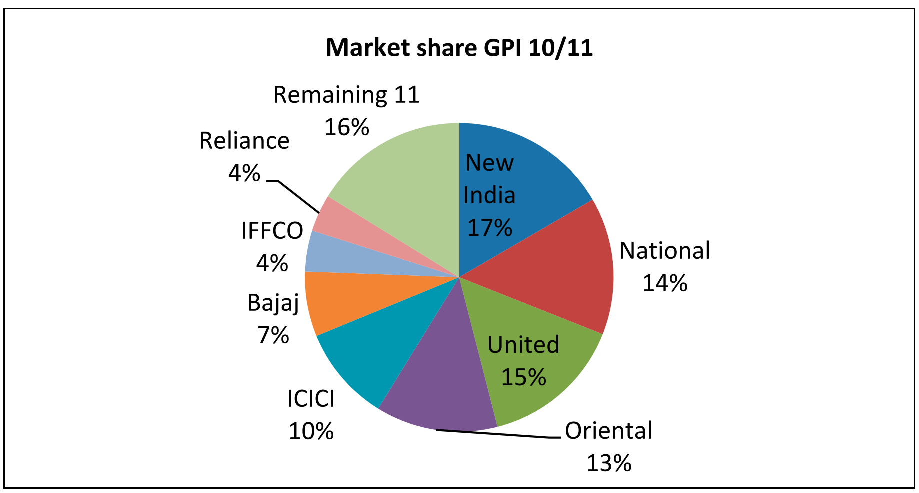
[13] Annual equivalent premium takes only 10 percent of single premiums into account.

[14] A proposed amendment under the LIC Amendment Bill modifies section 37 of the Life Insurance Act, 1956 to relax the government guarantee to 'the extent as the central government may by order from time to time determine.'

17. **The nonlife sector contained 19 multi-line, three specialized health (all JVs), one specialized agricultural insurer, and one specialized credit insurer at the time of the mission.** The 26 percent maximum foreign holding also applies to nonlife insurers. Four of the nonlife multi-line insurers are public sector undertakings (PSUs) competing actively with each other domestically and, in the case of New India, internationally. These do not carry the explicit government guarantee provided to LIC. Thirteen of the private multi-line nonlife insurers are JVs between local enterprises and international insurance groups and two are owned by local promoters. Concentration indicators for the nonlife sector are considerably healthier than for life sector although the public sector still dominates (Figure 5).

18. **The Herfindhal-Hirschman index for the multi-line nonlife insurers at 1,087 is substantially less than the indicative nonlife equilibrium of approximately 1,500, and in contrast to the life sector points to an industry that is overly fragmented and could benefit from some consolidation.** It may be an opportune time for the GOI to review its role and strategy in the nonlife market, as there is no market-based method for these insurers to merge or exit. While nonlife insurers appear to be addressing some of the recent market dysfunctions, the four PSUs appear to have identical business models, are already cooperating in some areas, and two may need capital injections.

Figure 5. India: Market Shares of Multi-line Insurers (GPI 2010/11)



Source: IRDA.

19. **There is one PSU reinsurance company, GIC, the former holding company for the four nonlife PSU insurers.** GIC is gradually developing an international portfolio to balance its Indian-sourced business, which includes a 10 percent compulsory local cession. No international reinsurers have established local branches, although most maintain representative offices.

20. **The analysis of intermediaries shows a clear alignment of channel and product/ market mix (Table 5).**

21. **LIC accounted for only 3,250 of the 12,018 life branches at the end of FY 09/10, demonstrating the enormous investment in new branches by the private life insurers over the last decade.** The four nonlife PSUs accounted for 4,696 of the 6,417 nonlife branches, pointing to a more measured build-up by the nonlife private insurers.

Table 5. India: Analysis of Intermediaries

(As of March 31, 2010)

Type	Number	Share of Non- life Premium	Share of Individual Life New Business	Share of Group Life New Business
Tied agent	4440881	35.7	79.6	5.8
Corporate agent (including banks)	2292	15.7	14.9	3.6
Broker	304	14.7	1.4	1.3
Direct:				
Life branches	12018		4.1	89.3
Nonlife branches	6417	31.1		
Other		2.8		

Source: IRDA.

22. **Banks are allowed to be agents for only one life and one nonlife insurer, whereas individual insurers may deal with multiple banks.** This policy is currently under review. Individual life insurers have up to 12 agencies with banks with the average over the 15 life offices with banc-assurance distribution being 3.6 agencies. The 12 nonlife insurers with bank tie-ups average 4.3 agencies.

23. **The authorities distinguished between the urban, social sector, and rural populaces.** Under their licensing requirements, direct insurers are required to achieve minimum penetrations of the latter two segments, formulated as follows:

- Social sector (largely the informal sector)—all insurers must insure at least 20,000 lives by their fifth year of operation.

- Rural sector—all life insurers must write at least 16 percent of policies in the rural sector by their fifth year of operation. All general (multi-line) insurers must write at least 5 percent of gross premium in the rural sector by their fifth year of operation.

Products

24. **All new or modified insurance products in India require supervisory sign off and IRDA has the authority to specify key product parameters, including expense loadings.**

25. **Prior to the opening up of the market to private sector players in 2000, the standard product offered by LIC was a traditional savings product (i.e., endowment insurance), although a wider range of products, including unit-linked contracts, were included in its rate book.** The new life insurers focused on unit-linked contracts (ULIPS) tied to stock market performance were able to take advantage of the high returns then available in India. For some insurers, ULIPS dominated their business model, which increasingly focused on pensions.

26. **The growth pattern shown in Table 6 reflects two sequential drivers.** The first phase of growth was attributable to a combination of extensive distribution and a booming stock market, combined with limited alternatives to insurers for retirement savings. The second was the impact of the global financial crisis on risk preferences in 2008.

Table 6. India: Life Insurance Product Trends—Share of Unadjusted First Year Premium

(In percent)

	2004/5	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11
Life	77.3	73.6	67.4	59.5	71.2	65.4	68.1
Annuity	6.7	4.3	2.6	2.8	5.0	5.3	6.0
Pension	15.6	22.1	29.9	37.6	23.4	29.0	25.7
Health	0.5	0.0	0.0	0.1	0.4	0.3	0.2
% linked	32.5	44.8	56.9	75.3	51.4	54.8	42.2

Source: IRDA.

27. **The drop in the ULIP/ pension components in 2010/11 reflects a significant withdrawal of the private life insurers from unit linked pension business.**[15] This in turn arises from consumer protection rules imposed by IRDA on linked products in October 2010. These include an extension of the locked-in period from three to five years, forced spreading of front-end charges over the locked-in period, limits on expense allowances, and a requirement for pension products that a guaranteed return be credited each year based on recent reverse repo returns.[16] The expense controls were largely justified, as a number of insurers were relying on heavy charges to cover inefficient distribution structures, and some insurers were allegedly relying on lapse-supported pricing. However, the minimum guaranteed return (4.5 percent at the time of the mission) is generous and would likely cost at least a hundred basis points per annum if properly priced, using realistic equity market

[15] A few continue to provide single premium products, which are more easily hedged.

[16] The guaranteed return is realized at the vesting date, but is reflected at all times in the insurer's liabilities.

simulations;[17] the new expense formula does not allow for such a loading (i.e., effectively, the required return to the notional additional capital required to support the guarantee).

28. **Given current interest rates, allowable expense spreads and actual expense levels, there is insufficient return (even with a matched portfolio of debt securities) to make ULIP pension business attractive to capital constrained insurers, let alone policy holders.** However, it is important that the ULIP products take on insurance characteristics, including a reasonable guarantee of terminal value (as opposed to what is a generous annual guarantee for actuarial purposes). Regardless, any such guarantees should be properly priced and allowed for in the liability valuation and capital management of an insurer providing such product features.[18]

29. **At the time of the mission, LIC was the only insurer that offered a regular premium pension product under the new requirements.** Given LIC's explicit government guarantee, GOI is effectively providing the return guarantee on new linked insurance products. As already implied, GOI could legitimately charge LIC a fee for this service, particularly if the PSU does not set aside adequate additional capital as the exposure grows. Other life insurers had developed a product guaranteeing minimum unit values based on stock index values, but this was under supervisory review due to its potential to destabilize stock markets.

30. **The major changes in the nonlife sector in recent years have been the rapid growth of health insurance and increased price competition in the property-related classes after premium tariffs were abolished in early 2007.** This was most pronounced in 2008–2010 when the nonlife sector recorded virtually no real growth in gross premiums written. In 2010–2011, under pressure from shareholders, insurers improved pricing discipline to focus on profitability (Table 7).

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[17] Shah has shown that a guaranteed real return of zero could be sustained in certain circumstances, while still offering the opportunity to have a significant equity weighting.

[18] The strong guarantees have now been withdrawn although non-zero, non-negative returns have been specified.

Table 7. India: Relative Importance of Business Lines in India: Nonlife Insurers

(In percent)

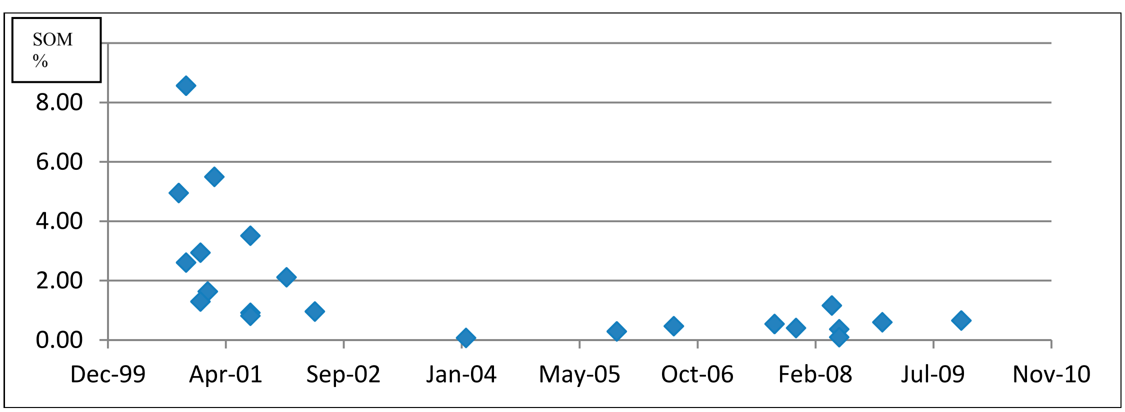
	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	CAGR % P.A. Notional Rs
Fire	18.5	16.6	12.4	11.1	11.2	10.9	4.3
Marine	6.3	6.5	6.5	6.5	6.3	6.0	14.8
Motor	42.9	43.0	45.6	43.9	43.4	42.6	15.7
Health	10.9	13.3	17.6	20.1	21.1	22.6	34.1
Other	21.4	20.6	17.9	18.4	18.0	17.9	11.8
Total Nonlife (Rs Crore)	20360	24905	27824	30352	34620	42576	16.0
CPI Incr. (Ind. Workers) %		6.7	7.9	8.0	14.0	8.8	9.1
Real Growth Rate %		14.6	3.5	1.0	0.0	13.0	

Source: IRDA Annual Reports.

Underwriting performance and profits

31. **A chart of 2010/2011 life market share versus year of registration shows a clear link between duration in business and scale (Figure 6).** Indian private sector insurers have been in operation for less than 11 years. A broad rule of thumb is that nonlife insurers take up to 7 years to reach break-even, and life insurers up to 12 years, with scale being a critical determinant of success. However, not all early entrants have in fact achieved break-even.

Figure 6. India: Private Life Insurers—SOM vs. Date of Registration

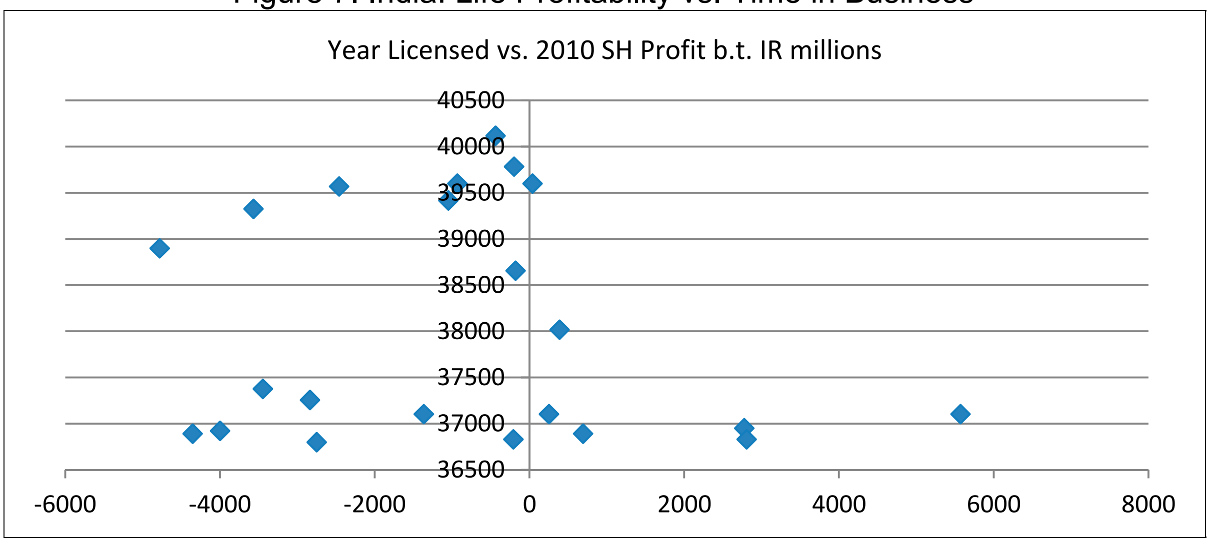


Source: Life Insurance Council.

32. **A chart of 2010 shareholders' profit before tax against year of registration (Figure 7) shows that there is a clear dichotomy among the early starters.** While some are reporting accounting profits (in a few cases, reflecting recent retrenchment and cost cutting[19]), a larger number are still making losses. As expected, the newer entrants are still incurring establishment losses.

33. **In practice, the only way of telling if a life insurer that is making accounting losses is successful is to assess the growth or otherwise in its embedded value (i.e., net present value of future profits from business in force).** This data is not available,[20] but it is likely that a number of life insurers have been making real economic losses and will need to re-assess their strategies. This is likely to involve a mutual review of expectations by both foreign and domestic investors in some life insurers.

Figure 7. India: Life Profitability vs. Time in Business



Source: IRDA.

34. **An analysis of investment by the early starters also shows a broad correlation between market share and accumulated losses, reflecting a common strategy of building traditional agency forces (Figure 8).** One exception, SBI Life, has been able to capitalize on a major in-situ distribution system.[21]

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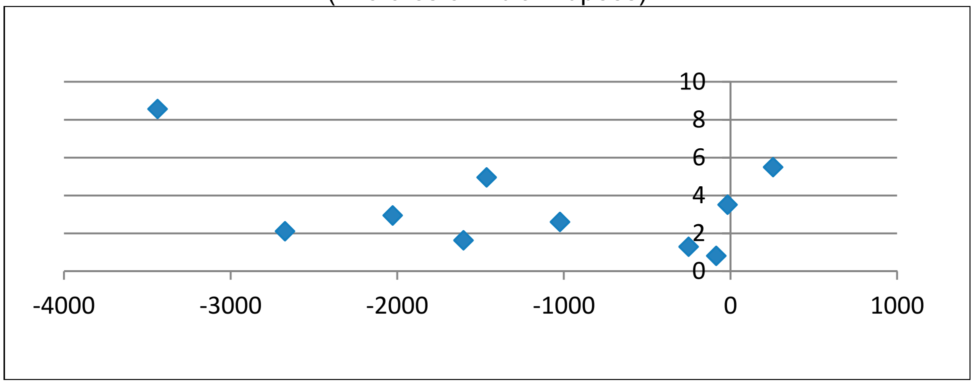
[19] Staffing levels in the life sector reduced by 25 percent over the 2010/11 year and approximately 900 branches were closed. The number of tied agents was reduced by 10 percent over the same period.

[20] However, embedded value accounting is implicit in the informal parallel solvency system recently introduced by IRDA.

[21] SBI's expense rate already approximates that of LIC (see Oliver Wyman, Charting a New Course—The future of life insurance in India, 2011 for a detailed analysis of life insurer operating expense rates).

Figure 8. India: Life SOM Percent vs. Cumulative Losses

(In crores of Indian rupees)



Source: BCG.

35. **A final indicator of the challenge facing private sector life insurers is illustrated by comparative expense rates, with LIC having a significant cost advantage over most of its competitors (Table 8).**

Table 8. India: Expense Ratios LIC vs. Private Life Insurers

(In percent of gross premium)

	II. Commission Expense Ratio		III. Operating Expense Ratio	
	2009	2010	2009	2010
LIC	6.4	6.5	5.8	6.6
Private sector life insurers	8.5	7.6	26.0	20.9

Source: 2009/10 IRDA Annual Report.

36. **The challenge for IRDA is to encourage the life insurance industry to find its natural equilibrium without egregiously interfering in the market.** In practice, this means facilitating mergers and exits, encouraging new business models, and ensuring that new capital is subscribed when solvency-based corrective action becomes necessary. A recent joint study by FICCI and BCG[22] demonstrates that the branch-based agency model is not viable outside the top 150 cities in India. New distribution channels need to be developed if access is to be widened. In this regard, life insurers affiliated through majority ownership with major banks have a distinct advantage.

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[22] India Insurance—Turning 10, Going on 20, April 2011.

37. **The business models of most nonlife insurers in India have, until recently, also focused on premium growth and market share, and profitability has suffered.** As with the life sector a number of the private players continue to make losses. However, as scale is not as important in the nonlife sector, more insurers have been able to approach or exceed break-even volumes while maintaining underwriting results.[23] During 2009/10 the private sector nonlife insurers made an overall operating loss, although seven multi-line insurers produced profits. Again, the late starters are making establishment losses (with one notable exception, Shriram, which, like SBI for life, shows the benefits of joint ownership of the underwriter and the distribution system).

38. **The nonlife sector's lack of profitability has been exacerbated by inadequate pricing of commercial third-party motor liability business.** Prior to the opening up of the Indian insurance market, a significant cross-subsidy from other classes of insurance to the commercial transport sector was mediated through the four nonlife PSUs, but competition has now largely negated this mechanism. A linear analysis of operating profit and key ratios demonstrates the impact of both the abolishing of premium tariffs and mandated participation of the private insurers in cross-subsidies to the commercial transport sector (Table 9).

39. **Initially, the private sector insurers naturally avoided the unprofitable motor business and the PSUs carried most of the commercial motor risk.** IRDA, working with the insurers, subsequently established a Commercial Vehicles MTPL pool (IMTPIP) in which all multi-line nonlife insurers have had to participate according to overall market share.[24] This pool has been operating since 2007/08 and has been recording losses consistently. In 2010/ 11 a study of the pool's experience was carried out, and the participating insurers were required to increase their relevant claims provisions significantly. In the case of two PSUs, this has pushed their solvency ratio below the 150 percent level and IRDA has decided to extend regulatory forbearance to the sector.[25]

[23] IRDA has been advising the insurance companies on the need to review the pricing philosophy and standards through the General Insurance Council. IRDA has also initiated review exercises on underwriting performance of individual companies to ensure that the pricing is consistent with the method and parameters filed with the authority.

[24] Own portfolio MTPL has been running at a claims ratio of between 115 percent and 120 percent and the commercial pool at more than 150 percent.

[25] Subsequent to the FSAP mission:

1. The authority vide order No. IRDA/NL/ORD/MPL/276/12/2011 dated December 23, 2011 has decided to dismantle the existing Indian Motor Third Party Pool with effect from March 31, 2012.
2. The authority vide order No. IRDA/NL/ORD/MPL/277/12/2011 dated December 23, 2011 has decided to create a declined risk pool for Act Only Commercial Vehicle Third Party Insurance with effect from April 1, 2012.

Table 9. India: Key Operating Results and Ratios—Nonlife Sector

(In millions of Indian rupees)

	4 PSUs				Private Sector			
	06/07	07/08	08/09	09/10	06/07	07/08	08/09	09/10
Profit b.t. and realized inv. profits Rs mill[26]	2565	-483	-17245	-16360	2709	53	-2769	-3468
Net Claims ratio	85.2	90.4	91.3	88.3	68.0	72.4	76.9	80.3
Net Expense ratio	34.6	34.2	37.0	38.5	35.0	38.0	37.0	34.7
Combined ratio	129.8	124.2	128.3	126.8	103.0	110.4	115.0	115.0

Source: IRDA Annual Reports.

40. **The rapidly growing health insurance sector[27] has also shown poor results, particularly for cashless coverage.**[28] The net claims ratio for health insurance in 2009/10 was 92.2 percent for the private insurers and 119.9 percent for the PSUs. This largely reflects heavy price competition and poor claims classification and control at both the service provider and third-party administrator (TPA) levels. In fact some of the supplier-driven issues characteristic of the U.S. market, such as over-servicing, appear to be creeping into the Indian market. Insurers are recognizing the need to introduce fraud-control mechanisms and tighter oversight of illness and intervention classifications.

