



Ref.No: IRDA/ENF/ORD/ONS/080/04/2016

Final Order in the matter of General Insurance Corporation of India

Based on reply to the Show Cause Notice dated 25th January, 2016 and submissions made during Personal Hearing on 8th March, 2016 at 2.30 pm taken by Member (F&I) at the office of Insurance Regulatory and Development Authority of India, 3rd Floor, Parishrama Bhavan, Basheerbagh, Hyderabad.

The Insurance Regulatory and Development Authority of India (hereinafter referred to as "the Authority") carried out an onsite inspection of **General Insurance Corporation of India** (hereinafter referred to as "the Reinsurer") from 03.10.2011 to 05.10.2011 and 10.10.2011 to 15.10.2011. The Authority forwarded the copy of the Inspection Report to the Reinsurer which was responded by them vide their communications dated 28.03.2012 and 11.09.2015. Upon examining the submissions made by the Reinsurer the Authority issued Show Cause Notice on 25.01.2016 which was responded to by the Reinsurer vide letter dated 17.02.2016. As requested therein, a personal hearing was given to the Reinsurer on 08.03.2016. Ms. Alice Vaidyan, CMD, Ms Usha Ramaswamy, General Manager, Ms. Girija Subramaniam, Deputy General Manager, Ms Latha Krishnan, Assistant General Manager and Sh. P. Dutta, General Manager were present in the hearing on behalf of the Reinsurer. On behalf of the Authority, Ms. V. R. Iyer, Member (F&I), Sh. Lalit Kumar, FA & HOD (Enforcement), Sh. Suresh Mathur, Sr. JD (Non-Life), Sh. Prabhat Kumar Maiti, JD (Enforcement), Ms. Jyoti Vaidya, DD (Enforcement), Ms. J. Anita, DD (Actuarial) were present during the personal hearing.

The submissions made by the Reinsurer in their written replies to the inspection observations, Show Cause Notice and also submissions made during the course of the personal hearing have been taken into account. The findings on the explanations offered by the Re-insurer against the charges made under Show Cause Notice and the decisions thereon are detailed below.

1. Charge – 1

The amount that was receivable from the cedants / brokers was shown as "Reserve Deposits with Ceding Companies". However, the reinsurer was neither in practice of obtaining the confirmation of balances receivable nor analyzing the ageing of balances. An age-wise analysis statement of these premium reserves receivable generated from the reinsurer's SAP system indicated that more than Rs. 500 crores out of total Rs. 1,153 crores was due for a period more than 1096 days. The reinsurer was taking credit of total balances receivable in arriving at 'Available Solvency Margin', which was not prudent.

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This is violation of

- IRDA (Asset Liability Solvency Margin Regulation), 2000 by considering reinsurance balances for more than 90 days for calculation of available solvency margin.
- Para 2 of IRDA Circular number 12/ IRDA/ F&A/ CIR/ Mar 09/ dated 26.05.2009 which stipulates that reinsurance balances outstanding for more than 3 months should be placed with value "0".

Submission of the Reinsurer:

Reserve deposits form an integral part of reinsurance premium income which is subject to retention and release successively and as such are not the actual net balance payable/receivable as per the statement of account received from cedant who is required to retain and release reserves as per treaty arrangements.

GIC Re is, therefore, considering the reserve deposits for the purpose of arriving at 'Available Solvency Margin' as the nature of these reserve deposits cannot be termed as "Reinsurer's balances outstanding for more than 3 months" as per IRDAI regulation- Schedule 1 for Valuation of assets.

Decision:

It is observed that there is no practice of seeking confirmation of balances receivable from the cedants/brokers. The entire reserve fund held by the cedants/brokers is taken credit of while arriving at the ASM. Whereas the reinsurer has submitted that such reserve deposits are subject to retention and release successively and as such are not the actual net balances/receivables. However, the prudence demands that only those balances which are receivable shall be taken credit while arriving at ASM. Therefore, the reinsurer is directed to reconcile the balances, in order to identify the balances which are not realizable and shall not be considered in ASM calculations.

The Reinsurer is directed to ensure strict compliance of Regulation 2(1) of Schedule I of IRDA (Asset Liability Solvency Margin of Insurers) Regulations, 2000 and Para 2 of IRDA Circular number 12/ IRDA/ F&A/ CIR/ Mar 09/ dated 26.05.2009 in true spirit.

