



Ref: IRDAI/ACT/PA/MS/001/2017

### Final Order

**In the matter of Mr Manalur Sandilya, Fellow of Casualty Actuarial Society (FCAS), USA and Fellow of Institute of Actuaries of India (FIAI)**

**Based on reply dated 28th March 2017 to the Show Cause Notice dated 7th March 2017 and submissions made during Personal Hearing on 18th April, 2017 at 12 noon taken by Member (Actuary) at the office of Insurance Regulatory and Development Authority of India, 3rd Floor, Parishrama Bhavanam, Basheerbagh, Hyderabad.**

#### Background:

In pursuant to circular Ref No IRDAI/ACT/MISC/MISC/048/03/2016 dated 14th March 2016 issued by Insurance Regulatory and Development Authority of India (hereinafter referred to as "the Authority"), Mr. Manalur Sandilya, FCAS, FIAI (hereinafter referred to as "Actuary") was included in the Panel of Actuaries subsequent to his expression of interest dated 14th April, 2016. Mr. Manalur Sandilya was qualified as FCAS in the year 1998, hence had around sixteen years post qualification experience in the field of Actuarial Science when he was included in the Panel of Actuaries.

The Authority vide email dated 5th May 2016 and letter dated 13th May 2016 had informed the Actuary the scope of work to be carried out as well as the extant norms and Regulations that the Actuary has to pay attention to while carrying his duties.

M/s National Insurance Co. Ltd. (hereinafter referred to as "Insurer") vide its letter dated 18th May 2016, had engaged the Actuary as their Panel Actuary for estimation of the financial position of the insurer and finalization of Annual Accounts for the Financial Year (FY) 2015-16. Accordingly, the IBNR (Incurred But Not Reported Claims Reserve) Report dated 6th July 2016, signed off by the Actuary, was received by the Authority on 19th August 2016 and Financial Condition Report (FCR) dated 28th September 2016 was received by the Authority on 1st November 2016. An Addendum to the FCR was received by the Authority on 20th December 2016.

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The Authority examined the actuarial reports certified by the Actuary to check the compliance of the insurer to Insurance Act, 1938, IRDA Act, 1999 and the Rules, Regulations, Circulars, Guidelines and other directions issued there under by the Authority.

The Authority convened a series of meetings with the senior executives of the Insurer along with the Actuary. The first meeting was held on 25th May 2016 to highlight the observations of the Authority with respect to IBNR reserves as at 31st March 2015. The meeting was attended by the Actuary along with other senior officials of the insurer. In the said meeting, the Chairman-cum-Managing Director of the insurer had assured that the IBNR reserves as at 31st March 2016 would be more prudent incorporating the observations of the Authority. The second meeting was held on 3rd June 2016 to discuss the progress of actuarial valuation work for FY 2015-16.

On 2nd August 2016, the Authority received an e mail from the Actuary with an annexure stating that the 'Most Likely' IBNR estimate as at 31st March 2016 would be Rs. 7293 Crores. However, the Actuary, in his IBNR report, (which was received by the Authority on 19 August 2016) certified a substantially lower amount of IBNR reserves as at 31st March 2016 of Rs. 3030 Crores.

Later, the third meeting was held on 29th September 2016 to discuss the financial submissions made by the insurer with Authority for FY 2015-16. In the said meeting, the Actuary had confirmed that the IBNR reserves, on gross basis, as at 31st March 2016, should be around Rs. 7000 Crores instead of Rs. 3030 Crores as was taken for preparation of financial statements.

On examining the IBNR report and submissions made by the Actuary, Authority had sent a letter dated 28th October 2016 to the Actuary asking for his response on the Authority's observations with respect to inadequate IBNR reserves provided in the financial statements of the insurer as at 31st March 2016. The Actuary's response was received vide his letter dated 8th November 2016.

Subsequently, observing serious lapses in the report, the Authority issued Show-Cause Notice on 7th March 2017, which was responded to by the Actuary vide email dated 28th March, 2017 (hard copy received on 3rd April 2017). As requested by him, a personal hearing was granted to the Actuary on 18th April, 2017. On behalf of the Authority, Ms Pournima Gupte, Member (Actuary), Shri S P Chakraborty, GM (Actuarial), Shri H Ananthakrishnan, HOD (Legal), Shri G R Surya Kumar, Executive Assistant of Chairman IRDAI, Mr. Sudipta Bhattacharya, DGM(Actuarial) and Mr. Parmeshwar Shelke, AGM (Actuarial) were present during the personal hearing.







The submissions made by the Actuary in his written reply to the Show Cause Notice, the documents submitted by him in evidence of his submissions in reply and also the submissions made during the personal hearing have been considered by the Authority and accordingly the decisions thereon are detailed below.