41. **Clearly the current level of operating losses in the nonlife insurance sector is not sustainable.** The PSUs in particular have been able to declare profits through asset realization, but this approach cannot be sustained, even in the medium term. Discussion with market players indicated that there is considerable scope to improve performance through rationalizing distribution[29] and introducing better controls over underwriting and claims management. In addition, if cross-subsidies to the commercial transport sector are to be maintained, risk-management efforts should be supported by the authorities to reduce the current high claims frequency.[30]

[26] Underwriting result plus interest and dividends.

[27] This reflects the fact that most health expenditure in India is out of pocket and, in particular, the development of group health plans is an attractive employee benefit.

[28] Cashless coverage arises when the insurer contracts directly with the health services provider and the patient does not need to arrange payment.

[29] Some PSUs allegedly have more than one branch in the same building, facilitating quote shopping from the same insurer.

[30] For example, driver training and mandatory safety checks.

42. **Other initiatives could include making it illegal for plaintiffs' lawyers to benefit from the claims they are handling[31] and capping (or at least bringing greater consistency to) catastrophic bodily injury awards.** Actions taken to gather claims run-off data for long-tail classes is appropriate, although both claims paid and claims incurred data should be gathered if a full actuarial analysis is to be carried out. To support this data-gathering exercise only actuaries formally qualified in nonlife methodologies and with appropriate experience should be allowed to certify claims provisions and nonlife premiums.

43. **Actions have already begun to bring the health insurance portfolio under control.** The four PSUs are engaging in a joint effort to develop a preferred-provider network and agreed cost schedules for certain surgical procedures with hospitals permitted to participate in the cashless system. In addition, IRDA has facilitated capture and transfer of data in a prescribed format to the Insurance Information Bureau (IIB—an initiative of IRDA and the General Insurance Council). The IIB has already started publishing analytical results of these data and is working on enhancing the quality of data captured and published. To complement these developments, and while action is occurring at the individual insurer level (including the use of multi point indicators), the sector should work more cooperatively to identify fraud and over-servicing.

44. **Given the somewhat fragmented nature of the nonlife sector there is likely to be some pressure for consolidation.** Legal exit mechanisms (i.e., portfolio transfer, merger, acquisition, and run-off) will need to be to fully employed to enable the market to move toward an optimal structure.

Reinsurance

45. **The retention ratios of the Indian insurers are broadly in line with international benchmarks (Table 10) after allowing for the stage of development of the private sector insurers and the compulsory cession to GIC.**

46. **The state-owned reinsurer, GIC, benefits from a mandatory cession of 10 percent for all nonlife classes, calculated on a potential maximum loss (MPL) or sum-insured basis according to the nature of the cover provided.** GIC also manages the marine hull, terrorism, and commercial vehicle MTPL pools. The international reinsurers have not established operations in India due to the 74 percent local-partner requirements and the relatively high initial capital requirements (Rs 2 billion). In addition, they are able to participate through GICs retrocessions and from direct placements by the four PSUs when local capacity is exhausted. All reinsurance schedules must be approved by an insurer's Board and filed with IRDA. Unless otherwise approved by IRDA, international placements

[31] Plaintiff lawyers have allegedly been, in effect, purchasing claims from accident victims and pursuing them on their own behalf.

may only be made with reinsurers rated at least BBB by S&P over the prior five years. IRDA also takes active steps to prevent fronting to ensure that local capacity is fully employed.

Table 10. India: Retention Ratios by Line of Business 2005–2010

(In percent)

	2004/5 inc. GIC	2009/10	2009/10 inc. GIC
Fire	76.0	56.8	74.0
Marine cargo	85.1	69.6	85.4
Marine hull and liab.	25.6	12.2	23.3
Motor	99.6	89.8	100.0
Aviation	23.5	14.6	25.6
Engineering	75.8	45.3	68.9
Other	88.4	79.8	91.4

Source: IRDA Annual Reports.

47. **The situation for foreign reinsurers may change if the Insurance Amendment Bill 2008 becomes law and global reinsurers are able to set up on a branch basis.** In the interim, GIC is well placed to exercise some discipline on market pricing and has been doing so recently through a tightening of its terms following very poor results from local cessions.

48. **GIC is the twenty-third largest reinsurer in the world and operates internationally, particularly in the East African and peripheral South Asia and East Asian markets.** It is understood to have ambitions to further expand internationally and become less dependent on the Indian market.

Technical provisions

49. **Nonlife claims provisions and life mathematical reserves need to be actuarially certified by an appointed actuary in India.** In the case of life insurers the appointed actuary must be a full-time employee, while this role may be outsourced for nonlife insurers. Unexpired risk provisions are established by formula unless otherwise approved, and tend to be conservative (50 percent of net premium, except for long tail Marine, which is fully reserved to premium).

50. **Life insurance mathematical reserves are set on a gross premium basis with allowance for adverse deviations.** In practice, the discount rate is established according to an informal agreement amongst life appointed actuaries (sanctioned under the relevant regulation): this allows for the book value/amortized book-value approach to valuing the majority of assets.

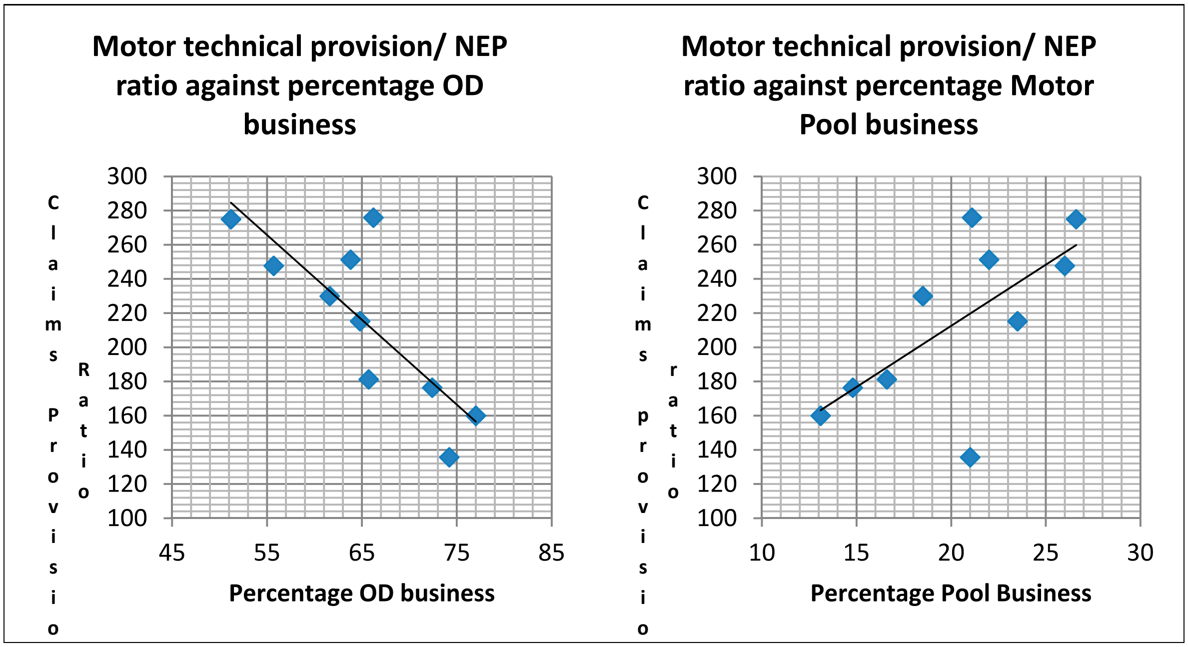
51. **Nonlife claims provisions are set according to a range of actuarial methodologies on a non-discounted basis.** However, there is no guidance as to where in the range of possible values the provisions should be set and there is no requirement that the actuary provide an insurer's Board with a range of possible values. In addition there is no requirement that the appointed actuary be certified to carry out nonlife valuations. Given the highly specialized nature of nonlife work and the growing claims experience database available in India, such certification should be considered within the next three years.

52. **On the basis of a high-level analysis[32] using the ratio of technical provisions (i.e., outstanding claims plus unearned premium provisions) to average net earned premiums in the last two years, at least one private sector insurer would appear to need closer examination (Figure 9).** This insurer was the only major private player that did not see a significant increase in its motor technical provision ratio between 2010 and 2011. At the other extreme several insurers appear to be maintaining strong risk margins. Two insurers have ratios well below the heuristic of 100 percent (60 percent outstanding and 40 percent unearned) for short tail classes. This could reflect large health insurance portfolios, but they are well out of alignment with the other major players.

53. **Overall, there appears to be limited (although improving) consistency in the methodologies and assumptions employed.** This adds further weight to the recommendation that specialist certification be required of nonlife insurer appointed actuaries, and that some guidance be provided as to the level of safety margin to be built into claims provisions.

[32] The analysis was facilitated by data provided by IRDA. However, most private insurers do not provide a full break up of earned premium by class and sub class. All insurers should be required to provide the same earned premium analysis as the PSUs in the public disclosures.

Figure 9. India: Nonlife Technical Provision Analysis—Largest 10 Multi-line Insurers (2011)



Source: IRDA.

Investment Practices

54. **The body of Indian law and regulation covering insurers' investments is more comprehensive than for any other area of risk.** Given that the solvency rules do not in practice have any elements explicitly covering asset risk (although the relevant regulations have provision for such loadings), this is probably appropriate. The basic rules are laid out in Clause 27 et seq. of the Insurance Act, and have been elaborated and amended most notably in 2000, 2004, and 2008. The July 30, 2008 regulation—as subsequently elaborated by guidelines—currently govern the investment activities of insurers.

55. **The July 30, 2008 regulation defines four different categories of liability, which in turn guide investment rules and exposure limits.** These are broadly appropriate and are as follows:

> Life – 1) Solvency margin component of shareholders' funds, 2) fund containing non unit reserves of ULIP business and traditional participating and non participating business; 3) the pension and general annuity fund; ULIP funds
>
> Nonlife – 4) solvency margin component of shareholders' fund and the fund containing policyholder liabilities.

Fund type 1) must be invested not less than 25 percent in government securities, and 50 percent in government securities plus Other Approved' Securities'. At least 15 percent must be invested in the housing and infrastructure sectors. No more than 35 percent may be invested in Approved Investments and Other Investments, with a 15 percent cap on the latter.

Fund type 2) must be invested not less than 20 percent in Government Securities with not less than 40 percent being in Government Securities plus 'Other Approved Securities'. The balance is to be invested in Approved Investments subject to specified exposure and prudential norms.

Fund type 3) is largely unconstrained (subject to policy terms) except that assets must be liquid and no more than 25 percent may be invested in 'Other Investments'.

Fund type 4) must be invested at least 20 percent (of investment assets) in Government Securities and not less than 30 percent in Government Securities and 'Other Approved Securities'. Housing investment must be at least 5 percent of invested assets and infrastructure not less than 10 percent. No more than 25 percent of investments may be in 'Other Investments'.

56. **'Other approved securities' include state government bonds, state government guaranteed loans and guaranteed equity.** Housing investments cover loans to State Government for housing, loans to HUDCO and institutions guaranteed by NHB, and debt instruments issued by HUDCO and NHB or under state mandated housing schemes. Similar levels of security are required for infrastructure investments. 'Approved investments' cover a wide range of liquid and secure securities and high quality mortgages and commercial paper. 'Other' investments include securities and venture funds that have been approved by an insurer's Board.

57. **Prudential and exposure limits are defined in terms of individual securities, groups and industrial sectors with an upper limit of 10 percent of issued securities or fund value generally applying, except for related groups in which case 5 percent normally applies. In addition overriding minimum credit ratings are applied to most securities.** No international investments are permitted and there are tight limitations on and reporting requirements for the charging of assets (holdings of government paper and approved securities may not be charged).

58. **The July 30, 2008 regulations also specify the investment governance structure (Investment and ALM Board committees including minimum representation from nonexecutive directors and key management) and a list of 11 quarterly investment returns.** While the Insurance Act requires that certain related party transactions are notified to the supervisor within 30 days, it is desirable that all exceptional investment transactions be reported in a timely fashion, possibly along similar lines to the monthly reporting of exceptional insurance underwritings.

59. **The original law and regulations specified relatively restricted limits on deposits with individual banks for both life and nonlife insurers.** However, this was changed and bank linkages are now largely the responsibility of the directors, subject to an overriding aggregate limit.[33] The Board Risk Management Committee is responsible for monitoring such exposures. Given increasing insurer/ bank links and the fact that there is no specific risk loading for large exposures, there may be grounds for reconsidering per bank exposure limits.

60. **Actual asset allocations have been driven by the popularity of unit linked products in the life sector and are broadly in line with the specified minima in the case of nonlife insurers (Tables 11 and 12).**

Table 11. India: Investment Mix—Life Insurance

(In billions of Indian rupees, percent)

	March 31, 2009		March 31, 2010	
Traditional				
Central Gov't Debt	3160.1	34.5	3615.2	30.0
State Gov't and other approved debt	1071.9	11.7	1370.0	11.4
Housing and Infrastructure	666.7	7.3	724.4	6.0
Approved investments	2024.7	22.1	2459.9	20.4
Other investments	512.6	5.6	565.9	4.7
ULIP				
Approved Investments	1514.9	16.5	2931.1	24.3
Other investments	212.7	2.3	385.1	3.2
Total	**9163.7**		**12051.6**	

Source: IRDA.

Table 12. India: Investment Mix—Nonlife Insurance

(In billions of Indian rupees, percent)

	March 31, 2009		**March 31, 2010**	
Central government debt	145.9	24.8	160.4	24.1
State government and other approved debt	60.8	10.3	69.7	10.5
Housing and infrastructure	132.2	22.4	151.6	22.8
Approved investments	210.3	35.7	242.6	36.7
Other investments	39.7	6.7	39.4	5.9
Total	**588.9**		**663.7**	

Source: IRDA.

[33] An overall exposure limit to financial institutions of 25percent of investment assets remains in place.

Capital and solvency margin

61. **India has high initial capital requirements by international standards, but given the costs of establishment in such a large and competitive market, the requirements appear to be reasonable.** Minimum establishment capital for a specialist direct writer is Rs 1 billion (approximately US$20 million) and twice this for a reinsurer.

62. **Indian insurers are required to report solvency quarterly and this is disclosed on their web sites.** Solvency is certified annually by the appointed actuary. Minimum solvency is broadly in line with the EU Solvency I regime (i.e., in aggregate approximately equal to the minimum solvency requirement under QIS 5 of Solvency II). In practice insurers are required to maintain a minimum capital of 150 percent of the statutory solvency amount. However, following a recent strengthening of Commercial Motor Pool claims provisions this requirement has been reduced to 130 percent for nonlife insurers for one year, with a stepped increase back to 150 percent over three years. Under the current law and regulations there is no explicit corrective action ladder tied to the solvency ratio.

63. **Solvency ratios at the end of FY 2009/10 were largely in the acceptable range.** Overall the life sector appears to be stronger than the nonlife sector. However, the current rate of losses and the weakness of the current life solvency regime (based on the EU QIS studies) should be taken into account when considering these charts. If a risk based solvency regime is introduced, the bars are likely to move to the left **-** Figures 10 and 11.

Other issues

64. **The Indian insurance sector and the authorities responsible for its development and stability are facing a number of major issues at present.** Some have been mentioned above in the sectoral overview, including stabilizing the MTPL results, putting health insurance onto a sound footing, raising the bar for the Actuarial Profession in terms of specialization, and formulating a framework for pension ULIPs that balances consumer protection and commercial viability. Others, such as taxation and the broader issue of supplementary pension provision, are not appropriately dealt with in a formal assessment. Some of these matters are addressed in a companion Background Note.

Figure 10. India: Nonlife Solvency Ratios

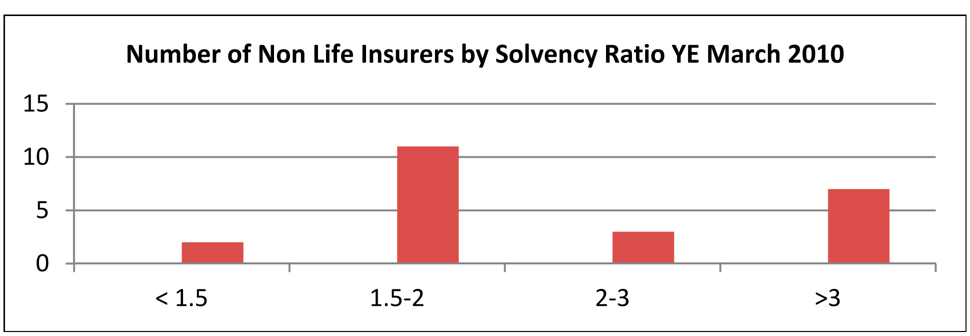
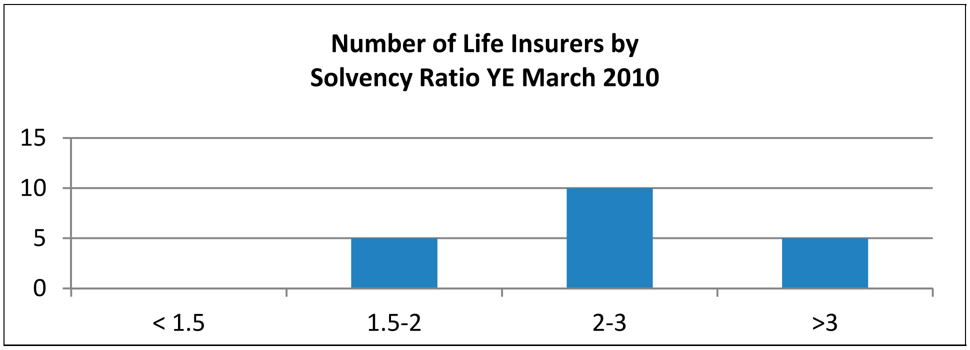


Figure 11. India: Life Solvency Ratio



Source: IRDA.

D. Main Findings

65. **The preconditions for effective supervision are generally met.** Where principles are not full observed, generally one of five reasons applies:

- The lacuna has been recognized but requires legislative action to implement. The Insurance Amendment Bill, which has been pending in parliament for three years, contains numerous required reforms, including the treatment of reinsurers, facilitating amalgamations and transfers, appeals processes, oversight of related party transactions, introducing fines at appropriate levels as effective deterrents, and clarifying the respective supervisory roles of IRDA and the central government.

- The ICP concerned has not had the same priority as others with greater urgency and potential impact. IRDA has begun work on such issues, including combating fraud and exit processes.

- IRDA has so far decided that India is not yet ready for a full transition to cutting edge international approaches due to informational and skills shortages and a continuing lack of international consensus. Certain prudential ICPs, come under this heading and IRDA will need to augment its resources in its core supervisory departments if it is to introduce a rigorous corrective action and enforcement regime built on a risk based approach to the capital and operational management of insurers.

- IRDA has adapted to policy decisions applying in the larger Indian context. Accounting approaches, particularly for assets, come under this category.

66. **There are also areas where IRDA has strong and explicit regulation in place or lacunas have been addressed through practice.**

- IRDA's ongoing supervision of insurance companies, markets, and consumers is tight and displays a strong level of control. Most ICPs in these sections are fully observed. Disclosure and consumer protection are at a high level by international standards.

- The application of prudential requirements needs to become less reliant on informal arrangements agreed by appointed actuaries. Relevant standards should be produced and ideally an Actuarial Standards Board established. In addition, there should be a plan to introduce specialized certification of actuaries, particularly for nonlife business.

A summary of principle-by-principle ICP assessments is exhibited in Table 13, which provides the grading and relevant comments applicable to each principle and rating:

Table 13. India: Summary of Observance of the Insurance Core Principles

Insurance Core Principle	Grading	Comments
ICP 1 – Conditions for effective insurance supervision	O	If supply continues to be an issue there may be a need to consider an appointed actuary system whereby qualified actuaries from acceptable overseas members of International Actuarial Association can gain local accreditation after a suitable period of experience and with proper references. IRDA should regularly obtain a listing of approved auditors from ICAI.
ICP 2 – Supervisory objectives	O	
ICP 3 – Supervisory authority	PO	The current uncertainty regarding IRDA's control of its funding and budget, its incomplete oversight of LIC, and the reserve powers of the central government to direct its activities all potentially detract from the supervisor's powers and independence.
ICP 4 – Supervisory process	O	
ICP 5 – Supervisory cooperation and information sharing	LO	The cooperation and information sharing system between the three key domestic financial sector supervisors (the former RBI High Level Committee) should be formalized. IRDA should formalize mechanisms to advise host supervisors of actions that are relevant to them—e.g., requiring an insurer to close down a poorly performing branch.
ICP 6 – Licensing	O	The government may wish to specify maximum timeframes for IRDA to respond to applications including specifying requirements for more information.
ICP 7 – Suitability of persons	O	It would be desirable that either a Board Nominating Committee become mandatory or the compliance officer be required to immediately advise IRDA of the fit and proper details of any new directorial appointment. In addition, it is desirable that the Actuarial Certificate of Practice specify the areas in which an actuary is qualified to practice.
ICP 8 – Changes in control and portfolio transfers	O	While practice achieves this, the Insurance Act would ideally state that the interests of the policyholders of both insurers involved must be taken into account in assessing a portfolio transfer or merger and that an independent actuarial report should be required to confirm this.

ICP 9 – Corporate governance	LO	While the Corporate Governance Guidelines are comprehensive, the monitoring process appears to be limited. In particular, the company secretary, who is the relevant compliance officer, is often beholden to the chief executive officer and has numerous other responsibilities, and the external auditor is not required to report on adherence to the guidelines—this additional check should be instituted. It is advisable that related party transactions be reported on an exceptions basis according to size or nature—ideally as part of the quarterly reporting process. If a related party transaction (e.g., provision of expert advice by one of the significant shareholders) appears to be egregiously mispriced then IRDA should seek independent advice on the pricing and if necessary take appropriate supervisory action.
ICP 10 – Internal controls	LO	The Corporate Governance Guidelines should explicitly cover the internal audit function, specify that it needs to have a senior officer responsible for its fulfillment and that it have sufficient resources and an unfettered access to required information, that it is sufficiently independent, and that it has direct access to the audit committee and the Board as a whole.
ICP 11 – Market analysis	O	
ICP 12 – Reporting to supervisors and off-site monitoring	O	It is desirable that the monthly reports include more short-term risk data in addition to sales and branch/geographical development data.
ICP 13 – On-site inspection	O	It is recommended that a staff member with IT system skills is added to a full scope inspection team—particularly given the growing role of IT in Indian insurers' strategies. In addition, it would be helpful to the managements and Boards of insurers, possibly through the Audit and Risk Management Committees, to arrange a feedback meeting after an inspection is completed. For normal scheduled full scope inspections a three or four year cycle is adequate: insurers normally have very different risk profiles to banks which do need more frequent inspection.
ICP 14 – Preventive and corrective measures	LO	IRDA does not have a modern risk-based early warning system in place and the ratios that are measured appear to be largely generic rather than based on emerging experience. The supervisor is currently examining the Northern European traffic light system. It is of concern that IRDA does not have a direct role when insurers engage in capital management such as

		buy-backs. This should be rectified in any Amendment Bill finally agreed.
ICP 15 – Enforcement or sanctions	PO	The enforcement actions and sanctions open to IRDA tend to be at the extremes—relatively light or very heavy. In addition IRDA needs to refer certain fundamental corrective actions, such as appointing an administrator, to the central government. The corrective actions regime needs to be formalized through a 'Supervisory Guide' or Ladder of Intervention so as to provide IRDA with stronger legal backing when it intervenes. The financial sanctions available in particular are outdated and need to become relevant to the modern scale of insurers and impact of inflation.
ICP 16 – Winding-up or exit from the market	O	The authorities may wish to consider allowing the voluntary wind-up of solvent nonlife insurers, subject to satisfactory safeguards. In some circumstances claims run-off can be the most efficient method of exit. In addition, it is desirable that the provisions relating to the appointment of an administrator for nonlife insurers be brought into line with those applying to life insurers.
ICP 17 – Group-wide supervision	LO	India has made a good start on creating a conceptual framework for conglomerate group supervision (and oversight of systemic risk) but the information flows, processes, and early warning mechanisms involved need to be formalized, possibly through an MOU among the four supervisors if a coordination body with statutory status is not seen as being desirable. Individual supervisors should have more power to consider group structures and exposures and related party transactions in determining its interventions. Ideally an ad hoc committee of an insurer's directors (the majority of whom should be independent) should, by law, consider each related party transaction to ensure that market prices have been applied, that the transaction is in the interests of the insurer, and that the quantum of value involved does not warrant shareholder approval (if there is more than one shareholder) or otherwise is not materially relevant to the insurer's net asset position.
ICP 18 – Risk assessment and management	O	This ICP has been assessed on the basis of control of investment and underwriting risk. Further work needs to be done on the monitoring of operational (including general systems) risk—see Internal Control (ICP 10).
ICP 19 – Insurance activity	O	

ICP 20 – Liabilities	Life - O Nonlife - PO	The need for life appointed actuaries to determine valuation discount rates through informal agreement is undesirable. In addition expense over-runs should be provided for if they appear to be chronic once the establishment period is finished. However, the basic liability methodology adopted is sound in practice. The nonlife valuation rules do not provide any guidance as to where claims provisions (typically the main component of the technical reserves) should be set on the distribution of possible results.
ICP 21 – Investments	LO	In a high interest rate environment the investment valuation basis is potentially inconsistent with the Insurance Act, which states that no asset may be held above its market value. The required skills and experience of investment officers should be specified, if only in broad terms and subject to oversight by the Board.
ICP 22 – Derivatives and similar commitments	O	If IFRS is fully implemented in India for insurers, the value of debt holdings will fluctuate and derivatives may become more attractive instruments in order to stabilize results. At this point IRDA would need to strengthen its governance oversight and perhaps require monthly reporting of exposures.
ICP 23 – Capital adequacy and solvency	LO	The Solvency II Quantitative Impact Studies have demonstrated that Solvency I levels of capital are inadequate. IRDA has recognized this with a non intervention 150 percent solvency ratio requirement. However, this has not been translated into a mandatory corrective action process and has been weakened already for the nonlife sector. The rating largely reflects the informal solvency testing system that is in process of being adopted, the nature of the ownership of Indian insurers, the need for insurers to examine their asset-liability matching, and the ongoing oversight role of the actuarial profession. In addition ICP 20 has identified prudential shortcomings in the nonlife sector. It is desirable that the economic capital calculation is formalized, possibly as an adjunct to the corrective action regime that is being examined in parallel.
ICP 24 – Intermediaries	O	As insurance brokers become more important in insurance intermediation the relevant statutory reporting should be upgraded. In particular an annual or six monthly report showing premiums collected, commissions received, amounts forwarded to insurers, and the amounts held in policyholder trust funds would provide more focused risk information.

ICP 25 – Consumer protection	O	The 12 Ombudsmen do not communicate and there may be some grounds for establishing a mechanism to share experiences and observations.
ICP 26 – Information, disclosure and transparency toward markets	O	
ICP 27 – Fraud	PO	Fraud is a growing issue, particularly in the health insurance business. At present preventive actions are being adopted by individual insurers. However, there had been little in the way of an industry wide response and relevant IRDA guidance is still to be developed and promulgated.
ICP 28 – Anti-money-laundering, combating the financing of terrorism	LO	It is advisable that the growing role of brokers be addressed through a new directive. Financial sanctions also need to be strengthened for legal person intermediaries but the existing name and shame option is likely to be effective in the interim.

E. Recommended Action Plan and Authorities' Response

67. **Recommendations are listed below for those principles where the observance is partly observed (Table 14).** It should be noted that in addition, to the extent there are recommendations for those principles found to be fully or largely observed, they were provided in the Table 13.

Table 14. India: Recommended Action Plan to Improve Observance of the Insurance Core Principles

Principle	Recommended Action
ICP 3 – Supervisory authority	The Insurance Amendment Bill needs to be passed and become effective so as to ensure that IRDA is clearly independent and has a wider range of direct powers of intervention. Greater transparency over the early departure of senior officers is required.
ICP 15 – Enforcement or sanctions	The enforcement regime needs to be formalized through a regulatory 'Supervisory Guide' or 'Ladder of Intervention' so as to provide IRDA with stronger legal backing when it intervenes and to limit the scope for forbearance. Additional intermediate enforcement powers could include: • The ability to impose selective time and volume limitations on business activities (including by geography and product); • The ability to require deposits if assets security is a concern; and • The ability to impose an expiry date for a license to encourage timely rectification of undesirable financial ratios or operating practices. Financial sanctions need to be updated to reflect the impact of inflation since the fines were first established.
ICP 20 – Liabilities (nonlife)	IRDA should provide guidance as to where long tail provisions should be set on the distribution of possible results. Ideally the nonlife actuary should provide a range of possible values to management and Board and show where, say the 75th percentile value lies. In addition, nonlife appointed actuaries should be certified on the basis of training and experience in this very specialized area.
ICP 21 - Fraud	Continue the development of fraud control systems.

F. Authorities' Response to the Assessment

Overall assessment

68. **IRDA was set up under an Act of parliament in the year 2000. The authority has been set up with the objectives of both regulation and development of the insurance sector in India.** The insurance sector in India has witnessed significant progress over the period 2000-2011. Simultaneously, the supervisory and regulatory framework has been built-up to match the international standards while adapting the same to meet the needs of the Indian jurisdiction.

69. **As part of the assessment process it has been brought out that there are issues relating to *de jure* independence of the regulator given the fact that the legislation provides for certain powers to be vested with the central government.** In this regard, it is reiterated that IRDA has been mandated with the statutory responsibility of regulation and supervision of the insurance sector in India. While the Insurance Act, 1938 and the IRDA Act, 1999 provide for certain powers to rest with the central government, these are more as a matter of caution to be invoked in emergent situations and do not in any manner impinge on the independence of the supervisory body.

Life insurance industry

70. **Concentration in the life insurance industry.** The insurance sector was opened up to private participation in the year 2000. Thereafter till date, 23 life insurance companies have been granted registration to underwrite insurance business in the country. While it is a fact that the life insurance industry is concentrated, this needs to be viewed against the fact that prior to the opening up of the sector, LIC was the only life insurance company operating in India. Post opening up of the sector, the size of the life insurance sector in the country has been growing and the share of LIC in the said market had steadily declined, other than in the last one year or so when the market has been a witness to significant corrections post issue of directions on the nature of ULIPs being offered.

71. **While certain issues have been raised about the supervision of the public sector life insurance company, it is reiterated that in so far as the supervisory and regulatory framework is concerned, it is a level playing field for both the private and state-owned insurance companies, and the oversight of LIC is comprehensive in terms of both prudential matters and market conduct.** It may further be mentioned that the government of India is examining the recommendations of the expert group set up in August 2010 to examine the functioning of LIC.

72. **During the period commencing 2005, a significant shift was observed in the sale of unit-linked products, with the growth in business coinciding with the bullish stock market conditions.** The growth in the ULIPs, over the years also resulted in certain practices creeping in which were not considered to be prudent for the healthy growth of the insurance

sector in the country. In 2010, IRDA took a number of steps to address concerns on the products being offered by the insurers. These include stipulations on both ULIPs and the variable insurance products.

Nonlife industry

73. **Performance of the industry in the de-tariffed scenario.** Prior to 2007, the Indian nonlife insurance market was predominantly under tariff price and the underwriting performance was satisfactory in most of the years except when catastrophic events had taken place (1998, 2001, and 2005). In 2007, the tariff pricing model was dismantled (except Motor Third Party Insurance) to encourage competition and risk-based pricing models to emerge. It has been the experience of markets elsewhere in the world that a shift from a tariff price regime to a free-price regime results in the price levels dipping significantly, resulting in a strain on the underwriting performance. The experience in India, in the post de-tariffed scenario has been on similar lines. With 24 nonlife insurers competing for a decent share in the available business and the last four years having been benign ones (devoid of any major catastrophic events like flood, earthquake, cyclone, etc.) the prices have dipped rather steeply. As part of the oversight under the file-and-use procedure, for new products filed by the insurers, the authority critically looks at the pricing method and ensures that the appointed actuary certifies its adequacy and viability.

74. **While observing that the underwriting performance has deteriorated over the last four years and that there is a need for an early correction to achieve sustainability, IRDA has been advising the insurance companies through interactions in the General Insurance Council as well as otherwise on the need to review the pricing philosophy and standards.** IRDA has initiated review exercises on underwriting performance of individual companies to ensure that the pricing is as per and in line with the method and parameters filed with the authority. As part of the review process, the IRDA also examines the adequacy of Reserves for Claims through interaction with the respective appointed actuaries.

75. **Remedial action required in health insurance—poor information, poor administration, and fraud issues.** The health insurance market has really picked up in the last five years in India. With the improvement in the availability of healthcare facilities, the Indian population has realized the need for an insurance protection to meet the cost of getting adequate healthcare and correction. Corporate insurers have adopted the model of providing a considerable insurance facility for their employees and their immediate family by procuring a Group Health Insurance Scheme. The growth of gross premium in this line of business has been over 30 percent year-on-year in the last five years. The third-party administrators have also been facilitated toward servicing of claims and to serve as a link between insurers and health service providers. The initial capture of data was insufficient and the market felt the need for adequate data to underwrite this line of business effectively and at competitive price. The authority has already facilitated capture and transfer of data in a prescribed format to the Insurance Information Bureau, an initiative of IRDA and General Insurance Council. The

Insurance Information Bureau has already started publishing analytical results of these data and the bureau is working on enhancing the quality of data captured and published.

76. **Acknowledging that fraud in this line of business is a challenge to be met squarely, IRDA is in the process of deploying a software tool to detect probable fraud cases and assist the insurers in tackling and curbing them effectively.** The authority also encourages exchange of information on fraud cases amongst the insurers through the General Insurance Council. The regulatory framework on detection, classification, monitoring, reporting, and mitigation of frauds is presently being put in place.

77. **Review of the government's role and strategy in the nonlife insurance market.** The government of India is already examining the various issues relating to its role and strategy, and has commenced consultation with various stakeholders, including the public sector insurance companies themselves. A White Paper on various alternatives (including merger, partial disinvestment) has been circulated. The dominant challenge will be dealing with the huge workforce of over 70,000 employees in the four direct insurance companies. It is also a fact that two of the companies have better financial credentials while the other two do not.

78. **The recent review on adequacy of reserves toward claims under the Indian Motor Third Party Insurance Pool for commercial vehicles and the correction effected resulted in dipping of the solvency levels of the two companies mentioned.** The authority has brought this to the attention of the government.

79. **Meantime, the authority has directed an increase in the price of the Motor Third Party Insurance line and it is expected to correct the trend to a considerable extent.** The IRDA has also recently issued directions (i) dismantling the existing Indian Motor Third Party Pool with effect from March 31, 2012; and (ii) setting up the framework for Motor Third Party Declined Risk Insurance Pool for commercial vehicles.

Investments: ***Specify the risk responsibility on insurers' Boards relating to bank exposures***

80. **The IRDA has put in place robust mechanisms for investment of the assets of management.** The limits of exposure at the company, group, and industry levels have been prescribed and have to be adhered to. The overall responsibility on compliance with the stipulations rests with the Investment Committee of the respective insurer with audit oversight and reporting requirements to the Boards. It is felt that no additional oversight is required specifically for bank exposures.

Solvency requirement: ***Corrective ladder mechanism***

81. **The statute has laid down the stipulation of solvency of 100 percent.** However, as part of the registration requirements, IRDA has laid down the solvency requirements at 150 percent, which must be complied with at all times. Against this background, the

authority does not envisage the need for a ladder approach to the intervention levels. However, with a view to facilitating a risk-based oversight, IRDA is working on the early warning signals. The early warning signals would enable IRDA to take quick action in case of concerns being thrown up as part of the regular monitoring process.

82. **As regards moving toward the risk-based approach to solvency (on lines similar to the European Union), IRDA is presently examining various issues related to the same and would take a concerted decision on the same after deliberations with all stakeholder.**

Comments on ICP-wise assessment

ICP 1 – Conditions for effective insurance supervision

- The authority has put in place the minimum eligibility criteria for the appointment of statutory auditors of an insurance company. Under the requirements put in place, the management of the respective insurers is required to ensure compliance with these stipulations, with the oversight of the respective Boards. While we have examined the suggestion that IRDA should regularly obtain a list of approved auditors from ICAI, it is our firm view that the supervisor should not get involved in maintaining the list of approved auditors from the ICAI.

- The IRDA (appointed actuary) Regulations, 2000 lay down the eligibility criteria for appointment of an appointed actuary by an insurer. The authority has taken note of the suggestion that we could consider an appointed actuary system whereby qualified actuaries from acceptable overseas members of the International Actuarial Association can gain suitable accreditation with the Institute of Actuaries of India. The authority is examining the proposal and has entered into consultation with various stakeholders on the matter.

ICP 3 – Supervisory authority

- The regulatory oversight on LIC is quite comprehensive to the extent that it requires monitoring both prudential and market conduct operations of LIC. Though LIC Act excludes the applicability of certain provisions of Insurance Act, 1938, nevertheless there is no dilution on the regulatory oversight on LIC.

- The assessment has raised concerns on certain reserve powers of the central government to direct the activities of IRDA and the same impacting the supervisor's powers and independence. In this regard, it is reiterated that these powers are of the "reserve" nature, with the objective of using them in emergent situations. These do not in any way impinge upon the IRDA's powers and independence. The concerns as regards the *de jure* independence are unfounded.

- As regards the need for greater transparency over early departure of senior officials of the authority, Section 5 and 6 of the IRDA Act provides for the appointment and removal from office of the chairman and other members of the authority. There are laid-down procedures for the same. All appointments and removals by the government of India are, as a matter of procedure, notified in the official gazette.

ICP 5 – Supervisory cooperation and information sharing

- The IRDA has applied to be a signatory to the Multilateral Memorandum of Understanding (MMOU) with the IAIS. This would provide gateways for exchange of information between regulators of various jurisdictions.

ICP 6 – Licensing

- It has been indicated that the central government may specify timelines with regard to licensing. The timeline for process of application for registration of intermediaries—namely brokers, corporate agents, and third-party administrators—are specified in the IRDA Regulation. The government's prescribing timelines for registration of new insurance companies may, however, not be appropriate as the process necessitates due diligence and judgement of the 'fit and proper' criteria of the promoters' financial strength, more particularly their ability to fund the insurance/activity both in the start-up and in the long term.

- In order to improve the transparency in the process of licensing, IRDA is exploring the possibility of putting-up the status of all entities' requests on the IRDA website.

ICP 7 – Suitability of persons

- The Insurance Act, 1938 requires that the chief executive officer and executive directors be appointed with the specific approval of the IRDA. Further, under the corporate governance guidelines issued by the authority, the Board of the respective insurers is responsible for checking the fit-and-proper compliance.

  While it is observed that no domestic regulator has stipulated a mandatory requirement on the Nomination Committee, the authority is examining the proposal for putting in place stipulations requiring the insurers to intimate to the authority on the compliance with fit-and-proper requirements on the appointment of new directors. (In effect, this would mean that details of other than executive directors being compliant with fit and proper would need to be filed with IRDA).

- It has been recommended that the Actuarial Certificate of Practice issued to the actuary should specify the area in which the said actuary is qualified to practice. The intent of such recommendation is that actuaries practising in the nonlife segment should have the requisite exposure to conduct technical valuations of nonlife insurance companies. The recommendation has been forwarded to the Institute of Actuaries of India and their views on the matter are awaited.

ICP 8 – Changes in control and portfolio transfers

- It has been recommended that the Insurance Law should explicitly state that interest of policyholders of both insurers involved must be taken into account in assessing the portfolio transfer/merger. Independent Actuarial report should confirm the same. The Section 35 of the Insurance Act, 1938 deals with amalgamation and transfer of life insurance business. Further, the IRDA (Scheme of Amalgamation and Transfer of General Insurance Business) Regulations, 2011 lay down the framework for mergers and amalgamation of nonlife insurance companies. The underpinning of the regulatory framework is protection of the interests of the policyholders. However, IRDA would examine the recommendation, and if it is felt necessary to incorporate specific stipulations stating that interest of policyholders of both insurers involved must be taken into account in assessing the portfolio transfer/merger, these provisions shall be explicitly incorporated in the regulatory framework.

ICP 9 – Corporate governance

- The authority will examine the proposal to enhance the scope of the statutory auditor's report to cover compliance with the corporate governance guidelines. Further, the reporting on the same can form part of the Auditor's Report attached to the financial returns filed by the insurance companies on an annual basis.

- Another recommendation on strengthening the corporate governance framework is on the requirement that related-party transactions should be reported to the authority ideally as part of the monthly reporting process. The Accounting Standard 18 (AS-18) issued by ICAI deals with the related-party transactions. The statutory auditors are required to comment on the arm's length of such transactions. The insurance companies are also required to make disclosures on related-party transactions on an annual basis. A view whether there is a need to strength the mechanism through greater oversight and for reducing the periodicity on such reporting would be taken based on discussions with the other financial sector regulators.

ICP 10 – Internal control

- Additional recommendations have been made on strengthening internal control and internal audit under the corporate governance guidelines. The authority's comments on the same are that both internal control and internal audit have been mandated under the regulatory framework and under the corporate governance guidelines. The statutory auditors and the Audit Committee have an oversight over these functions. The statutory auditors are also required to comment on the adequacy of the internal controls. All insurance companies have in place Internal Audit Departments headed by senior level executives and internal audit is carried out through in-house/ outsourced personnel. At the moment, the authority does not consider it necessary to stipulate that the internal audit function should necessarily be carried out by an internal department of the insurance company. The authority will, however, examine the existing framework and the corporate governance guidelines, if necessary.