### **Charges, Submissions in reply thereof and Decisions:**

#### **1. Charge No. 1:**

The initial estimation of Ultimate Loss Ratio (ULR) for Accident Year (AY) 2015-16 for Motor Third Party Commercial Vehicles (CV) line of business (LoB) for the Insurer, expressed by the Actuary in the meeting dated 3rd June 2016 with the Authority, was around 130%. However, the Actuary provided an ULR of 46.58% for the said LoB in his IBNR report submitted to the Authority. This was substantially lower than that communicated earlier by the Actuary and also as per the industry standard.

#### **Violation of:**

Para 6.2 of Chapter 1 of Guidelines on estimation of IBNR Claims provision under General Insurance Business dated 8th June 2005 and Para 2(c) of Schedule II-B of Insurance Regulatory and Development Authority (Assets, Liabilities, and Solvency Margin of Insurers) Regulations, 2000.

#### **Submission of the Actuary:**

In the reply to the Show Cause notice, the Actuary submitted that he had deviated from the straightforward application of industry averages and his initial ULR estimate of around 130% for Motor TP CV LoB was based on the available evidence within the insurer and the opportunity to participate in the Actuarial Cycle in a consistent manner adjusting for the remaining "life-span" of a "loss experience" cohort.

The Actuary also submitted, during the personal hearing, that the initial estimate stated in the meeting dated 3rd June 2016 was without seeing the data of the insurer and hence was a mere guess based on his experience.

#### **Decision:**

The purpose of the "Guidelines on estimation of IBNR Claims provision under General Insurance Business" dated 8th June 2005 issued by the Authority is to specify an approach to the determination of IBNR in a logical manner and for compilation of data required for such determination.

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The Para 6.2 of Chapter 1 of Guidelines on estimation of IBNR Claims provision under General Insurance Business dated 8th June 2005 specifies that the ULR for successive years should be credible as compared to ratios of other insurers in the market and for the same insurer over time. The loss ratio assumed by the Actuary for Motor Third Party CV LoB was 46.58%, which was substantially lower than what other insurers have expressed in their financial statements.

Thus, the Actuary failed to perform the functions of Panel Actuary as stated in Circular on Expression of Interest – Panel of Actuaries dated 14th March 2016.

The submissions made by the Actuary are therefore not accepted as he has violated the provisions of the Guidelines and the Regulations stated above.

## **2. Charge No.2**

The Actuary had submitted to the Authority, vide his email dated 2nd August 2016, that the “Most Likely” IBNR reserves as at 31st March 2016 should be Rs. 7293 Crores. However, he certified IBNR reserves, as at 31st March 2016, of Rs. 3030 Crores for financial statements of the insurer, which resulted in shortfall of Rs. 4263 Crores of IBNR in the published financials of the insurer.

### **Violation of**

Guidelines on estimation of IBNR Claims provision under General Insurance Business dated 8th June 2005 and Para 2(c) of Schedule II-B of Insurance Regulatory and Development Authority (Assets, Liabilities, and Solvency Margin of Insurers) Regulations, 2000

### **Submission of the Actuary:**

The Actuary submitted that when he started the work in June 2016, he observed that the data condition in motor & health (which comprised almost 82% of insurer’s business) lines of business was bad as the insurer had operational problems as it did not have a Chairman-cum-Managing Director (CMD) for two years. Also, it was not feasible to get the required data from the IT of the insurer within a reasonable timeframe.

He also submitted that had he stuck to mathematical models with the faulty data it could have resulted in under/over estimation of IBNR reserves. Hence, the Actuary prioritized protecting the interest of the policyholders.

Given the circumstances, he used a range based solution based on his experience, and thus selected the lower end of the range so derived.

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Further, he submitted that there was around Rs. 5000 Crores in the "fair value change account" under equity investments available to pay for the policyholders' claims, but which was not allowed to be used in solvency calculations. The maximum possible estimation error of around Rs. 4000 Crores, in estimation of IBNR reserves as at 31st March 2016, would have been offset by the fair value of equity investments available within the insurer.

**Decision:**

The instructions provided in Guidelines on estimation of IBNR Claims provision under General Insurance Business dated 8th June 2005, provide that mathematical methods should be used for computation of IBNR Reserves. It is also stated in the guidelines that, in case the chosen method is not well known, the Actuary should describe the method and the underlying assumptions used in that method in his report. This was not mentioned in his report submitted to the Authority.

When the data was inadequate or was not credible, the Actuary should have been more cautious in estimation of reserves and should have complied with the provisions of the Guidelines on estimation of IBNR Claims provision under General Insurance Business dated 8th June 2005, instead he selected the lower end of a range of numbers without considering the risk underlying with inadequate data. The logical and mathematical basis of such range was never revealed by the Actuary.