ICP 12 – Reporting to supervisors and off-site monitoring

- It has been recommended that monthly reporting could include more short-term risks, data in addition to sales, and branch/geographical development data. The Annual Appointed Actuary's Report requires the insurance companies to cover the risks faced by them. It is proposed that such reporting is robust to cover all risks faced by an insurance company. Once the mechanism stabilizes, it is proposed to reduce the periodicity to half-yearly.

ICP 13 – Onsite inspection

- Certain comments have been made on making the onsite inspection more robust. IRDA's comments on the recommendations are as below:

    - The inspection teams are well formed, including inspectors from major areas on which the inspections are required to be carried out. Further, such teams also have a systems person as part of the full-scope inspection teams.

    - The authority has in place a mechanism whereby the reports of the inspection team are shared with the insurance company. The IRDA further has in place an internal Standing Committee, which deliberates on the findings of the inspection teams and the responses of the respective management on the findings prior to taking a final call on further course of action in case of any regulatory issues.

    - It is proposed that the necessary onsite inspection capacities be built within the IRDA to ensure full financial audit at a periodicity of three to four years for each company. In case the situation so warrants due to regulatory concerns, the inspections may be carried out even at shorter intervals.

ICP 14 – Preventive and corrective measures

- The IRDA is presently working on strengthening the preventive and corrective measures through the early warning system to facilitate early intervention in case of an emerging regulatory concern.

- IRDA also proposes to put in place the mechanism to require its concurrence/ compliance with certain prerequisites in cases where the insurer proposes to engage in capital management through such actions as 'buy-back' of shares.

ICP 15 – Enforcement of sanctions

- The existing provisions of Section 102 of the Insurance Act, 1938 enable IRDA to levy a penalty of Rs 5 lakhs for each instance of violation without any overall ceiling or cap. Hence, based on severity and outcome of a violation, the authority takes a call. Further, the Insurance Amendment Bill, 2008 proposes to increase the quantum of penalty leviable on insurers for various violations (with the maximum penalty proposed to be raised to Rs 25 crores).

ICP 16 – Winding-up and exit from the market

- It has been recommended that IRDA may consider allowing the voluntary wind-up of solvent nonlife insurers, subject to satisfactory safeguards. In some circumstances claims run-off can be the most efficient method of exit. It has also been recommended that the provisions relating to the appointment of an administrator for nonlife insurers be brought into line with those applying to life insurers. The authority is examining these recommendations.

ICP 17 – Group-wide supervision

- The recommendation on formalizing the information-sharing mechanism has been commented upon under ICP 5. The subcommittee of FSDC has the mandate to examine issues relating to sharing of information and coordination between the financial sector regulators. The issues relating to individual supervisors having greater power to consider group structures, exposure and related-party transactions, and determining their intervention shall be taken up at the subcommittee to consider the way forward.

ICP 18 – Risk assessment and management

- The authority's stand on the proposed framework for reporting of risks by the insurance companies has been spelt out against ICP 12. It is proposed that the internal audit and control functions and the corporate governance guidelines are dove-tailed to ensure a robust risk-assessment-management framework. Certainly, addressing the operational risks is at the top of the IRDA's agenda. Stipulations on Asset Liability Management to address various risks faced by insurance companies have been mandated for all insurance companies, which become effective April 1, 2012.

ICP 20 – Liabilities

- The FSAP mission has made recommendations on valuations of liabilities of life and nonlife insurance companies. Broadly, the recommendations are two-fold as indicated below:

    - Need for life actuaries to compensate difference between the philosophies underlying the liability and asset valuation undesirable. In addition expense over-runs should be provided for if they appear to be chronic once the establishment period is finished.

    - Nonlife valuation rules do not provide guidance on where long tail provisions should be set on—distribution of possible results.

- IRDA has recently set-up *vide* Order No. IRDA/ACT/ORD/MISC/131/06/2011 dated June 21, 2011, an Actuarial Standing Committee to advise on various matters relating to actuarial standards/regulations, etc. These recommendations have been forwarded to the Standing Committee for examination.

ICP 21 – Investments

- The mission has drawn attention to the contradiction in the valuation of debt instruments, whereby these are not being valued at not exceeding their market or realisable value as provided under section 64V of the Insurance Act, 1938. The authority has taken a conscious decision in the matter in view of the fact that investments made by insurance companies are, by their very nature, long term, and are thus being valued at acquisition cost subject to provision for nonperforming assets.

- As regards the comment on required skill and experience of investment offices of insurance companies being specified by the regulator and should be subject to oversight by the Board, the IRDA is of the view that these requirements fall within the mandate of the Investment Committee, which is further within the oversight of the respective Board. The stipulations on the constitution of the Investment Committee have also been laid down under the regulatory framework.

ICP 22 – Derivatives and similar commitments

- The reporting mechanism with respect to derivatives would be strengthened on the insurance companies taking exposure to derivatives.

ICP 23 – Capital adequacy and solvency

- As indicated above, IRDA is working on the early warning signals.

- The authority has taken note of the recommendations on strengthening the capital adequacy and solvency regime. In this regard, attention is drawn to the fact that while the Insurance Act requires the insurance companies to maintain the solvency of 100 percent, the authority as part of the registration requirements stipulated that all insurance companies must maintain a solvency of 150 percent at all times. In addition, IRDA has laid down stipulations on computation of economic capital by life and nonlife insurance companies. Further, the Institute of Actuaries of India has released guidance on embedded value calculations for life insurance companies. IRDA is also examining the merits of moving toward a standardized risk-based solvency model. It is envisaged that with the stabilization of these initiatives, the capital adequacy and solvency regime would become risk based.

ICP 24 – Intermediaries

- It has been recommended that as insurance brokers become more important in insurance intermediation the relevant statutory reporting should be upgraded. In the context of the comments made, it may be mentioned that only reinsurance Brokers are permitted to collect and remit the premiums (Reg. 4 (j)) and provisions relating to segregation of insurance money and Insurance Bank Account also relate to Reinsurance Brokers (Reg. 23). Further, IRDA has in place reporting requirements for insurance brokers, including that all licensed insurance brokers shall submit to the authority premiums placed to the insurance companies segment-wise and the brokerage received on the same from the insurance company. The insurance brokers are also required to file annual audited accounts and half-yearly unaudited accounts.

- The direct insurance brokers are not permitted to accept insurance premiums in their account, except reinsurance brokers. Therefore, there are no policyholder trust funds. The insurance brokers are also required to have a cover through professional indemnity policy. Reporting norms for reinsurance brokers about the amounts held by them in their reinsurance accounts can be examined by the authority.

ICP 25 – Consumer protection

- The recommendation on strengthening the framework on Ombudsman is under the consideration of the Government of India. IRDA would be providing the necessary inputs in this regard to the Government of India.

ICP 26 – Information, disclosure, and transparency toward the market

- As a way forward, IRDA is proposing to work on the snapshot of financial performance parameters to be disclosed by insurance companies at an annual periodicity, which may be further shortened.

ICP 27 – Fraud

- The IRDA is presently working on putting in place the regulatory framework on frauds for the insurance sector in India. The mechanism would aim at insurance companies having a robust framework to address, monitor, and mitigate risks arising from frauds, reporting of frauds for life, nonlife, and reinsurance companies.

ICP 28 – Anti-money laundering, combating the financing of terrorism (AML/CFT)

- It has been recommended that insurance brokers should also be brought within the purview of AML/CFT guidelines. While the percentage of business procured through brokers is very low at around 1 percent in case of life insurance companies, in case of nonlife insurance companies, their presence is much more significant. The authority is examining the proposal to bring brokers under the ambit of AML/CFT guidelines.

- The issues relating to financial sanctions being enhanced have been addressed under ICP 15.

II. Detailed Assessment

Table 15. India: Detailed Assessment of Observance of the Insurance Core Principles[34]

Conditions for Effective Insurance Supervision	
Principle 1.	Conditions for effective insurance supervision Insurance supervision relies upon: -a policy, institutional and legal framework for financial sector supervision. -a well developed and effective financial market infrastructure. -efficient financial markets.
Description	India has long had a formal planning process through its Planning Commission and the annual Finance Bill. The FRBM Act was enacted by parliament in 2003 to bring in fiscal discipline and the government issued the supporting rules in July 2004. These impose caps on fiscal and revenue deficits. In case of a breach, the government is held accountable under the law and is required to explain to parliament the reasons for the breach, the corrective steps that will be taken and the proposals for funding the deficit. In addition, India has some of the longest established laws dealing with the financial sector oversight. However, while supervisory institutions now exist to cover all major aspects of the financial sector, the Insurance Regulatory and Development Authority of India (IRDA) is still relatively young, having only started operations in 2000. The pension supervisor is even younger and the relevant pension law has yet to be passed. Following recent global instability, a mechanism to ensure oversight of the financial system, the Financial Stability Development Council (FSDC), was established by the Ministry of Finance (MOF). FSDC , which does not have statutory status, is Chaired by the Minister of Finance and meets as necessary to deal with high level issues requiring Ministerial involvement. A sub-committee of FSDC, chaired by the Governor of the Reserve Bank of India (RBI) and including the Chairmen of the insurance, securities and pension supervisory bodies, has been established to guide the work of FSDC, coordinate supervisory activities and monitor early warning signals across the system. This group, which replaces a High Level Coordination Committee on Financial Markets, has met several times already and has an informal agreement to meet at least quarterly. The RBI produces a semi-annual Financial Stability Report and the June 2011 version included a section on the insurance sector for the first time. The three main regulatory bodies have broad powers to issue regulations and circulars necessary to deal with lacunas or new developments. Laws are issued by the parliament after extensive consultation. New regulations are drafted by the relevant supervisor after consultation (including with a formal Advisory Committee in the case of IRDA) and then submitted to both houses in the parliament for consideration and approval. Circulars carry the full weight of IRDA's general powers and have been employed to clarify the law and regulations and as a precursor to full regulation. In practice, regulations and circulars have the force of law.

[34] References to 'the Act' refers to the Insurance Act 1938, as amended.

	The base law covering the insurance sector is the Insurance Act 1938, which has recently been subject to frequent amendment and, is now relatively modern. However, a number of key changes included in a draft 2008 Bill are still awaiting legislative approval (see comments below). IRDA was established under the Insurance Regulatory and Development Authority Act, 1999. Under the Constitution, administrative decisions (including sanctions) applied by IRDA are appealable to the High Court and the Division Bench of the Supreme Court. The legal system in India (based on the British Common Law tradition) has been long established and appears to operate reliably and there is confidence that court decisions will be enforced. The Bar Council of India and state level legal associations function as SROs. Both the actuarial and accounting professions have ruling bodies established by statute and members are subject to professional codes of conduct. India has a very large accounting profession as this is seen as a desirable career. There are approximately 175,000 certified accountants and half a million trainees. Approximately 15,000 to 20,000 new accountants are produced each year after a rigorous qualification process based on examinations and experience. Accounting and Auditing standards are formulated by the Institute of Chartered Accountants of India (ICAI). These are applicable to insurers, with the exception of a carve-out for investments. ICAI has produced a number of guidance manuals covering the annual and concurrent auditing of insurers. Despite being a full member of the International Actuarial Association the actuarial profession is relatively young as it atrophied during the years in which the sector was nationalized and has had to be revived with the entry of private sector insurers after 1999. The institute of actuaries gained full legal status in 2006 and is responsible for a range of matters including standards, training and accreditation and discipline. As at the mission date, there were 238 Fellowship level actuaries qualified to practice in India of which 72 were working in the insurance sector. There were 137 associates and more than 9,000 students. While there was currently a chronic shortage of actuarial skills (particularly for nonlife) the number of actuaries is expected to double in the next three to four years (although the numbers have been relatively static for the last four years). The external auditors of insurance companies are appointed with the approval of the shareholders. IRDA has laid down the minimum eligibility criteria for appointment as a statutory auditor and a dual audit system applies. However, unlike the RBI, IRDA does not require a listing of approved auditors from ICAI. The Regulations lay down the requisite qualification for the appointed actuary. The requisite qualifications are laid down in the IRDA (appointed actuary) Regulations, 2000. Prior approval of IRDA is required for the appointment of an appointed actuary. Basic economic, financial and social statistics are available to the supervisory authority, industry and the general public as they are published in various government publications and are available on the respective websites of relevant ministries. Both annual data and time series data is available on various aspects of the Indian economy. These include the Economic Survey, the Annual Report of the Ministry of Finance, annual reports and monthly journals of RBI, SEBI and IRDA; statistical reports and handbooks are published at annual and periodic intervals by the respective regulator.

	With specific reference to the insurance industry, information is disseminated through the IRDA website and publications - Annual Report, Handbook on Insurance Statistics, the monthly journal and through the Insurance Information Bureau (www.iib.gov.in). In addition, through its Circular issued in January, 2010, IRDA has mandated all insurance companies to put in place financial data as per the prescribed format for the last five years on their respective websites. In addition, quarterly disclosures are made on the companies' websites and half yearly disclosures are made in the newspapers. In 2010, the disclosure requirements for the sector have been further enhanced: company-wide insurance statistics are available to the public through the websites of individual companies. Well established money and securities markets are in place. During 2009–2010, turnover on all stock exchanges in the cash segment stood at Rs 55.2 trillion (US$1.1 trillion) compared to insurance sector total assets of Rs 12.7 trillion (US$260 billion). Over the Counter (OTC) trades and trades reported on the exchanges indicates the number of trades in corporate bonds during 2009–2010 increased by 68.5 percent—insurers currently hold 35 percent of outstanding corporate bonds. During 2009–2010, turnover in the Wholesale Debt Market (WDM) segment increased to Rs 5.6 trillion (US$115 billion). The main issue for insurers is that debt markets are relatively illiquid and they are largely dependent on the primary issue market to acquire new securities.
Assessment	Observed
Comments	India is becoming an outsourcer of actuarial services and the number of actuaries in the country is significantly greater than those qualified to practice locally. If the availability of qualified actuarial professionals continues to be an issue, there may be a need to consider an appointed actuary system whereby qualified actuaries from acceptable overseas members of IAA can gain local accreditation after a suitable period of experience and with proper references.
The Supervisory System	
Principle 2.	Supervisory objectives The principal objectives of insurance supervision are clearly defined.
Description	The objectives of supervision as stated in the preamble to the IRDA Act are "to protect the interests of holders of insurance policies, to regulate, promote and ensure orderly growth of the insurance industry", both insurance and reinsurance business. Section 14 of the IRDA Act specifies the functions of the IRDA. The powers and functions listed elaborate on this broad mandate and include: • Protection of the interests of policyholders. • Promoting efficiency in the conduct of the insurance business. The dual mandate—protecting policyholders and promoting orderly growth—reflects a requirement of the parliament at the time the IRDA law was passed. The original bill referred only to policyholder protection and efficiency and was consistent with ICP 2, which does not explicitly contemplate a development mandate. However, under criterion c, if multiple objectives do exist the supervisor is required to explain how each objective is to be achieved. In this regard, IRDA has been transparent with an explicit requirement that insurers support the access agenda and that certain levels of penetration of socially deprived and rural populations are to be achieved. This requirement is applied on a consistent basis and IRDA does not direct the strategies of

	individual insurers. There are no inherent contradictions in the objectives as interpreted and IRDA has not deviated from its legal mandate.
Assessment	Observed
Comments	
Principle 3.	Supervisory authority The supervisory authority: - has adequate powers, legal protection and financial resources to exercise its functions and powers; - is operationally independent and accountable in the exercise of its functions and powers; and - hires, trains and maintains sufficient staff with high professional standards; and treats confidential information appropriately.
Description	The duties, powers and functions of IRDA are laid down in section 14 of the IRDA Act, 1999 and Sections 33, 34 and 114A of the Insurance Act, 1938. The broad authority under the IRDA law includes: • issuance of registration and subsequent modification, suspension and withdrawal thereof; • specifying qualifications of intermediaries and the codes of conduct under which they operate; • carrying out inspections of all insurance entities coming under the Insurance Act; • control and regulation of insurance contract rates and terms; • specifying the form of accounts to be maintained and rendered by insurers; • regulating investments; • regulating solvency; and • specifying social and rural insurance targets. The more detailed supervisory role is covered in the Insurance Act. Under s34(1) a very broad power exists to issue any appropriate direction if IRDA believes that it is in the public interest or to prevent actions detrimental to policyholders or the insurer, and to ensure proper management of an insurer. The insurer concerned must be given adequate notice of such action and have an opportunity to appeal its case. Under Section 33, IRDA may investigate an insurer at any time and upon receipt of a report to require the insurer to take actions arising from the report, to cancel the registration of the insurer or to direct any person to apply to the court for the winding up of the insurer. IRDA may at its discretion also publish entire or some parts of the report. Under Art 34A(1) all appointments of managing or executive directors, managers or CEOs must be approved by IRDA. IRDA may also remove any director or the CEO of an insurer for similar reasons to those specified under Art 34(1) and subject to the same protections (except in case of severe risk in which case the hearing can occur after the individual is removed). Another person can be appointed in their place at the pleasure of the Chairman of IRDA – the “Controller’. The Controller may also appoint additional directors (up to one third or the Board count) if there is severe concern about the management of an insurer.

	Life Insurance Corporation (LIC) of India provides an exception to IRDA's powers regarding insurers' management and governance structures as its directors and senior management are appointed by the central government. LIC has its own Act and in a number of respects (mainly related to its capitalization) lies outside the requirements of the Insurance and IRDA laws (see risk management assessment below). LIC accounts for approximately 70 percent of the life market, has recently been increasing its market share, is a significant player in the financial markets and in particular is a key source of long term financing for the government and infrastructure. Under Clause 34E the Controller can prevent insurers, either collectively or individually, from entering into undesirable transactions. In addition, he can require the Board of an insurer to be the intermediary in carrying out managerial and other changes and can appoint an officer of IRDA to observe the day to day running of an insurer. The Controller may issue desist directions regarding undesirable reinsurance arrangements and require that an insurer close down a foreign branch if it is prejudicing the home activity. IRDA has broad powers of search and seizure of books etc. Under Clause 37A(1) IRDA may prepare a scheme of amalgamation of an insurer with any other insurer if it believes that it is in the interests of policyholders, the public interest or *in the interests of the insurance business of the country as a whole.* The other insurer has to give written consent to such a transaction. Section 114 of the Insurance Act sets out the respective powers of the central government and IRDA to make rules and regulations. The former, insofar as they relate to insurers, apply to the qualifications required of actuaries, the definition of insurance activities and the fees that may be collected other than those specified under IRDA's authority. The latter cover virtually 30 administrative matters typically dealt with by an insurance supervisor including the quantum of transaction related fees, accreditation of intermediaries and insurers' reporting requirements. Despite these broad powers, certain functions are reserved for the central government (i.e., the Ministry of Finance). In particular, IRDA may not appoint an administrator to a life insurer. This requires a referral with reasons to the central government, which will appoint the administrator if it believes so warranted. The central government may also compulsorily acquire an insurer after receipt of a report from IRDA to the effect that the insurer is ignoring directions or otherwise acting in a way which is detrimental to policyholders, shareholders or the public interest. This action has not been necessary to date and the detailed rules (including valuation of shareholders' interest) have yet to be published. The IRDA Act, 1999, provides that the IRDA Board shall consist of the Chairperson; not more than five whole-time members and not more than four part-time members. The members of the IRDA Board are appointed by the central government, and must have expertise and knowledge in the specified fields, viz., life insurance, general insurance, actuarial science, finance, economics, law, accountancy and administration. The Chairperson has the powers of general superintendence and direction in respect of all administrative matters of the IRDA. Policy decisions are taken by the IRDA by a majority of votes.

	The Chairperson of IRDA is administratively appointed by the Cabinet Committee on Appointments, headed by the Prime Minister. The central government reserves the right to remove any member from office under specified conditions. However, no member shall be removed for reasons of abuse of office or for being in the position that is likely to his ability to function effectively, without being given a reasonable opportunity to be heard. The appointment of officers and staff is transparent. IRDA may appoint officers and staff as it considers necessary for the efficient discharge of its functions. IRDA is required to submit to the central government a report giving a true and full account of its activities including the activities for promotion and development of the insurance sector during the previous financial year. Copies of the report are required to be laid before both houses of parliament. IRDA's accounts are audited by the Comptroller & Auditor General of India (C&AG) on an annual basis. The annual accounts of IRDA as certified by the C&AG along with the audit report are required to be forwarded annually to the central government and these are required to be laid before each House of parliament. The internal audit functions of IRDA are carried out by independent auditors, on a quarterly basis. To date, IRDA has been allowed to act as an independent agency reporting to the parliament on its activities through the Union Ministry of Finance. The operations of IRDA are reviewed by the Standing Committee on Finance on an annual basis. IRDA collects its own levies (0.1 percent of premiums) and fees and maintains control of its planning and budgeting, subject to the oversight of its Board and the government auditor. However, there has been a move by elements of the central government, using a Constitutional provision, to require that IRDA funds are placed with a central account and that budgeting becomes subject to central oversight. In addition, there are broad provisions under both the Insurance Act and the IRDA law permitting the central government to take control of IRDA and even to usurp its role: • Under Clause 18 of the IRDA law the central government may direct IRDA on questions of policy. However, any decision of the central government is final regardless of whether it relates to policy or not. • Under Clause 19, the central government may usurp IRDA's authority for a period of up to six months. The conditions under which this may happen are laid out and include: o for reasons beyond its control IRDA cannot carry out its functions; o that IRDA has not complied with a direction of the central government or has defaulted on its duties; and o in the public interest. These provision have not been applied during the 11-year life of IRDA, and based on precedent with other statutory bodies are rarely applied. The role of the judiciary is also specified under the Insurance Act and is relevant in the context of acquisition of an undertaking or under a statutory winding up. IRDA follows a process of consultation with the industry stakeholders in framing various policies/ regulations. The manner of framing the regulations is transparent. The Councils of Life and General insurers which comprise of the members of the

	respective industry segments are consulted in the process. In most instances IRDA sets up a consultative committee/ group comprising experts representing the industry to examine the various aspects related to the issue at hand. The recommendations of the Group are submitted to IRDA. The IRDA considers the comments received while framing the draft of the regulations. The draft is then vetted by the Insurance Advisory Committee. The draft of each regulation is finally approved by the Board of IRDA. The regulations are then notified in the Official Gazette. All regulations and circulars issued by IRDA are placed on its website. As noted above IRDA is equipped with adequate rapid intervention powers under the Insurance Act to order an investigation into the affairs of any insurance company. The investigating authority can further employ any auditor and/or actuary. Based on the report filed with it, IRDA can, after giving due opportunity to the insurer to be heard, issue any directions as it may deem fit, including cancellation of registration or even to apply for winding up of the insurer. The conditions of service for officers and staff of IRDA are laid down under a code of conduct. There are also restrictions on certain types of employments and activities to guard against conflict of interest. Officers of IRDA are prohibited from trading/ speculating in stock, shares or securities of any insurance company or any other company which is likely to affect the discharge of official duty and on the value of investments that can be held in an insurance company or its subsidiary. There are reporting requirements to be complied with on an annual basis to ensure compliance. Employees are required to submit details of movable, immovable and valuable properties held by them on an annual basis. The manner of disciplinary proceedings is laid down in case of breach of the code of conduct. All employees are governed by the requirements of confidentiality. These stipulations are equally applicable to outside experts. Income levels and benefits (tangible and intangible) of employment appear to be largely adequate for lower and mid-level staff most of whom already have formal insurance qualifications or are in the process of obtaining them (including a number of relatively advanced actuarial students). Staff turnover has been relatively low and there appear to have been few problems in recruiting new officers. There has, however, been some turnover in the more specialized areas and the role of member–actuary recently became vacant. It is proving to be difficult to find a senior actuary to take on this role and there may be a need to arrange a mechanism whereby the remuneration can be brought to market levels (other countries including some industrial countries have dealt with the same issue by making the actuary a long term contractor). Given the complexity of many issues currently facing IRDA it is highly desirable that a senior actuary who is also familiar with current actuarial practice and developments is recruited. No officer or employee who has retired can accept or undertake a commercial employment in any insurance company except with previous sanction of the Supervisor, within 2 years from his cessation of employment with IRDA. No officer can misuse his position to secure employment with any insurer/intermediary. Chairman, Members, officers and staff of the authority are given the status of Public Servants and are protected from being sued for actions done in good faith in discharge of their responsibilities. The cost of defending any legal action taken against any of them in their official capacity, if incurred would be treated as the official expenses of the IRDA.

Assessment	Partly observed.
Comments	The current uncertainty regarding IRDA's control of its funding and budget, its incomplete oversight of LIC and the reserve powers of the central government to direct its activities all potentially detract from the supervisor's powers and independence. The Amendment Act of 2008 and proposed changes to the LIC Act are, amongst other things, intended to address a number of these issues (including LIC'S transparency regarding its level of capitalization). In addition it is important that a suitably qualified Member – actuary is recruited.
Principle 4.	Supervisory process The supervisory authority conducts its functions in a transparent and accountable manner.
Description	IRDA issues regulations/ guidelines in consultation with all the stakeholders. The various stages of the consultation process are: 1. Consultation with the Councils 2. Hosting of the website, inviting comments of stakeholders. 3. Consideration of draft regulations through the Insurance Advisory Committee. 4. Approval of the Board 5. Notification of the Regulations. Section 25 of the IRDA law provides for the establishment of an Insurance Advisory Committee which has representatives from commerce, industry, transport, agriculture, surveyors, agents, intermediaries, organizations engaged in safety and loss prevention, research bodies and employees' association in the insurance sector. All decisions of the IRDA are based on properly recorded notes that take into account any precedents that are relevant to the issue under consideration. This ensures that decisions are consistently applied. Most, but not all, actions of the IRDA are subject to Judicial Review. The investigation and actions taken in exercise of the powers vested under Section 33 of the Insurance law cannot be questioned in a Court of Law except for cancellation of registration. All applicable legislation, regulations and circulars, and consultation papers are available on IRDA's website. IRDA also has an outreach program, mediated through the press. Decisions on major policy issues are taken by the IRDA Board. Matters which require immediate decision are dealt with by the Chairman and full time members. Where a meeting of the full Board is required, the meeting will be called at short notice. Under Section 9 of the IRDA Act, the Chairperson has powers of general superintendence and direction in respect of all administrative matters. Under Sections 33 and 34 of the Insurance Act IRDA have adequate powers to take emergency actions. Section 110 of Insurance Act provides for appeal before the Court having jurisdiction over any of the following orders of the supervisor – - Under section 3 cancellation of registration of insurer; - Under section 5 directing the insurer to change its name; and - Under Section 42 cancelling a license issued to an agent.

	Currently, no administrative provision is available to appeal penalties imposed by the IRDA. However, most administrative actions under Section 34 require prior notification and an opportunity for the entity involved to state its case, and must be reviewed by an expert Consultative Committee before an Order is issued. Finally, the IRDA publishes its decisions and this places a constraint on any egregious use of its authority. Section 20 of the IRDA Act requires the IRDA to submit an annual report giving a true and full account of its activities including the promotion and development of insurance business during the previous financial year. This document also covers an overview of the insurance market, and reviews of policies, programs and operations. In addition, IRDA publishes a Monthly Journal on its website providing up to date data on the sector and covering topics of current interest.
Assessment	Observed
Comments	
Principle 5.	Supervisory cooperation and information sharing The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.
Description	Neither the Insurance Act nor the IRDA law explicitly mentions information sharing. Thus, there appears to be no a priori requirement for a formal agreement to share information and in practice information is shared with regulators both within the country and abroad. To regularize the situation and using its general powers, the IRDA has recently laid down an Internal Policy on sharing of information both within India and other jurisdictions under Circular No. IRDA/F&I/CIR/GLD/202/12/2010. The policy framework for information sharing classifies data into three categories: 1. Information in the public domain 2. Information not in the public domain – o Confidential information. o Information that could impinge on proprietary rights. 3. Other information. For information not in the public domain, the response is dependent on the nature of the applicant and the reason for seeking the information. Where the information is sought by an Indian regulator, international supervisors or agencies or public authorities the criteria are: • Convincing reasons for the request made. • Nature of the information (not proprietary). • Maintenance of confidentiality. • Reciprocity. For other stakeholders, including information sought under the Right to Information Act, information would not be provided if it is commercial in nature and could impinge on proprietary/ privacy rights. In all cases, the IRDA retains the right to withhold information if it could destabilize a regulated entity or the sector as a whole.

	In terms of Cooperation, the IRDA is a member of a number of international bodies: at the SAARC level – a. The South Asian Regulators have formed a group for regional cooperation – South Asian Insurance Regulators Forum (SIRF). b. Asian Federation of Insurance Regulators (AFIR) - set up for cross border cooperation amongst supervisors, and • at the global level - IRDA is an active member of the IAIS (the Chairman of the IRDA is on the IAIS Executive Committee). The IRDA has applied to become a signatory to the IAIS MMOU, which will facilitate its entering into agreements with other supervisors. The exchange of information rules and policy have yet to be tested in cases where IRDA proposes to act on information received from another supervisor or intends to take action as a home supervisor that could be relevant for a host supervisor. Given the current shareholding rules, the IRDA is unlikely to become a host supervisor. The existing domestic information sharing system is effected through the former RBI hosted high level committee, which is now part of the FSDC (see ICPs 3 and 17).
Assessment	Largely Observed
Comments	The cooperation and information sharing system between the three key domestic financial sector supervisors (the former RBI High Level Committee) should be formalized. Relevant international agreements should be formalized as soon as membership of the IAIS MMOU is ratified. IRDA should formalize mechanisms to advise host supervisors of actions that are relevant to them – e.g. requiring an insurer to close down a poorly performing branch.
The Supervised Entity	
Principle 6.	Licensing An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public.
Description	Sec 2(7A) and Sec 2(8) of the Insurance Act define the permissible forms of insurers namely a company formed under Companies Act 1956 or a Cooperative Society registered under the Cooperative Societies Act, 1912 or under the Multi-State Cooperative Societies Act, 1984. Section 2C of the Act prohibits unauthorized insurance activities and Section 14(2) of the IRDA Act, 1999 gives the IRDA the necessary powers to issue certificates of registration. Sec 3 stipulates grant of certificate of registration by the IRDA. Certain insurance activities do not come under the IRDA's oversight. These are mainly state based government employee life insurance schemes, health mutuals and insurance supervised by the Postal Department. The total premiums involved currently amount to approximately IR40 million (US$0.8 million) and is not material. The registration of Indian insurance companies is a three stage process –R1, R2 and R3. At the R1 stage the capital structure of the applicant is considered along with its overall business plans. Due diligence is also carried out on the promoters – both

	Indian and the joint venture partner, if any including a financial strength examination to assess their ability to meet the growth plans and the solvency requirements. The R1 is taken to the IRDA Board for its consideration. Post approval, the applicant furnishes the R2 to provide further details (see below). On approval of the R2 by the IRDA, R3, i.e., the certificate of registration, is granted. Key information sought under the R1 and R2 stages is as follows: The R1 application seeks business plan of the applicant for next 5 years which reflects the business lines, projected setting up costs, capital requirements, projected development of business, solvency margin, reinsurance arrangements, expenses of management, incurred claims ratio, projected investments, etc., which is comprehensive. R1 also seeks details of directors and key persons, significant owners and whether they are suitable to become promoters of an applicant. The R2 application seeks details of the applicant's risk management systems including reinsurance arrangements, internal control systems and information technology systems; to ensure that policies and procedures would be adequate for the nature and scale of the business in question. It also seeks details of products to be offered by the applicant, details of internal controls with regard to underwriting, customer service, investment, accounting, claims settlement, regulatory compliance and solvency margin (includes reporting to its own management and to the supervisory authority). Core function outsourcing is not permitted currently and must be carried out in-house. Noncore activities are subject to the requirements of an outsourcing circular. Suitability requirements are imposed at the time an insurer is seeking registration. These apply to prospective owners, directors and key management and senior technical staff, including the appointed actuary. As part of standard regulatory practice, the IRDA writes to the promoters' regulatory body or to the foreign supervisory authority regarding the track record, credibility and financial strength of the promoter companies (both domestic and joint venture promoters). All these requirements are available on the IRDA website. Foreign controlled insurers are not permitted to operate in India and the relevant criteria are not applicable. Composites are not permitted in India with the exception of GIC, the state-owned reinsurer. Due to lacunas elsewhere in the law and regulations, the IRDA takes the opportunity to apply certain requirements at the time of registration, including a five-year lock in for the founding promoters and a requirement that insurers maintain at least 150 percent of the minimum statutory solvency requirement. No specific timeframe for processing applications is laid down in the law: normally the IRDA processes the application within a period of eight to nine months. Sec 3(2B) of the Insurance Act states that registration may be refused in case the applicant does not fulfill the requirement stipulated in the law. Para's 7 and 12 of the

	IRDA's registration regulation grants powers to the IRDA to refuse registration . The rejection can be on account of the application not being complete in all aspects or where the IRDA is satisfied that it is not desirable to grant registration to the applicant. The reasons for rejection could include likely inability of the promoters to meet the capital requirements on an on-going basis or supervisory issues raised by other regulators inside or outside the IRDA's jurisdiction. Sec 3(2C) of the Insurance? law requires the IRDA to give reason for the rejection of an application, and the applicant is required to be given an opportunity to be heard. Paras 8, 9, and 13 of the IRDA's registration regulations provide for the applicant to file for a reconsideration of the decision of the IRDA and the right of appeal to the central government.
Assessment	Observed
Comments	The central government may wish to specify maximum timeframes for the IRDA to respond to applications including specifying requirements for more information.
Principle 7.	Suitability of persons The significant owners, Board members, senior management, auditors and actuaries of an insurer are fit and proper to fulfil their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications
Description	The insurer registration regulations define a key functionary as the Chief Executive Officer, Chief Marketing Officer, appointed actuary, Chief Investment Officer, Chief of Internal Audit and Chief Finance Officer. Key functionaries, significant promoters (those who will hold more than 1 percent of the issued shares) and proposed directors of an insurance company are required to meet fit and proper criteria, assessed by the IRDA based on detailed questionnaires specified under Clause 12 of the IRDA (Registration) Regulations 2000. After registration, compliance with the fit and proper criteria is required to be met on an on-going basis. A special regulation issued in 2000 lays down the procedure for appointment of an appointed actuary. This covers the fit and proper requirements in terms of qualifications, eligibility criteria, age, etc., and mandates the prior approval of the IRDA before appointment. The Insurance Act also requires the prior approval of IRDA for the appointment or reappointment of the CEO/MD and full time directors, with the relevant fit and proper checks being carried out by IRDA. Fit and proper checks on statutory auditors are performed by insurance companies based on the stipulations laid down in the guidelines on the appointment of statutory auditors of insurance companies. Insurers are also required to advise the IRDA the name and address of the audit firms within one week of their appointment. Under paragraph V of the guidelines on the appointment of statutory auditors, if it comes to the notice of the IRDA that the appointment is not in line with the prescriptions/ information furnished by the audit firm, the appointment is liable for cancellation and it is open for the IRDA to consider appropriate action. However, IRDA does not maintain a list of approved auditors and it is not clear how it carries out the relevant checks. Under Section 37A of the Insurance Act, the IRDA has powers to ask a shareholder to disinvest its stake in an insurance company where they no longer meet fit and proper requirements (see ICP 8). Appointed actuary. Adequate disciplinary powers including powers to remove a Certificate of Practice exist under the Actuaries Act and, in practice, the chief

	executive of the institute has been ensuring that practitioners are suitably qualified by withholding renewal of certificates. Thus, the main gap in the fit and proper requirements is the continuous monitoring of the fit and proper status of non-executive directors—appointments may be made during the financial year without supervisory oversight. Responsibility rests with the insurers' Boards under Paragraph 5.3 of the Governance Guidelines. However, a Nomination Committee is not mandatory under the Corporate Governance guidelines. Section 48A and section 48B of the Insurance Act prohibits a life insurance agent from being a director of the a life insurance company subject to one exception: The IRDA (Licensing of Corporate Agents) Regulations, 2002 specifies that a corporate agent/specified person may nominate a director to an insurer (life or general) if it holds more than 10 percent of the insurer's equity. The Law also prohibits common directorships among life insurance companies. Similarly, the managing director or other officer of a life insurer carrying on life insurance may not be the managing director or other officer of any other insurer carrying on life insurance business or of a banking company or of an investment company. Under Annexures 2 and 3 to the Corporate Governance guidelines, insurers are required to annually document the declarations and undertakings given by directors with an emphasis on any absence of change in the details furnished at the time of their appointment, the existence of deeds of covenant with the directors clearly identifying roles and responsibilities of directors, details of their qualifications, experience, integrity etc.. IRDA also brings concerns which have been detected through supervisory activities to the attention of the Board and senior management of insurers.
Assessment	Observed
Comments	It is desirable to either mandate that Boards appoint a largely independent Nominating Committee or require that the compliance officer immediately advise IRDA of the fit and proper details of any new directorial appointment. In addition it is desirable the Actuarial Certificate of Practice specify the areas in which an actuary is qualified to practice.
Principle 8.	Changes in control and portfolio transfers The supervisory authority approves or rejects proposals to acquire significant ownership or any other interest in an insurer that results in that person, directly or indirectly, alone or with an associate, exercising control over the insurer. The supervisory authority approves the portfolio transfer or merger of insurance business.
Description	**Changes in control:** Section 4(2) of the Companies Act, 1956 defines the term control: "a company's Board of Directors shall be deemed to be controlled by another company if, but only if, that other company by exercising some power without the consent or concurrence of any other person, can appoint or remove the holders of all or a majority of the directorships." The equity held by the original promoters are the same as other shareholders with each equity share carrying one vote. Post registration share transfers need the IRDA's approval where, after the transfer, the total holding of the transferee in the shares of the company is likely to exceed 5 percent of its paid-up capital or, where the transferee is a banking or investment company, if it

	is likely to exceed 2.5 percent of paid-up capital. Approval is also required where, the nominal value of the shares intended to be transferred exceeds 1 percent of the paid-up capital of the insurer. Under the IRDA (Registration of Indian Insurance Companies) Regulations 2000, the acquisition of shares by foreign entities is capped at 26 percent. Due diligence on foreign promoters is carried out. The IRDA approves the transfer of a controlling interest to an entity both within and outside India only after carrying out due diligence, if necessary in coordination with the foreign supervisory authorities. The standards followed are the same as those applied at the time of licensing of a new insurance company. Section 6A (4) of the Insurance Act provides that an insurer cannot register any transfer of its shares unless the transferee furnishes a declaration as to whether he proposes to hold the shares for his own benefit or as a nominee on behalf of others and in the latter case, giving the name, occupation and address of the beneficial owner or owners and the extent of the beneficial interest of each of them. Where group structures are involved the group as a whole is examined as part of the due diligence process carried out on the incoming shareholder. This is to ensure that the group structure and controls likely to be exercised on the insurance companies do not hinder the independence of operational activities of Indian Insurance business. **Portfolio transfer:** The transfer of business or amalgamation of one life insurer with any other life insurer can only be made in accordance with a scheme prepared under section 35 of the Insurance Act. The insurance companies are required to file a notice of intention with the IRDA and the application must cover the nature of the amalgamation or transfer and the reasons there for, together with the following documents: 1. Draft of the agreement for amalgamation or transfer 2. Balance sheets in respect of insurance business of both insurers 3. Actuarial reports and abstracts in respect of the life insurance business of each of the insurers 4. Report on the proposed amalgamation or transfer prepared by an independent actuary who has never been professionally connected with any of the parties concerned during the preceding 5 years; and 5. Any other reports on which the scheme was founded. The regulation recommends notification to and feedback from policyholders, although this is not a legal requirement. Similar provisions apply under recently issued guidelines for nonlife insurers. There have been no instances of portfolio transfer or transfer of insurance business to date. However, the IRDA advised that it would be guided in its assessment of the scheme primarily by the need to secure the interests of policyholders. The due diligence process would be on the lines similar to the process undertaken at the time of considering the application for registration of insurance companies.
Assessment	Observed

Comments	While practice would achieve this the Insurance Act should ideally state that the interests of the policyholders of both insurers involved must be taken into account in assessing a portfolio transfer or merger and that an independent actuarial report should be required to confirm this. In addition policyholders should at law be given adequate notification and an opportunity to provide feedback.
Principle 9.	Corporate governance The corporate governance framework recognizes and protects rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards.
Description	After consultation with interested parties, the IRDA issued a Circular laying out insurers' minimum corporate governance standards in August 2009. These became effective from the financial year 2009-10 (i.e., the year ending March 31st 2010). One key matter where the original document was modified concerned related parties, where the IRDA accepted that existing disclosure standards in the Companies Act and under the accounting standards were adequate and that prior clearance by IRDA is not necessary. Compliance with the guidelines is required to be disclosed as part of the annual report of insurance companies: certification to that effect is to be given by the corporate governance compliance officer (the Company Secretary) for this purpose. At present, the external auditor does not have to report on compliance. The guidelines are comprehensive, covering amongst other matters the Board of Directors, control functions (including internal controls, the internal audit function and independence from operations), senior management (CEO and senior officers, appointed actuaries and external audit), disclosures, outsourcing and interactions with the supervisor. Annex I of the guidelines contains an extensive list of the responsibilities of the Board. Amongst other things this specifies that the Board is required to define a set of business conduct and ethical standards for directors and senior management and standards to be maintained in policyholder servicing and in redressing of grievances of policyholders. The Board is also responsible to provide strategic guidance for the implementation of business policy and to ensure an information system that will identify strategic threats and opportunities is in place. Clause 5 of the guidelines requires that the Board delegates certain responsibilities to mandated and other recommended Committees of Directors while retaining its primary accountability. Five committees of the Board are mandatory. These are Audit; Investment; Risk Management: Policyholder Protection; and Asset Liability Management (ALM). An option is given to life insurers to make the ALM Committee a part of the Risk Management Committee provided that the terms of reference of ALM are made part of the Risk Management Committee. The Remuneration, Nomination and Ethics committees are not mandatory. The guidelines require that an insurer is compliant with all statutory provisions and regulations through a sound system of internal controls and audit in respect of all aspects of the insurer's activities and accounts, including financial, operational and compliance controls and that such systems are reviewed annually by the Board for their effectiveness. The Internal Audit function is to be performed in an objective, independent and risk oriented manner, with timely feedback to the Board. While the existence of an internal audit process is mentioned in the law and the regulations, there is no reference to the internal audit function in the guidelines.