The Actuary should have computed the IBNR reserves based on mathematical method prescribed under the guiding principle of IRDA guidelines dated 8th June 2005. While selecting an estimate for IBNR reserves, the Actuary need not have considered the effect of such selected IBNR estimates on the insurer's financial position. Further having chosen an inappropriate method under that circumstances, the Actuary sought to justify his errors on the plea that, if any problem arose as a result of his estimation, the market value of equity investments of the insurer would take care of any error in the estimation of IBNR reserves.

This preposterous approach adopted by the Actuary not only tends to justify his erroneous method, but also reveal that there could be a situation arising when the insurer may have to encash its equity investments.

Thus, the Actuary failed to perform the functions of Panel Actuary as stated in Circular on Expression of Interest – Panel of Actuaries dated 14th March 2016.

The submissions made by the Actuary are therefore not accepted as he has violated the provisions of the Guidelines and the Regulations stated above.

### 3. Charge No.3

In spite of request from the Authority for submission of detailed calculation of IBNR Reserves as at 31st March 2016, of Rs. 3030 Crores provided for in financial statements of the insurer, the same was not furnished to the Authority by the Actuary.

#### **Violation of**

Para 3.3 of Chapter 2 of Guidelines on estimation of IBNR Claims provision under General Insurance Business dated 8th June 2005 and provision 14(2)(h) of IRDA Act, 1999.

#### **Submission of the Actuary:**

The Actuary submitted that he was travelling, preparing for Board meetings and handling family exigencies and hence, he overlooked the Authority's request for additional information and also thought that the range statement provided by him to the Authority would suffice the requirement.

#### **Decision:**

Para 3.3 of Chapter 2 of Guidelines on Mathematical Estimation of IBNR Claims Provision under General Insurance Business dated 8th June 2005 states that the Actuary should explain the methodology and provide adequate working sheets to understand the calculations and results. Further, provision 14(2)(h) of Chapter IV of IRDA Act, 1999 gives the Authority the power to call for information from any person/organization connected with the insurance business.

In spite of the Authority requesting the Actuary to share the detailed workings of IBNR estimates vide letter dated 28th October 2016, the Actuary has failed to furnish the details of calculation. Further his reasoning that he was travelling, preparing for Board meetings and handling family exigencies shows scant regard for and contemptuous treatment of guidelines of the Authority.

The submissions made by the Actuary also show intentional disobedience towards guidelines framed by the Authority and therefore are not tenable.

It is therefore clearly established that the Actuary has violated Guidelines on estimation of IBNR Claims provision under General Insurance Business dated 8th June 2005 and provision 14(2)(h) of IRDA Act, 1999.







#### **4. Charge no. 4**

The Actuary, vide his mail dated 28th October 2016 and Addendum to FCR dated 20th December 2016, stated that he had decided on a "wait and see" approach and selected an appropriate number as IBNR estimate at the lower end of the distribution after discussions with the management owing to unavailability of credible data.

The above stated assumptions made by the Actuary in estimating the IBNR reserves are contrary to the actuarial principles.

#### **Violation of**

Guidelines on Mathematical Estimation of IBNR Claims Provision under General Insurance Business dated 8th June 2005 and Para 2(c) of Schedule II-B of Insurance Regulatory and Development Authority (Assets, Liabilities, and Solvency Margin of Insurers) Regulations, 2000

#### **Submission of the Actuary:**

The Actuary expressed that he did not consider the requirements of the guidelines for estimation of IBNR reserves because the data was grossly inadequate.

He, therefore, moved from purely mathematical basis to range based solution based on his experience. He then selected the lower end of the range so derived, as he was comfortable with the range.

Given the data issues within the insurer, he also submitted that as his engagement with the insurer was for longer period, it could have been possible for him to monitor the situation.

He, further, submitted that he signed the number as his guiding point was that the insurer should quickly move and should not be pushed into run-off which could have impacted the policyholders. He felt this was a particular situation that allowed the actuary to deviate from strict guidelines. This kind of deviation is a global best practice amongst the actuaries.

#### **Decision:**

It is evident from the above submissions that the Actuary did not adopt mathematical methods to arrive at the IBNR reserves as stipulated in the Guidelines on estimation of IBNR Claims provision under General Insurance Business dated 8th June 2005, rather selected an arbitrary number as IBNR

reserve estimate. Therefore, the Financial Reports submitted by the insurer as at 31st March 2016 did not disclose true and fair view of the insurer's financial position.

Thus, the Actuary failed to perform the functions of Panel Actuary as stated in Circular on Expression of Interest – Panel of Actuaries dated 14th March 2016.

Further, global best practices should not be used as shelter for not following the norms and guidelines prescribed by the Authority.

The submissions made by the Actuary are therefore not accepted as he has violated the provisions of the Guidelines and the Regulations stated above.