	The Board defines and periodically reviews the corporate business policy; underwriting policy; retention and reinsurance policy; and in particular the levels of risk retentions by the insurer; the nature and extent of reinsurance protection to be maintained by the insurer; the policy of the insurer in investment of its assets consistent with an appropriate asset liability management structure; policy on appointments and qualification requirements for staff at all levels and for fixing their remuneration and benefits. The Corporate Governance guidelines require that the Board consists of competent and qualified directors with appropriate knowledge, skills, experience and commitment along with a minimum specified number independent directors—ideally consistent with the listing requirements but in any case at least two. The Directors shall have access to all relevant information for taking informed decisions including strategic business plans and forecasts; organizational structure; delegation of authority; corporate and management controls and systems including procedures; marketing environment; information and updates as appropriate on company's products; information and updates on major expenditure; and periodic reviews of performance. In assessing the governance practices in place, the IRDA seeks confirmation that an insurer has adopted and effectively implemented sound corporate governance policies and practices; assesses the fitness and propriety of Board members; monitors the performance of Boards; assesses the quality of insurers' internal reporting, risk management, audit and control functions; evaluate the effects of the insurer's group structure on the governance strategies; etc. The IRDA also periodically shares with the management its findings in the supervisory processes as regards the insurer's activities and performances.
Assessment	Largely observed
Comments	While the Corporate Governance Guidelines are comprehensive, the monitoring process of insurers appears to be limited. In particular, the Company secretary, who is the relevant Compliance Officer, is often beholden to the CEO and has numerous other responsibilities. In addition, the external auditor is not required to report on adherence to the guidelines – this independent check should be instituted. It is desirable that the role and functioning of the internal audit function is mentioned in the guidelines. The assessor was advised by the IRDA that that insurers may not offer guarantees and there are legitimate grounds for arguing that other related party transactions should not be cleared by the supervisor (allowing that transactions above a certain size require shareholder clearance), but it is advisable that such transactions are reported on an exceptions basis according to size or nature (see ICP 17 re. related party reporting). If a related party transaction (e.g. provision of expert advice by one of the significant shareholders) appears to be egregiously mispriced then the IRDA should seek independent advice on the pricing and if necessary take appropriate supervisory action.
Principle 10.	Internal control The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the Board and management to monitor and control the operations.
Description	The IRDA (Registration of Insurance Companies) Regulations 2000 require the applicant to establish, on grant of registration, internal controls adequate to the nature and size of its business. The Corporate Governance Guidelines require insurers to

	have in place the requisite control functions on an ongoing basis. The oversight of the control functions is vested with the Boards of directors of insurers (Board). The Circulars dealing with product File & Use for nonlife (general) insurers require that the Board approves underwriting policies and that a Board approved policy for the delegation of authority for insurance underwriting is in place. In addition, the underwriting function has to be separated from business development functions and internal technical audits have to be carried out quarterly. The Board also approves the risk retention and reinsurance program annually before it is submitted to the IRDA. The investment regulations and related circulars require the internal audit of investment transactions and systems on a quarterly basis where AUM is less than Rs 1,000 crore (approx. US$50 million). For larger amounts, a concurrent (i.e., daily) audit is required by an external CA firm that does not already have an appointment with the insurer. This CA firm has to certify that internal controls satisfy a technical standard relating to investment risk and systems. In addition, all insurers must subject systems and processes to audits at least once every three years by an external auditor who is not the statutory, concurrent or internal auditor. The Corporate Governance Guidelines provide for the role of appointed actuaries and statutory auditors and lays down the role of the Audit Committee and certain roles for the internal audit function. They also require the Board Risk Management Committee to have responsibility for the effective operation of the risk management system. The committee must look at the risk profile of the insurer both on an individual and group wide basis. The committee is required to advise the Board on the risk management decisions at the strategic and operational levels. The Audit Committee's responsibilities are laid out in detail in the Corporate Governance Guidelines. The committee has to be chaired by an independent director (ideally a CA) and to place its findings before the main Board. Responsibilities include ensuring the efficient functioning of the internal audit department (assuming it is an internal function). However, there is no specific section covering the internal audit function in the Corporate Governance Guidelines and the IRDA's questionnaire states that audit reports go to the CEO. Internal audit is also included as a noncore activity under the outsourcing guidelines. Consistent with the recent SEBI SCODA committee findings, and the RBI requirements for banks, internal audit should be a core function. Insurers already have to use up to five external CA firms on a three-year cycle and the addition of a sixth, which would need to maintain a permanently staffed department within the insurer seems excessive. In addition, the internal audit function needs to be able to assess specialized processes and functions such as underwriting and claims handling. One possible practical approach would be to allow outsourcing of some internal audit activities for small insurers (including those recently licensed) subject to a dedicated individual (say a risk manger) within the insurer being responsible for the effective carrying out of the function and having a direct line to the audit or risk management committee. Other responsibilities of the Audit Committee include the setting up of procedures to ensure the adequacy of checks and control mechanisms and procedures relating to maintenance of accounting systems, transactions and administrative activities. The Board is also expected to discuss internal controls with the statutory auditor.

	A Policyholder Protection Committee of the Board is mandatory under the Corporate Governance Guidelines. Amongst other duties, this committee needs to ensure that a complaints and grievances process is in place, ensure the adequacy f disclosed information and ensure that policyholders are aware of the insurance ombudsman service. The Insurance Act and IRDA (appointed actuaries) Regulation 2000 require that every abstract given by the actuary needs to be accompanied by a certificate from the principal officer of the insurer 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 his investigation. The actuarial reports form the basis for finalization of final accounts and are reviewed by the Board of an insurance company while adopting the accounts. In addition, the appointed actuary has to certify the actuarial report and abstract and be available to the Board.
Assessment	Largely observed
Comments	While the internal controls relating to the investment function for larger insurers is exemplary, it is difficult to see how an internal control system can operate without a more structured approach to the internal audit function (which is process oriented while the Risk Management function is oriented to high level threats and is forward looking). The Corporate Governance Guidelines should explicitly cover the internal audit function, specify that it needs to have a senior officer responsible for its fulfillment and that it have sufficient resources and an unfettered access to required information, that it is sufficiently independent and that it has direct access to the audit committee and the Board as a whole. SEBI and RBI have interpreted these requirements to mean that internal audit should be an internal department.
Ongoing Supervision	
Principle 11.	Market analysis Making use of all available sources, the supervisory authority monitors and analyzes all factors that may have an impact on insurers and insurance markets. It draws the conclusions and takes action as appropriate.
Description	IRDA analyzes the performance of insurance companies on a monthly basis, based on the business figures reported by life and nonlife insurers. Business trends are studied at frequent intervals to keep track of developments in the sector and to take regulatory action where necessary. Performance of the sector is also more fully analyzed on an annual basis. The major issues made available in a range of publications by the IRDA, all of which are available through the IRDA's web site: 1. Monthly Journal; 2. Annual Report; and 3. Insurance Sector Appraisal. In addition, issue-based analysis is also carried out by the IRDA. Some recent instances of such analysis include: 1. Features of ULIPS and their accounting treatment; 2. Infrastructure investments; 3. Premiums Awaited Policies; 4. Claims settlement; and 5. Motor Third Party Provisioning.

	Analysis of trends and scenarios is not formally carried out by the IRDA, but the Journal often carries article touching on international developments (Solvency II etc). Both publicly available and confidential sources are used to conduct the analysis. Quantitative analysis is based on the data filed with the IRDA, Insurance Information Bureau, Tariff Advisory Committee, other regulators and in the public documents and reports; and available in the public domain, including with the General and Life Insurance Councils. Qualitative analysis is based on market conduct activities that are brought to the notice of the IRDA through public/media and also from the publicity material filed with the IRDA for information and/or for prior approval. Market conduct issues are also assessed through the Grievance Cell of the IRDA which attends to grievances of customer/agencies of insurers. The IRDA publishes the following reports which give granular aggregated market data and individual insurer data: • Annual Report of the supervisor • Handbook of Insurance Statistics • Business statistics on monthly and quarterly basis To fulfill its statutory mandate to promote sectorial efficiency, the IRDA has established the Insurance Information Bureau (IIB). While this entity is primarily intended to support pricing, the data collected also facilitates market analysis. Additional data is also captured by the Councils of the Life and General industries. When a market-wide event having an impact on insurers occurs, the IRDA obtains relevant information from insurers and monitors developments. Some of these instances include claims arising from the Sumatra Tsunami (2006) and the Investment exposures of insurers in Satyam Computers Ltd.
Assessment	Observed
Comments	
Principle 12.	Reporting to supervisors and off-site monitoring The supervisory authority receives necessary information to conduct effective off-site monitoring and to evaluate the condition of each insurer as well as the insurance market.
Description	Section 11 of the Insurance Act requires all insurers to submit prescribed annual financial statements. The format and accounting principles guiding these statements are prescribed in the Preparation of Financial Statements Regulations of March 2002. The audited annual accounts of insurers are required to be signed by the chairman and two directors and by the principal officer of an insurer. Similarly, the Actuarial report and abstract prepared by the appointed actuary has to be filed, accompanied by a certification from the principal officer of the insurer 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 investigation. The valuation bases of assets and liabilities are not consistent although the asset valuation could be prudent in certain macro settings. The largest asset class, fixed interest securities, is valued on a book/ amortization basis, while liabilities are by regulation valued at fair value (in practice the actuarial profession has adjusted – see ICP 23). This is evidently consistent with a view that insurers should not be subject to

	volatile results or large solvency fluctuations. However, it means that the economic performance of insurers is not properly disclosed (an issue if they become listed) and in certain circumstances, apparent capital strength could be overstated if there is significant mismatching. In this regard, the insurance sector is not consistent with Indian accounting standards (IndAs). Other monthly, quarterly and annual reports have been prescribed under relevant regulations (the IRDA provide 60 pages of reporting forms covering all operational and financial aspects of insurers except investments, which are subject an alternative concurrent audit process) and these are generally appropriate, although the monthly reports tend to focus on business volumes and branch openings and could include more information on areas where risks can arise in the short term. In particular, while a large insurance risks report has to be submitted there is no requirement to report significant investment items such as related party transactions. An audit opinion is required on the financial statements on an annual basis. The half year financials are required to be subject to a limited audit review. Under specific circumstances, where an insurer's business may be undergoing strategic changes which are likely to affect policyholders interests, additional statistics/data or reports may be sought at shorter intervals. Similarly, where there are industry wide implications or special circumstances, the IRDA may require more frequent and more detailed additional information. Under the Insurance Act, no distinction is made in reporting requirements on the basis of ownership. State owned entities and private insurers are equally governed by the disclosure requirements. Both life and nonlife insurers are also required to file an annual Financial Condition Report in a prescribed format. The Actuarial Reports are required to be complaint with the Guidance Notes issued by the Institute of Actuaries of India (IAI). The accounting regulations require reporting on off- balance sheet exposure by way of disclosure of the nature and amounts of contingent liabilities. Where insurers are part of defined financial conglomerates information is collected on a group wide basis. Regulation 7 (c) of IRDA (Registration of Companies) Regulations, 2000, states that "The applicant will carry on "all functions" in respect of insurance business including "management of Investment" within its own organization." In a circular issued in February 2011 IRDA clarified this be defining core and noncore activities. Noncore activities include pension fund trustee activities, website development, HR services and tele-marketing. Details of outsourced functions have to be advised to the IRDA.
Assessment	Observed.
Comments	In practice there is a greater consistency than is apparent from the accounting and actuarial liability valuation standards and the asset valuation issue is covered under ICP 21. It is desirable that the monthly reports include more short term risk data on an exceptions basis. Peak risk underwritings already have to be reported and this concept could be extended to cover major investment allocations, including related party transactions breaching defined thresholds.

Principle 13.	On-site inspection The supervisory authority carries out on-site inspections to examine the business of an insurer and its compliance with legislation and supervisory requirements.

Description

The Insurance Act empowers the supervisor to call for information from, undertake inspection of, conduct enquiries and investigations including audit of insurers. The regulations governing insurance intermediaries empower the IRDA to conduct on-site inspection of intermediaries.

IRDA's (Insurance Brokers) Regulations, 2002, IRDA's (Third Party Administrators – Health Insurance Services) Regulations, 2001 and IRDA's Insurance Surveyors and Loss assessors (Licensing, Professional Requirements and Code of Conduct) Regulations, 2001 empower the IRDA to conduct on-site inspection of insurance brokers, TPAs and surveyors & loss assessors.

The Insurance Act envisages the appointment of an external qualified person to carry out an investigation and specifies the manner of reporting to the IRDA. Similar provisions apply for brokers, surveyors and loss assessors under the above mentioned regulations.

On-site inspections are carried out after taking into consideration inputs/data from the relevant off-site regulatory departments. The inspections are led by the Inspections Department, which may draw on other resources. The current plan is to have enough capacity to carry out scheduled inspections every 2 years for every insurance entity. However, current resources would not in fact permit this.

The on-site inspections are carried out in two ways:

1. Financial / Comprehensive inspections, and

2. Focused/ Specific Inspections carried out for the purpose of ensuring compliance with legislation, regulations, circulars, guidelines, or any other directions of the IRDA.

The activity table is as follows:

Inspections conducted during the last 3 financial years

Sl. No.	Type of the entity	Scope	No. of companies			Duration (No. of weeks)			Staff allocated (Nos.)		
			2008-09	2009-10	2010-11	2008-09	2009-10	2010-11	2008-09	2009-10	2010-11
1	Agents Training Institutes	Full	16	0	0	2.29	0.00	0.00	32	0	0
2	Brokers	Full	24	27	7	9.29	11.14	3.00	56	55	19
		Limited	0	0	8	0.00	0.00	2.29	0	0	16
3	Corporate Agents	Limited	0	3	4	0.00	0.86	1.14	0	6	8
4	Health Insurers	Full	0	0	1	0.00	0.00	0.71	0	0	6
5	Life Insurers	Full	4	0	9	6.29	0.00	6.43	12	0	54
		Limited	11	8	11	2.43	2.71	3.71	22	21	26
6	Non-Life Insurers	Full	0	0	8	0.00	0.00	5.71	0	0	50
		Limited	0	23	10	0.00	6.86	1.57	0	46	12
7	TPAs	Full	13	0	6	4.86	0.00	1.71	37	0	12
		Limited	0	1	1	0.00	0.43	0.29	0	3	2
		Total	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Source: IRDA.

IRDA has prepared detailed procedures manuals for on- site financial condition and market conduct inspections. The financial condition manual contains a questionnaire

	covering the main processes and procedures in an insurance operation. The inspection team normally contains actuarial, accounting and insurance operations personnel. A staff with information technology (IT) skills is not formally included, although as the IRDA currently has such an individual on staff this lacuna has been covered in practice. Discussions with the insurance sector confirmed that on-site inspections are carried out in a professional manner by competent personnel. The post inspection report consists of a statement of the Methodology and sampling process, an Executive Summary and the accumulated individual findings and information informing the findings. A report is sent to the insurer after the inspection. However, there is no formal feedback meeting required under current procedures although procedures are prescribed for giving the insurer an opportunity to be heard before action is taken on an investigation report. An internal Standing Committee deliberates on the findings of the inspection teams and the responses of management prior to taking any prescribed actions.. The Circular on outsourcing covers third parties for the purpose of on-site inspection in so far as relates to the processes and documents of the insurance company.
Assessment	Observed
Comments	It is recommended that a staff member with IT system skills is added to a full scope inspection team – particularly given the growing role of IT in Indian insurers' strategies. In addition, it would be helpful to the managements and Boards of insurers, possibly through the Audit and Risk Management Committees, to arrange a feedback meeting as a matter of course after an inspection is completed. For normal scheduled full scope inspections a 3 or 4 year cycle is adequate: insurers normally have very different risk profiles to banks which do need more frequent inspection. It is important to emphasize that the role of the supervisor is not to replicate the work of the external auditors. Rather the role is one of carrying out a risk audit with then primary objective of ensuring that the insurer is following sound business and financial practices and that policyholder interests are being satisfied.
Principle 14.	Preventive and corrective measures The supervisory authority takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.
Description	The IRDA has adequate instruments to enable it to take timely preventive and corrective measures. These include: • Section 14(1) of the IRDA Act directs IRDA to regulate, promote and ensure the orderly growth of the insurance business and sub-section (2) empowers IRDA to perform the necessary functions to achieve these objectives. • Clause (h) of Section 14(2) enables IRDA to call for information, undertake inspections, and conduct inquiries and investigation including audit of registered entities and other organizations connected with the insurance business. • Section 33 of the Insurance Act empowers the IRDA to appoint an investigation authority to investigate the affairs of any insurer and seek a report thereon. • Section 34 of the Act empowers the IRDA to issue directions to secure the interests of the general public, policyholders, and the insurer.

	• Clauses 34B to 34H give the IRDA wide ranging powers over management. • 34H of the Act specifies powers to conduct searches and seize documents and records. • Section 37A – Prepare a scheme of amalgamation. • Section 64VA(2) requires the submission of an action plan where the solvency margin is breached. • Section 102 specifies the penal provisions for non-compliance with the provisions of the Insurance Act. • The IRDA (Registration of Indian Insurance Companies) Regulations 2000 provide for the suspension/cancellation of registration in certain circumstances. Progressive escalation of action or remedial measures is broadly provided for in the legislation and intervention practice (which is not presently documented) was stated by the IRDA to be as follows: • Calling for information; • Rectification of anomalies observed; • Financial penalties; • Suspension of business; and • Cancellation of license. The scope for financial penalties is limited at this stage – see ICP 15. Section 6A of the Insurance Act requires that any transfer of shares above the stipulated limits requires prior approval of the IRDA. The buyback of shares of insurance companies is governed by the general commercial law which lays down the terms and conditions based on which a company can buy its own shares. In case of buy back, administration of the process is carried out by the central government in case of unlisted companies .In the case of listed companies, buy back is administered by the supervisor of the capital market, viz., SEBI. In both cases, detailed procedural guidelines have been laid down. In addition, no progressive corrective actions according to the level or solvency margin are currently formalized, leading to the potential for forbearance. In practice, supervisory action begins if an insurer's solvency ratio drops below 150 percent although this tends to be largely consultative. Relatively minor procedural irregularities are rectified by insurers and corrective measures are taken to obviate the need for a formal order or action. The IRDA may call for an acceptable course of action with appropriate time schedules as and when required.
Assessment	Largely Observed
Comments	IRDA does not have a modern risk based early warning system in place and what ratios are measured appear to be largely generic rather than being based on emerging experience. The supervisor is currently examining the Northern European traffic light methodology and other early warning systems. It is of concern that IRDA does not have a direct role when insurers engage in capital management such as buy backs. This should be rectified in any Amendment Bill finally agreed.

Principle 15.	Enforcement or sanctions The supervisory authority enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.
Description	• 34 E (b) enables the IRDA to call for a meeting of directors and to depute its officers to watch the proceedings. • Sec 52A provides the authority to recommend to the central government that an Administrator be appointed for a life insurer. Similar provisions could conceptually be invoked with respect to general insurance companies under section 14 of the Insurance Act. • Section 52 H provides the central government with the power to acquire the business of an insurer. The IRDA closely monitors the operations of the insurers in the light of any directions issued or compliance schedule indicated and has the power to seek more frequent reporting. Fines against individuals and insurers are specified under the Insurance law under sections 102 to 105C. These include failure to follow directions, failure to maintain an adequate solvency margin, acting illegally as insurance intermediaries and rebating, accepting business from other than licensed intermediaries, failure to comply with specific provisions of the Insurance Act and the wrongful submission of information. Fines are also specified under specific headings in other sections of the Insurance Act. The fines that can be imposed are still based on the conditions that applied when the Insurance Act was drafted and are capped at Rs 5 lakh (approximately US$11,000). The drafting normally states that this applies for 'each such failure,' however, most of the major conditions and actions requiring censure are of a one of f nature and any attempt to apply this (say on a daily non-compliance basis) would likely be challenged with some chance of success in the courts. The 2008 Amendment Bill sitting in the parliament addresses this issue. The scope for imprisonment, not being time dependent, is appropriate. The IRDA at its discretion can bar an insurance promoter who withdraws from an insurance venture from re-entering the insurance business. Similarly, where persons in positions of responsibility have been found to be delinquent, they would in such circumstances, not be given regulatory clearance. Where situations call for immediate and prompt action, the supervisor issues ad-interim directions pending investigation and enquiry as a preventive measure The operations of defined conglomerates having operations across banking, NBFCs, insurance and capital markets are monitored through sharing of information amongst the regulators. However, this system is still informal and to some extent ad-hoc. The IRDA (Registration of Companies) Regulations 2000 provide for the suspension of registration of an insurer in the case of default in complying with, or acting in contravention of any requirements of the legislation/regulations/directions/guidance/ orders applicable to them. The performance of "financial conglomerates" is monitored closely for any systemic risks.