## **5. Charge no. 5**

The IBNR reserves estimated by the Actuary has gravely imperilled the financial position of the insurer and has resulted in the following:

- a. Over stating the insurer's profits and its premature distribution
- b. Endanger the payment of benefits to policyholders
- c. Distorted Solvency Position of the insurer

### **Violation of**

Guidelines on estimation of IBNR Claims provision under General Insurance Business dated 8th June 2005 and Para 2(c) of Schedule II-B of Insurance Regulatory and Development Authority (Assets, Liabilities, and Solvency Margin of Insurers) Regulations, 2000

### **Submission of the Actuary:**

The Actuary submitted that the IBNR reserves certified by him, had led to the insurer declaring a profit of Rs. 150 Crores and the dividend & tax pay-out of around Rs. 60 Crores for FY 2015-16. This was minuscule fraction of the net cumulative assets available with the insurer with an almost non-existent material impact on the insurer's finances.

In the reply dated 28th March 2017, he submitted that since he had sound actuarial reasoning to arrive at the insurer's IBNR on a "range and selection" regime rather than a "strict actuarial method based estimate" regime, he had the necessary degrees of freedom to select the IBNR figure within the range without jeopardizing policyholders' ability to collect their dues.

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The Actuary has also submitted that he has adopted international best practices and developed a contrived "bogey" in the form of (a) including the "fair value adjustment" in ASM and (b) used a discounted value of the IBNR requirements. He further submitted that both of these modifications are standard procedures in Solvency II regimes.

**Decision:**

The under-reserving by the Actuary has resulted in the shortfall of Rs. 4263 Crores in the IBNR reserve shown in the financial statements of the insurer as at 31 March 2016. This is not miniscule or insignificant amount.

If the calculation of IBNR reserves as per current regulatory norms were resulting in increase in IBNR endangering the solvency position of the insurer, the Actuary should have highlighted this fact in his IBNR and FCR reports suggesting alternative methods on how to deal with such situations in the best interest of policyholders.

The Actuary cannot unilaterally decide to understate the IBNR figures in the name of "policyholders interests" without consulting the board of the insurer and the Authority. If the Actuary had given the complete and correct picture on the IBNR reserves, it would have enabled the board of the insurer to take timely and appropriate corrective actions in consultation with the Authority for saving the interests of policyholders.

The Actuary has used international practices such as Fair value adjustment and discounted value of IBNR only when it resulted in huge reduction in the IBNR to the extent of Rs. 4263Crores. He, however, has ignored the other international practices that are normally used along with fair value adjustment and discounting of IBNR such as making specific allowance for each risk (e.g. data inadequacy), which would have resulted in the increase in IBNR reserves. The Actuary should have reported a logically identifiable reason to support the number selected as IBNR reserves as per the Guidelines on estimation of IBNR Claims provision under General Insurance Business dated 8th June 2005.

The arguments put forward by the Actuary, in his response to the Show Cause notice, were neither discussed with the Authority during various meetings held in the Authority's office from May 2016 to September 2016 nor mentioned in any correspondence with the Authority.

It is evident from the above submissions that the Actuary did not adopt mathematical methods to arrive at the IBNR reserves as stipulated in the Guidelines on estimation of IBNR Claims provision under General Insurance Business dated 8th June 2005, rather selected an arbitrary number as IBNR

reserve estimate. Therefore, the Financial Reports submitted by the insurer for the FY 2015-16 did not disclose true and fair view of the insurer's financial position.

Thus, the Actuary failed to perform the functions of Panel Actuary as stated in Circular on Expression of Interest – Panel of Actuaries dated 14th March 2016.

The submissions made by the Actuary are therefore not accepted as he has violated the provisions of the Guidelines and the Regulations stated above.

**Decision for the above charges:**

The Authority in judicious exercise of powers vested in Section 14 (2)(b) and (e) of Insurance Regulatory and Development Authority Act, 1999 decides as under:

- Termination of appointment of the Actuary as Mentor to the Appointed Actuary of the insurer
- Barring the Actuary from doing any further work on review of reports as at 31st March 2016 for United India Insurance Co. Ltd
- The Actuary had deviated from what he was authorised to do as per the circular for Panel of Actuaries dated 14th March 2016 that endangered the payment of benefits to policyholders of the Insurer as the Solvency Position of the insurer was distorted due to such action of the Actuary. Considering the gravity of such unauthorised actions taken by the Actuary, the Reports, certificates and any other work of the Actuary shall neither be recognized nor accepted by the Authority for a period of two years from the date of communication of this order.

If the Actuary feels aggrieved by any of the decisions in this order, an appeal may be preferred to the Securities Appellate Tribunal as per Section 110 of the Insurance Act, 1938.



(Pournima Gupte)  
Member (Actuary)



Place: Hyderabad

Date : 1st June 2017