	All decisions are recorded through speaking orders (a speaking order is an order that speaks for itself. The order should stand the test of legality, fairness and reason if challenged in the courts. That is, the order should contain all the details of the issue and list clear findings).
Assessment	Partly observed
Comments	The enforcement actions and sanctions open to IRDA tend to be at the extremes – relatively light or very heavy. In addition IRDA needs to refer certain fundamental corrective actions, such as appointing an administrator, to the central government. The enforcement regime needs to be formalized through a 'Supervisory Guide' or 'Ladder of Intervention' so as to provide the IRDA with stronger legal backing when it intervenes and to limit the scope for forbearance. Additional intermediate enforcement powers could include: • The ability to impose selective time and volume limitations on business activities (including by geography and product) • The ability to require deposits if assets security is a concern • The ability to impose an expiry date for a license to encourage timely rectification of undesirable financial ratios or operating practices International experience shows that supervisors can be unwilling to intervene at a sufficiently early stage due to legal and reputational risks, not to mention political interference, in the absence of a formalized set of rules. These could be based purely on solvency measures or on a more inclusive risk rating system. The financial sanctions available are outdated (although IRDA believes they operate on a per event basis and are uncapped) and need to become relevant to the modern scale of insurers and impact of inflation. This could possibly be handled in a special Bill carved out of the 2008 Amendment Bill, which proposes the following sanctions: • Section 102: proposes to levy a penalty of Rs 1 lakhs for each day of such failure to comply with Act, rules or regulations subject to a maximum of Rs 1 crore. • Section 103 proposes to levy a penalty of Rs 25 crore and with imprisonment up to 10 years for doing insurance business without obtaining a certification of registration. • Section 104 proposes to levy a penalty up to Rs 25 crore for not complying with Section 27, 27 A, 27 B and 27 D and 27 E • Section 105 proposes to levy a penalty up to Rs 1 crore for wrongfully obtaining or withholding property. • Section 105 B proposes to levy a penalty up to Rs 25 crore for not complying with the provisions of 32 B, C & D. Evidently, the securities supervisor has now obtained more appropriate financial sanctions. Given the limitations of the current tools available IRDA has adopted a name and shame approach whereby sanctions and enforcement actions are disclosed on its web site.

Principle 16.	Winding-up and exit from the market The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines insolvency and establishes the criteria and procedure for dealing with insolvency. In the event of winding-up proceedings, the legal framework gives priority to the protection of policyholders.
Description	A minimum solvency ratio (based on the statutory minimum solvency requirement) of 150 percent has been stipulated by the IRDA through insurers' registration requirements. Section 64VA of the Insurance Act stipulates the requirement for sufficiency of assets. Under the Insurance Act, where an insurer is in breach of the solvency requirements and is unable to rectify the position within such time as stipulated by the IRDA, it is not permitted to continue its business. If at any time the IRDA has reason to believe that a life insure is acting in a manner prejudicial to interests of its policyholders, it may make a report thereon to the central government which then has powers to appoint an Administrator. In case of nonlife insurance companies, the provisions of section 14 of the IRDA Act would be invoked. The Insurance Act contains extensive provisions dealing with both enforced and voluntary wind ups under Sections 52 to 58 of the Insurance Act: Sections 52 H to 52 K deal with the power of central government to acquire the undertakings of an insurer and to make a scheme for carrying transferring such business to another insurer. Section 52K and L authorize the Central government to establish a Tribunal with the powers of a Civil Court to deal with insurer wind ups. Section 53 covers the conditions under which a Tribunal may order an insurer to be wound up, including in accordance with the Companies Act, 1956, application by a sufficient corpus shareholders and upon the application of the IRDA based on continued non-compliance with the Insurance Act, insolvency and in the interest of policyholders or the general public. Section 54 states that an insurer may not be wound up voluntarily, except for the purposes of amalgamation or restructuring if by reason of its liabilities it cannot continue in business. Section 57 deals with situations where cross liabilities exist between insurers. Section 58 deals with scheme for the partial winding up of insurance companies (again under a Tribunal). The sections relating to winding up give priority to the interests of policyholders within policyholder funds, which must be held in separately earmarked accounts. There after policyholders are treated as secured creditors.
Assessment	Observed
Comments	The authorities may wish to consider allowing the voluntary wind up of solvent non- life insurers, subject to satisfactory safeguards. In some circumstances, claims run off can be the most efficient method of exit. For consistency, the provisions relating to the appointment of an Administrator for non-life insurers preferably should harmonize with those applying to life insurers.

Principle 17.	Group-wide supervision The supervisory authority supervises its insurers on a solo and a group-wide basis.
Description	In the Indian context there is no definition of an 'Insurance Group'. Insurance companies can, however, belong to specified promoter groups under a defined conglomerate structure. Current coordination mechanisms for financial conglomerates (FC) are largely informal, although information is generated at individual supervisor level: A. IRDA (Registration of Indian Insurance companies) Regulations, 2000: at the time of registration, the applicant is required to furnish details of other group companies. B. Guidelines on monitoring framework of Financial Conglomerates C The High Level Committee on Capital and Financial Markets (now a FSDC sub-committee) defined Group, Specified Financial Intermediaries (SFI), Non- specified Financial Intermediaries (NSFI) and Non- Financial Intermediaries (NFI) and has laid down the criteria for the identification of FC. The scope of supervision through the FC mechanism covers all group companies especially Specified Financial Intermediaries and Non- financial intermediaries and Non-specified financial intermediaries in the financial sector. A FC group is assigned to respective regulator based upon its overall exposure in a regulated financial activity – banking/NBFC/securities market/insurance. However, the other sectoral supervisors are required to share their specific concerns with the lead supervisor. This avoids unnecessary duplication in the supervision in the regulatory processes. The reporting format prescribed for FC captures the following information: o Group structure and cross holdings. o Capital Adequacy/solvency position. o Financial information of SFIs such as capital adequacy/solvency position, NPA, investments, operating profit, net profit, etc. o Intra-group transactions & exposures. o Outstanding exposure of each SFI. In addition to the above, the format also captures qualitative information such as governance structure, auditors, penal action and the group risk profile report. The IRDA is lead supervisor for three FC groups (including LIC). Reports are prepared quarterly by the Finance and Investment (F&I) department. Meetings with the other regulators occur six-monthly, when one group is normally discussed. It is not clear from the reporting documents provided to the assessor that all intra group exposures are currently captured (including insurer deposit with banks). Insurers are allowed to lend money to parent or subsidiary companies (Para. 29 of the Insurance Act) and only need to report this (within 30 days) if it is from a life fund. However, the monthly reports do not have an explicit section on related party transactions. The current approach conceptually provides an oversight of group structure, their interrelationship, ownership structure, management structure, capital adequacy, various risks including reinsurance to which the group is exposed to, inter-group

	transactions and internal control mechanism. However, an oversight of the current reporting requirements for insurers indicates that the information to carry out such detailed and complex analysis is not currently available. Controlled subsidiaries may not be included as assets for solvency determination. There is no specific provision for withdrawal of an insurer's registration if the organizational or group structure hinders effective supervision. The Insurance Amendment Bill 2008 has a provision for cancellation / suspension of the license in case the home supervisor has cancelled or suspended the license of a foreign insurer having presence in India.
Assessment	Largely Observed
Comments	India has made a good start on creating a conceptual framework for conglomerate group supervision (and oversight of systemic risk) but the information flows, processes and early warning mechanisms involved need to be formalized, possibly through an MOU between the four supervisors if a coordination body with statutory status is not seen as being desirable. Individual supervisors should have more power to consider group structures and exposures and related party transactions in determining its interventions. Ideally an ad hoc committee of an insurer's directors (the majority of whom should be independent) should, by law, consider each related party transaction to ensure that market prices have been applied, that the transaction is in the interests of the insurer and that the quantum of value involved does not warrant shareholder approval (if there is more than one shareholder) or otherwise is not materially relevant to the insurer's net asset position.
Prudential Requirements	
Principle 18.	Risk assessment and management The supervisory authority requires insurers to recognize the range of risks that they face and to assess and manage them effectively.
Description	The Corporate Governance Guidelines require that an insurer shall have a proper policy framework in place which is a "robust and efficient mechanism for the identification, assessment, quantification, control, mitigation and monitoring of the risks." They place the responsibility for monitoring and controlling risks on the Board's Risk management Committee. The committee reports to the Board which is ultimately responsible for such compliance. Sections 13, 27, 64V, 64VA of the Insurance Act require investigations to be made by the Appointed actuary into the financial conditions of the insurer. The appointed actuary's Annual Report (AAAR) template requires that all the major risks including withdrawal, expenses, mortality and investment risks, should be analyzed. Risk control: The following risk controlling mechanisms are mandatory: • Annual submission of re-insurance return. • Approval of re-insurance treaties. • Approval underwriting at File & Use level. • Analysis of surplus in order to take any corrective action and modification of valuation assumptions.

	For complex products, risk mitigation procedures are checked at the File and Use level: • Investment mechanism. • Pricing and monitoring of guarantees and options. • Reinsurance arrangements. • Result of experience analysis supporting the assumptions used in pricing. • Underwriting procedure used. The extent of requirements indicated above, vary depending on the complexity, size and nature of business. Regulations on preparation of Financial Statements require that management make disclosure with regard to overall risk exposure and strategy adopted to mitigate risks. The IRDA (Investment) Regulation of November 2008 lays down a framework for portfolio diversification and reduction of over-exposure to a particular asset class/ company/group/industry.
Assessment	Observed
Comments	This ICP has been assessed on the basis of control of investment and underwriting risk. Further work needs to be done on the monitoring of operational (including general systems) risk - see Internal Control (ICP 10).
Principle 19.	Insurance activity Since insurance is a risk taking activity, the supervisory authority requires insurers to evaluate and manage the risks that they underwrite, in particular through reinsurance, and to have the tools to establish an adequate level of premiums.
Description	Under IRDA's File & Use circular issued in September, 2006 nonlife (general insurance) underwriting policy is to be placed before the Board of Directors of insurers (Board) for approval. The form and frequency of reporting to the Board on the performance of the management in underwriting the business is also specified. Any changes in the underwriting policy are required to be approved by the Board. Further, the appointed actuary has been assigned the responsibility of ensuring that the premiums charged are fair. Similar requirements now also apply for life insurers following an earlier self-assessment. A circular issued in 2001 requires life insurers to furnish details of pricing and reserving assumptions in the 'File & Use' application for new products/ modification of existing products. These are reviewed by the IRDA. Under the IRDA (appointed actuaries) Regulations, 2000, the appointed actuary is responsible for ensuring that the premiums rates are fair. The actuary files an actuarial report with the IRDA every year where he/ she expresses an opinion on the mathematical reserves being adequate to meet the insurer's future commitments under the contracts given policyholder reasonable expectations. A Circular issued in February 2010 requires life insurers to submit an annual report on risk management which includes a detailed analysis of expenses. The appointed actuary and the underwriters of a nonlife insurers are required to ensure that various details on claims incidence, claims payments etc are captured at the underwriting stage: The appointed actuary and the underwriters are responsible for compiling first loss rating schedules and schedules of discounts for higher deductibles or franchise for different products based on statistical data. In

	respect of long term insurance products, the appointed actuary states the basis on which the reserves for unexpired risks are calculated. The IRDA (Life Re-insurance) Regulations 2000 require insurers to submit details of their re-insurance program to the IRDA for approval. The policy spells out the limits on the amount of risk to be retained on the account of the insurer, names of re-insurers with whom the insurer proposes to place the reinsurance and the types and extent of reinsurance contracts arranged. The reinsurer shall have a minimum credit rating by specified credit rating agency. The IRDA (General Insurance-Reinsurance) Regulations 2000 require the reinsurance program of a general insurer, after approval by the Board, to be submitted to the IRDA. The reinsurance program is to be guided by the following objectives: a) maximize retentions within the country; b) develop adequate capacity; c) secure the best possible protection for the reinsurance costs incurred; and d) simplify the administration of business. The regulation spells out the limits on the amount of risk to be retained on the account of the insurer, types and extent of reinsurance contracts arranged etc.
Assessment	Observed
Comments	Ideally the IRDA should not formally approve reinsurance schedules as this could expose it to legal liability. Rather all reinsurance schedules should be submitted to IRDA and the supervisor should have the power to require that the insurer seek an independent expert report on its reinsurance strategy, to be submitted to the Board if it deems that the strategy needs modification.
Principle 20.	Liabilities The supervisory authority requires insurers to comply with standards for establishing adequate technical provisions and other liabilities, and making allowance for reinsurance recoverables. The supervisory authority has both the authority and the ability to assess the adequacy of the technical provisions and to require that these provisions be increased, if necessary.
Description	The valuation bases for insurance liabilities is laid out in Schedules II-A (life) and II-B (nonlife) of the IRDA Assets, Liabilities and Solvency Margin of Insurers Regulations 2000. The valuation of liabilities for traditional insurance contracts (whole of life, endowment assurance etc) is carried out using a gross premium (bonus reserve) valuation method on a policy by policy basis. This employs realistic assumptions about future cash flows (including bonuses allowing for reasonable policyholder expectations). Mortality, interest and other key assumptions are based on realistic projections after adjusting for margins for adverse deviation. For solvency purposes negative reserves have to be set at zero and if the surrender value is greater than the reserve calculation the higher figure applies. The reserve calculation also needs to take into account the nature of the assets and the basis under which they are valued. This provision has enabled appointed actuaries to make adjustments to allow for the amortization valuation basis of debt instruments (i.e., debt instrument valuations do not necessarily reflect current market values). In

	particular, they have been determining investment returns based on both market and actual asset valuation bases and choosing the lower figure for purposes of determining the immediate discount rate. The issue of earning rates on future new cash flows is less easily dealt with and could potentially lead to inconsistencies but again the profession appears to have taken appropriate steps. Unit linked policies have a combination of a unit value based liability and a general liability to cover other future cash flows. The reserve determination is subject to peer review by an independent actuary. Of potentially more concern is the treatment of expenses when insurers are running consistent expense over-runs. Currently, actuaries are not required to use the current expense rate in determining prospective expenses. Nonlife provisions are partly formulaic and partly actuarially determined. Unexpired risk reserves are calculated as a conservative proportion of net written premium, according to the class of insurance. Outstanding claims provisions are determined actuarially. The relevant guidelines state that undiscounted provisions should be established based on expected future claims flows projected employing at least three different models, with the largest value being chosen. By not discounting the methodology implicitly assumes that future excess claims inflation (called super-imposed inflation in the actuarial literature and usually arising from changing court attitudes) over that assumed in the models will be matched by investment income.' Both the life and nonlife policy liability estimates are subjected to a Peer Review Committee within the IRDA. Policy liabilities need to be reported on a gross and net basis, with limits being placed on the reinsurance allowance.
Assessment	Life: Observed Nonlife: Partly observed
Comments	The need for life appointed actuaries to determine valuation discount rates through informal agreement is undesirable. In addition expense over- runs should be provided for if they appear to be chronic once the establishment period is finished. However, as the basic liability methodology adopted is sound in practice an Observed applies. The nonlife valuation rules do not provide any guidance as to where claims provisions (typically the main component of the technical reserves) should be set on the distribution of possible results. Ideally the nonlife actuary should provide a range of possible values to management and Board and show where, say the 75th percentile value lies (depending in the risk margin specified by relevant regulations or standards). The recent need to impose a significant increase in commercial MTPL claims provisions and the impact this had on numerous insurers' total technical reserves also brings into question the quality of nonlife actuarial work in the affected insurers. A concern was expressed that some actuaries establishing long tail claims provisions are not properly qualified to do this work. In addition, there is a lack of data at present as long tail business claims paid run-off triangles are still being developed and there is no requirement that claims incurred data is gathered. Some significant insurers appear to have only 4 years run off data. In the circumstances it is advisable that actuarial certification be made specific to the work being done (life, nonlife etc). This could be introduced over the next 3 years to allow a sufficient supply of nonlife actuaries to emerge and in line with the development of adequate claims run-off (triangle) data.

	IRDA has recently set-up (vide Order No.IRDA/ACT/ORD/MISC/131/06/2011 dated June 21, 2011) an Actuarial Standing Committee (ASC) to advise on various matters relating to actuarial standards/regulations etc.
Principle 21.	Investments The supervisory authority requires insurers to comply with standards on investment activities. These standards include requirements on investment policy, asset mix, valuation, diversification, asset-liability matching, and risk management.
Description	Sections 27, 27A, 27B, 28 of the Insurance law and the IRDA (Investment) Regulations, 2000 lay down the framework for the management of investments including exposure limits. IRDA (Preparation of Financial Statements and Auditor Report of Insurance Co) Regulations, 2002 and INV/GLN/003/ 2003-04 lay down the norms for valuation of assets. The guidelines for determining the market value of securities are covered in Sections 27A, 27B of the Insurance Act and Regulations 9 and 11 of the IRDA (Investment) Regulations 2000; and a Circular issued in 2008/9. Equities are valued at market, debt securities at amortized value, loans at book and property at book value. While the Insurance Act (Clause 64V) states that no asset may be valued at more than its market value this provision has been over-ridden by a circular that stipulates that debt securities will be valued at amortized value regardless of underlying market value. There are no liquidity requirements specified in the law or regulations. However, the insurer's Investment Policy document is required to include management of all investment risks, liquidity, and stop loss limits. Clear individual responsibility and accountability for transactions should be laid down for the Investment department. Policyholders' funds cannot be invested outside India. Permissible investments are explicitly indicated in the Insurance Act and the regulations (see industry overview section). Assets (other than deposits with the Reserve Bank and assets of foreign insurers held under trust) must be held in the name of a public officer approve d by the IRDA. The use of derivatives is permitted to a very limited extent for the purpose of hedging only. Insurers are required to hold unencumbered assets. Short selling of assets is not permitted. Section 28 of the Insurance Act and Regulations 9 and 11 of the IRDA (Investment) Regulations 2000 and a Circular issued in 08/09 require the insurer to have clearly defined risk management systems and procedure and that compliance should be certified by a 'systems auditor'. The appointed actuary's Report covers the requirements on risk management, which are further segregated into Insurance Risk, Credit Risk, Market Risk, Operational Risk and Liquidity Risk. The IRDA (Investment) Regulation requires clear segregation of the investment function and related middle and back office operations. Heads of the front and back offices are required to independently report to the CEO. The functions of the front, mid and back offices are defined in the guidelines.

	The Investment Policy document is required to be reviewed by the Board to ensure compliance with the law and regulations regulation. Investment functions are treated as core activities and may not be outsourced. The skill set and the required experience of the investment personnel have not been specified. However, the Standard Operating Procedure specifies the guidelines to be adhered to by the investment officers. Every investment transaction is required to be certified by a third party concurrent auditor and the report of this individual has to be placed before the Board Audit Committee. The Investment Regulations require a proper methodology to be adopted by the insurer for matching of assets and liabilities. The Corporate governance Guidelines lay out the constitution of the Asset Liability Committee in case of life insurance companies. This may be formed under the Risk management Committee. Assets subject to supervisory oversight may not be charged in most circumstances. Insurers are required to report the effect or the probable effect of any event coming to their knowledge which could have a material adverse impact on the investment portfolio and consequently on the security of policy-holder benefits or expectations. The investment policy is required to be reviewed on a half yearly basis. The Corporate Governance Guidelines provide for the Investment Committee to take cognizance of any deteriorating conditions and to have in place contingency plans.
Assessment	Largely observed
Comments	In a high interest rate environment the investment valuation basis is potentially inconsistent with the Insurance Act, which states that no asset may be held above its market value.
Principle 22.	Derivatives and similar commitments The supervisory authority requires insurers to comply with standards on the use of derivatives and similar commitments. These standards address restrictions in their use and disclosure requirements, as well as internal controls and monitoring of the related positions.
Description	Fixed interest derivatives may be used by Indian insurers purely for hedging purposes (i.e., the underlying securities must be held by the purchaser). Currently, fixed interest and foreign exchange derivatives markets exist, but the former is constrained by the illiquidity of debt markets. To date, no Indian insurer has employed derivatives. Essential criteria have been addressed in the IRDA (Investments) Regulations, 2000, and investment guidelines and circulars subsequently issued. The IRDA has prescribed minimum standards for implementation of Investment Risk Management Systems and processes. These are audited in real time by an on-site third party (Internal/ Concurrent Auditor). Exception reports go to the Audit committee of the Board. Before transacting in derivatives and related markets, insurers have to submit a policy for approval by their Boards, including how risk will be measured. In turn, and before dealing in fixed income derivatives, an insurer's Board is required to produce a risk management policy, ensure adequate internal controls are in place (including the qualifications of dealers; separation of front, middle and back office; periodical audit; and capital adequacy) and set prudential limits.

Assessment	Observed
Comments	If IFRS is fully implemented in India for insurers, the value of debt holdings will fluctuate and derivatives may become more attractive instruments in order to stabilize results. At this point, IRDA would need to strengthen its governance oversight and perhaps require more frequent reporting of exposures.
Principle 23.	Capital adequacy and solvency The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses.
Description	Minimum capital at entry is Rs 100 crore (approximately US$22 million) for a direct insurer and Rs 200 crore for a reinsurer. Capital has to be in the form of ordinary shares with a single par value. The minimum solvency requirement has been set at the greater of Rs 50 crore or a formulaic solvency value. The relevant regulation states that the latter is a combination of an amount based on the EU solvency I formula and, in the case of life insurance, an asset based value. In practice the weighting for asset risk has been set at zero. This may have reflected the solvency strain that some insurers, including LIC, experienced when the solvency rules were introduced. For nonlife insurers, the minimum formulaic solvency margin is the greater of 20 percent of the greater of net premiums and an assumed minimum retention factor applied to gross premiums and 30 percent of the the greater of net incurred claims and an assumed retention factor applied to gross net incurred claims. For life insurers, minimum solvency is specified in the IRDA (Actuarial Report and Abstract) Regulations 2000. This applies a factor to a minimum of 85 percent of gross mathematical reserves and another factor to a minimum of 50 percent of sum at risk. The factor varies according to the type of contract and whether there are embedded guarantees. The maximum factor applied to the net mathematical reserve is 4 percent. For corrective action purposes, a minimum solvency ratio of 150 percent has been prescribed. This is monitored on a quarterly basis. If the insurer falls below the 150 percent level the insurer will be subjected to more frequent solvency reporting. However, no prescribed ladder of corrective actions has been put in place. Following a recent significant mandated increase in claims provisions for the MTPL Commercial Pool the minimum capital requirement for nonlife insurers has been reduced to 130 percent to accommodate 2 of the PSUs. The 150 percent level has to be re-attained by 2104. Given developments elsewhere (IFRS4, Solvency II, Market Consistent Embedded Value) the IRDA has required insurers to undertake a parallel solvency calculation. This requires a determination of solvency ratio based on an economic capital calculation. The relevant papers and circulars have not been specific as to methodology and the assessor was advised that an Market Consistent Embedded Value (MCEV) approach has been adopted by the life appointed actuaries (i.e., required economic capital is determined by stressing the MCEV). Two quantitative impact studies have occurred so far for the life sector, with the 2nd study being based on a relatively harmonized approach. Nonlife insurers are in the process of carrying out tier first study and are due to report in September 2011.

Assessment	Largely observed
Comments	The Solvency II quantitative impact studies have demonstrated that Solvency I levels of capital are inadequate. IRDA has recognized this with a non intervention 150 percent solvency ratio requirement. However, this has not been translated into a mandatory corrective action process and has been weakened already for the nonlife sector. The rating largely reflects the informal solvency testing system that is in process of being adopted, the nature of the ownership of Indian insurers, the need for insurers to examine their asset liability matching and the ongoing oversight role of the actuarial profession. IRDA has also issued exposure drafts on asset liability management requirements and stress testing, and the comments received are presently being considered. In addition ICP 20 has already identified prudential shortcomings in the nonlife sector. It is desirable that the economic capital calculation is formalized, possibly as an adjunct to the corrective action regime that is being examined in parallel.
Markets and Consumers	
Principle 24.	Intermediaries The supervisory authority sets requirements, directly or through the supervision of insurers, for the conduct of intermediaries.
Description	The Insurance Act defines ‘intermediary or insurance intermediary’ to include insurance brokers, reinsurance brokers, insurance consultants, surveyors and loss assessors. The legislation permits only licensed intermediaries to transact any insurance business in India. Section 42, 42D and Section 64UM of the Insurance Act requires intermediaries, including agents, brokers, third-party administrators, surveyors & loss assessors to be issued licenses to in order to transact any insurance business in India. IRDA’s (Insurance Brokers) Regulations 2002 sets out the minimum conditions for grant of Insurance Broker License. A 2007 Circular dated makes it mandatory to insert the word insurance broker in the name of the company to enable the public to distinguish licensed brokers from other unregistered entities. IRDA’s (Licensing of Insurance Agents) Regulations and IRDA’s (Licensing of Corporate Agents) Regulations, 2002 lay down the procedure for issuance of an agency license by the authority. IRDA’s (Insurance Surveyors and Loss Assessors (Licensing, professional Requirements and Code of Conduct)) Regulations 2000 deals with the licensing requirements for surveyors & loss assessors. The (Third Party Administrators – Health Services) Regulations, 2001 deal with the licensing conditions for TPAs. Under the IRDA’s (Sharing of database for distribution of insurance products) Regulations, 2010 the authority recognizes referral arrangements for selling insurance. Under Sec.14 of the IRDA Act 1999, the IRDA can specify the requisite qualification, codes of conduct and practical training applying to Intermediaries. Under Sec.42D of Insurance Act, a license applicant is disqualified if he does not possess the requisite qualification, practical training and has not passed the examination specified by the IRDA. Sec.14 of IRDA Act, 1999 empowers the IRDA to specify the requisite qualifications and practical training for intermediaries. Mandatory training has been specified for

	Agents, Corporate Agents, Insurance Brokers, surveyors and TPAs. Legislation further disqualifies a person from acting as an insurance intermediary if he does not undergo the mandated training or does not fulfill the basic qualifications specified under the regulations. Individuals are required to have completed at least 50 hours of relevant training from an approved institution (or 75 hours if they wish to be a composite insurance agent). Applicants with specified existing insurance qualifications have to undertake a lesser number of hours of training. Agents and staff of Corporate Agents have to possess a minimum qualification of tenth pass for rural agents and twelfth pass for urban agents. All agents have to pass the examination before they obtain a license. A broker shall have in his employment a minimum of two persons who have the necessary qualifications and cleared the Insurance Broker Examination. In case of corporate intermediaries, regulations specify the minimum capital requirements and minimum infrastructure requirements of the entity. While considering an intermediary application, the IRDA seeks due diligence reports from other bodies such as SEBI, RBI, foreign regulators and examines the accounts of promoters to ascertain financial strength and sources of funds. Section 64UM (1D) gives powers to the IRDA to take necessary action against insurance surveyors and loss assessors for the violations committed by them. The manner of imposing penalty and circumstances under which corrective action can be taken by the IRDA including suspension or cancellation are laid down in the respective regulations. The authorized representative of the insurer can cancel the license of an agent (selected personnel in insurance companies insurers have a portal into IRDA's agency registration system). A range of possible sanctions relevant to brokers are listed in the IRDA (Insurance brokers) Regulations 2002. These include suspension and withdrawal of a license. Direct insurance brokers are not permitted to accept insurance premiums in their account. Therefore, there are no policyholder trust funds. Reinsurance brokers may collect and transmit premiums. and Art 23 of the IRDA (Insurance brokers) Regulations 2002 requires that money collected by a licensed insurance broker should be segregated and kept in a separate bank account or with an institution approved by the supervisor. The broker is permitted to recover only charges, fees or commission earned and interest received from such funds. Clause 24 requires that insurance brokers hold professional indemnity insurance of at least 3 times annual fee income or an absolute amount depending on the nature of the broker. Sec.64VB of the Insurance Act, 1938 prescribes that the money collected though agents or corporate agents has to be deposited with the insurer before the commencement of risk: where an insurance agent collects premium on a policy on behalf of an insurer, he should deposit/dispatch by post to the insurer the full amount collected without deducting their commission within 24 hours of the collection. The prescriptions on the 'Code of Conduct' applicable to various intermediaries specified under the regulations require an intermediary to furnish relevant information to the prospective customers including identifying themselves, educating the client on

	the insurance contracts and various processes involved therein, and disclose the scales of remuneration to them in the insurance contracts if asked by the client. When an insurance broker belongs to the same group as an insurance company it is required to make adequate disclosure to clients. Regulation (3) and (4) of the IRDA's (Insurance Brokers) Regulations 2002 lay down in detail the functions of a direct and reinsurance broker respectively, including educating the client about their insurance contract(s). Agents and corporate agents represent the insurance company and this is not applicable to them. The Insurance Act stipulates that an insurance agent can work for one insurer only. Art 8 of IRDA's (Licensing of Insurance Agent) Regulations 2000 requires the insurance agent to disclose as part of the code of conduct which insurance company it represents and disclose the scales of remuneration to them in the insurance contracts if asked by the client. Similarly regulation 9 (2) of the code of conduct for IRDA's (Licensing of corporate agents) regulations, 2002 lays down the requirement for corporate agents. The Insurance Act and regulations provide for penal provisions for any person/entity who acts as an insurance agent/insurance broker without holding a valid license. Any person who acts as an intermediary or an insurance intermediary without holding a license issued under this section to act as such, shall be punishable with a fine (see ICP 15). The Insurance Act states that any insurer or any person who appoints as an intermediary or an insurance intermediary any person not licensed to act as such or transacts any insurance business in India through any such person, shall be punishable with fine. Section 64UM (7) of the Insurance Act, 1938 gives powers to the IRDA to take suitable action against unlicensed insurance surveyors and loss assessors.
Assessment	Observed
Comments	As insurance brokers become more important in insurance intermediation the relevant statutory reporting should be upgraded. In particular an annual or six monthly report showing premiums collected, commissions received, amounts forwarded to insurers and the amounts held in policyholder trust funds would provide more focused risk information.
Principle 25.	Consumer protection The supervisory authority sets minimum requirements for insurers and intermediaries in dealing with consumers in its jurisdiction, including foreign insurers selling products on a cross-border basis. The requirements include provision of timely, complete and relevant information to consumers both before a contract is entered into through to the point at which all obligations under a contract have been satisfied.
Description	**A. INSURERS** The main consumer issues in recent years have been the mis-selling of ULIPS and the handling of health insurance claims. A 2009 Circular mandates that a Board sub-committee for Policyholders' Protection be established. Other regulations prescribe of time limits on various service parameters such as acceptance of proposals, issuance of policy documents, disposal of claims/complaints. Compliance is monitored by way of on-site inspections, off-site inspections and reviews of policyholders' complaints.

	The IRDA (Insurance Advertisement & Disclosures) Regulations 2000 require the filing of insurance advertisement with IRDA and a procedure is in place for remedial action in cases of complaints. The Guidelines on Group Insurance Policies 2005 define a "group" and also prescribe guidelines relating to group insurance marketing and group insurance administration. Compliance is verified at the time of filing of group insurance products. A Circular regarding the transaction of general insurance risks in a post tariff environment laid out good practices for insurers and brokers. Another 2006 Circular deals with the non availability of compulsory motor third party liability insurance and established a high risk motor pool. This incorporates a policy of zero tolerance regarding refusal to accept Motor TP Insurance. This was backed up mystery shopping checks. A 2008 Circular prescribes benefit illustrations for ULIPS – compliance is examined while clearing the product. Proposal forms have a provision to confirm that a proposer has seen/received the benefit illustration. A 2009 Circular deals with the renewability of health insurance policies, including a zero tolerance policy on any refusal to renew individual health insurance policies. Compliance is examined while clearing the product under File & Use Guidelines. A 2010 Circular dealing with public disclosure requires insurers, amongst other items, to show details of consumer complaints on their website. A 2010 Circular provides guidelines on ULIP policies. These guidelines prescribe a minimum sum assured, minimum lock-in periods and maximum expense charges. A 2010 IRDA regarding the 'Treatment of Discontinued Linked Policies' prescribes the obligations of life insurers on discontinuance of policy including mandating the creation of a separate fund for discontinued policies and details thereof to be shown separately in the balance sheet. Insurers are also required to file statement on discontinued policies. A recent Guideline on Complaints Redressal prescribes time limits for the resolution of complaints. Grievance redressal policies have to be approved by the Board and are filed by the insurers with the authority. A further circular provides guidelines to insurers regarding Variable Insurance Products and the benefits that may be allowed under such products. **B. INTERMEDIARIES** Clause (8) of IRDA (Licensing of Insurance Agents) Regulations, 2000 prescribes an Agents Code of Conduct during pre and post sale process. Chapters IV & VI of Insurance Surveyors & Loss Assessors (Licensing Professional Requirements & Code of Conduct) Regulations, 2000 prescribe the duties and responsibilities of Surveyor & Loss Assessors & Code of Conduct. Chapter IV of the IRDA (Health Services) Regulations 2001 prescribe a Code of Conduct for Health TPAs. Regulation 9 of the IRDA (Licensing of Corporate Agents) Regulations 2002 prescribe a Code of Conduct for Corporate Agents. Schedule III of Insurance Brokers Regulations 2002 prescribe a Code of Conduct for Insurance Brokers.

	Regulation 4 and 5 of IRDA (Licensing of Insurance Agents) Regulations 2000 prescribe the qualification and training of agents. Regulations 3, 14, and 16 of Insurance Surveyors and Loss. Assessors (Licensing Professional Requirements & Code of Conduct) Regulations 2000 prescribe practical training for Surveyors & Loss Assessors. Sections 3(5) and 8 of the IRDA (Health Services) Regulations 2001 prescribe the qualification of the CAO/CEO of a TPA. Regulations 4, 5, and 6 of IRDA (Licensing of Corporate Agents) Regulations 2002 prescribe the practical training of the CIE of a Corporate Agent. Regulation 9 (2)(F) of the IRDA (Insurance Brokers) Regulations 2002 prescribe qualifications and training for the Principal Officer of Insurance Broker. The licensing of agents, corporate agents and brokers regulations require that sufficient information is obtained to advise the consumer. Warning notices regarding unsupervised entities are issued and are available on IRDA website. Regulations 5, 8, and 9 IRDA (Protection of Policyholders' Interests) Regulations 2002 prescribe time limits for insurers on the acknowledgement of a claim and disposal of a claim, interest for delayed settlement of claim, appointment of surveyor and the time-frame for the surveyor/investigator to release their report in general insurance/life insurance claims. Insurers are required to have in place an effective grievance redressal mechanism. Under guidelines introduced in July 2010 time limits have been prescribed for the resolution of complaints. In terms of consumer protection infrastructure, the IRDA has set up a separate department which carries out consumer education activities, including campaigns carried out through print, radio and television and through seminars. The primary recourse mechanism once internal insurer processes are exhausted is the Insurance Ombudsman system established under the Register of Public Grievance Rules 1998. There are 12 Insurance Ombudsmen in India. Each is appointed for 13 years and has a staff of experts deputed from the PSUs. They are authorized to settle claims up to a cap of IR20 lakhs. However, the Ombudsmen do not deal with MTPL claims – these are settled through the local dispute settlement arrangements. All decisions of the Ombudsmen are required to be fully documented.
Assessment	Observed
Comments	The 12 Ombudsmen do not communicate and there may be some grounds for establishing a mechanism to share experiences and observations.
Principle 26.	Information, disclosure & transparency toward the market The supervisory authority requires insurers to disclose relevant information on a timely basis in order to give stakeholders a clear view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed.
Description	IRDA issued comprehensive guidelines on public disclosures in January 2010. All insurers are required to disclose their quarterly results in addition to other relevant information within 45 days from the end of the quarter. Quarterly disclosures are made on the web-site of the insurers; and half yearly & yearly disclosures are published in the major newspapers.

	The disclosures specified by IRDA covering the financial position and performance results of the company. In addition, it covers product composition, business concentration, grievance disposal status, solvency status, geographic spread, the investment pattern of the company by duration, information about the Board of Directors and senior management and aggregate data on related party transactions. The quarterly disclosures are required to be approved by the Board of Directors of insurers. The half yearly disclosures are subject to limited review in addition to the Board approval. The format of disclosure has been specified by the IRDA. Sections 11 and 12 of the Insurance Act requires all insurers to produce annual financial statements, duly audited ,which are required to be filed with the supervisor within six months from the close of the financial year ending March 31st. The statements are made available to both the shareholders and the supervisor. IRDA has further stipulated that the financials shall be filed with it within 15 days of adoption by the Board. Insurers are required to maintain the last five years financial statements on their web sites.
Assessment	Observed
Comments	
Principle 27.	Fraud The supervisory authority requires that insurers and intermediaries take the necessary measures to prevent, detect and remedy insurance fraud.
Description	Claims fraud being a pecuniary fraud is a crime punishable under the Indian Penal Code. However, while the powers to issue relevant regulations, circulars and directions are clearly available, there is currently no reference to fraud in the corpus of Insurance Acts and rules and there are no specific requirements at present for insurers to dedicate resources to the combating of fraud. Section 42 (4) of the Insurance Act sanctions agents who engage in criminal misappropriation or breach of trust, cheating or forgery, or of fraud / dishonesty /misrepresentation against an insurer or policyholder, with loss of license. Codes of Conduct are prescribed for each of the different types of insurance agent and intermediary in their respective regulations. These prescribe certain etiquettes to ensure ethical market conduct practices while soliciting insurance business and during subsequent servicing. In terms of actual practice a central list of declined lives is maintained by life insurers at the Tariff Advisory Committee (TAC) to enable insurers to detect life insurance fraud. The data base enables the life insurers to refer any case before a life insurance contract is underwritten. General insurers have in place a central database on stolen vehicles to prevent fraud arising from the sale of stolen vehicles. The IRDA proposes to issue guidelines for the insurance industry prescribing procedures for minimizing fraud and relevant reporting. It is intended that all instances of fraud are shared through a common platform which may either rest within the IRDA or may be managed through the Life and General Insurance Councils. A RFP is for systems to detect health insurance fraud is currently open and this will later be extended to motor and fire insurance.
Assessment	Partially observed.

Comments	Fraud is a growing issue, particularly in the health insurance business. At present preventive actions are being adopted by individual insurers. However, there had been little in the way of an industry wide response and relevant IRDA guidance is still to be developed and promulgated.
Principle 28.	Anti-money laundering, combating the financing of terrorism (AML/CFT) The supervisory authority requires insurers and intermediaries to take effective measures to deter, detect and report money laundering and the financing of terrorism.
Description	AML/ CFT regulation and supervision for the financial sector (including insurance) is directed by the Prevention of Money Laundering Act, which came into force in 2005. The IRDA has responsibility for the supervision of insurers' AML/ CTF prevention systems and has issued a number of sector specific circulars since then under its general powers to issue directions (Arts 34 of the Insurance Act and 14 of the IRDA law). This essentially places full responsibility for AML/ CTF prevention on the direct insurance companies, although this is inconsistent with the FATF guidelines for life insurers, which also applies directly to intermediaries. While IRDA's approach may be reasonable for tied agents the ability of insurers to take responsibility for brokers' actions is limited. Actual reporting of suspicious transactions goes directly to the FIU which is located in the Ministry of Finance. Any AML/CFT transactions discovered that are relevant to insurance are notified to IRDA by the FIU. While breaches of other laws (e.g., taxation) have been reported, no AML/ CTF transactions have been identified to date. India underwent an assessment of compliance with the 40+9 recommendations of FATF as part of the Mutual Evaluation process that resulted in India gaining membership of FATF in June 2010. This assessment appears to assume that all insurance intermediaries are tied agents. A concern expressed out of the Mutual Evaluation exercise was that sanctions are potentially not sufficient to dissuade criminal activity by legal persons. A committee has been set up by the Ministry of Finance as part of India's action plan committed to FATF. Certain other deficiencies not requiring law changes have already been addressed through circular. Subject to these caveats, the IRDA has taken energetic action to implement the FATF requirements: Application - in case of life insurance companies due diligence requirements are to be carried out and complied with at all stages of an insurance contract while in case of general insurance companies these are required to be carried out at the payout stage. CDD – KYC processes have been introduced including photographs/ proof of identity, enhanced due diligence and identification of sources of funds. High and low risk categories have been identified. Monitoring – insurers now need to have systems in place to identify large transaction under five headings (>Rs 10 lakh over one month), objective criteria and systems have to be in place to identify suspicious transactions, a principle compliance officer of sufficient seniority and with access to the insurer's Board has to be appointed, adequate internal audit processes have to be in place along with a system of

	exceptions reporting to the Board. A list of banned entities must be maintained by insurers. The IRDA s currently working with the FIU to develop a typology of suspicious transactions for training and monitoring purposes. AML/ CTF is examined as part of the on-site inspection process for insurers. AML policy – an AML/ CFT policy needs to be drafted, cleared by the Board of Directors of insurers and be submitted to IRDA. Screening – proper screening processes for agents and staff are in place, partly through the fit and proper requirements under the Insurance Act and regulations. In addition, insurers are required to train staff and agents on AML/ CTF requirements periodically. This has been supplemented by IRDA outreach activities (three sessions to the date of the assessment) which have included staff from the FIU.
Assessment	Largely observed
Comments	It is advisable that the growing role of brokers be addressed through a new directive. Financial sanctions also need to be strengthened for legal person intermediaries but the existing name and shame option is likely to be effective in the interim.