2. Charge – 2

The reinsurer had considered 'Loan to staff (housing, car, vehicle and computer)' amounting to Rs.2.73 crores under Non Mandatory Investments and 'Advances to Directors/Officers' amounting to Rs.15.45 lakhs under 'Advances and Other assets'.

This is Violation of Section 29 of Insurance Act, 1938 which does not allow such Loans and Advances to any director, manager, actuary, auditor or officer of the insurer.

Submission of the Reinsurer:

From the year 2011-12 onwards, that out of the total loans, GIC Re has been excluding the amount of loans provided to employees for the purpose of calculation of Assets for SM. However the practice of giving housing loans, loans for vehicles for marketing functions, for purchase of computers and such other prose have been there since nationalization of insurance industry.

Decision:

Noting the submission of the reinsurer and considering that such loan/advance are being given as part of employee benefits, as per the board approved policy, the charge is not pressed further.

3. Charge – 3

The Authority granted permission to the reinsurer for opening the foreign branches (London, Kuala Lumpur, and Dubai) with a condition that 'GIC shall file a copy of periodic returns submitted to the respective local regulator to the Authority'. However the reinsurer had not complied with the condition.

This is a violation of Clause 6 of Annexure II of Corporate Governance guideline vides circular no. IRDA/F&I/Cir/F&A/014/01/2010 for not having appropriate internal controls to ensure that compliance policies are observed.

Submission of the Reinsurer:

The reinsurer submitted that the annual returns for three financial years i.e. 2012-13, 2013-14 and 2014-15 of the 3 foreign branches are filed with IRDAI on 11.09.2015. The reinsurer further submitted that they would ensure to comply with the requirement in future by filing of the annual returns of the branches immediately on receipt.

Decision:

The Authority has noted the submission that **the reinsurer has taken corrective action and ensures compliance with the requirements in future by filing of the annual returns as per the requirements of the Authority. No charge is being pressed.**

4. Charge – 4

The reinsurer had maintained negative 'Outstanding Loss Reserve (OSLR)' in 1347 cases with a total of Rs. -80.57 crores that have in effect unduly reduced the OSLR provision as at

31-03-2011 and as such an indication of inadequate system controls adopted by the reinsurer.

The reinsurer had entered into an 'Alternate Risk Transfer' (ART) arrangement with effect from 01-05-2002 and the arrangement was renewed with Swiss Re for a period of three years with effect from 01-05-2010. On examination of the arrangement, it was observed that significant portion of the reinsurance premium for the ART arrangement was not paid to Swiss Re but was held back by the reinsurer in 'Funds Withheld Experience Account' (FWEA). It was observed that, as per the terms of arrangement, first FWEA would be exhausted by the reinsurer before any claims are payable by Swiss Re under the arrangement and any negative balance in the FWEA would be made good (in full up to a limit and in part thereafter) as 'penalty premium' at annual renewal date. FWEA account balance as at 31-03-2011 (Rs. 682 crores) was similar to the OSLR being maintained by the reinsurer. But by not treating the FWEA as part of OSLR the reinsurer had unduly reduced the 'Required Solvency Margin' (RSM) requirement by Rs.205 crores, which is 30% of FWEA.

Violation of

- Clause 6 of Annexure II of Corporate Governance circular no. IRDA/F&I/Cir/F&A/014/01/2010
- Regulation 2 (II) (b) of Schedule II B (Valuation of liabilities general insurance) of IRDA (Asset Liability Solvency Margin) Regulation,2000.

Submission of the Reinsurer:

The Re-insurer submitted that they had initiated checks and controls to identify the negative OSLR so that corrective action was taken immediately. Over the period, the number of OSLR entries appearing as negative is reducing at greater rate proving the effectiveness of the monitoring systems which had been put in place. Efforts were in progress to implement further controls to eradicate this problem altogether.

The reinsurer further submitted that FWEA was a fund created out of the premium for the contract payable to reinsurers and belongs to the reinsurers. It was only held in trust by GIC Re. The balance at any point of time was net of incurred claims under the contract till that point of time, and reflected the fund profitability at that point and therefore could not be treated as OSLR. The claims under the contract were first paid for by the FWEA balance and only the balance was paid for by reinsurers. In the event of a negative FWEA at annual renewal, penalty premium was payable at annual renewal. If the FWEA was in positive balance at annual renewal, the same remained as a positive balance and could be used to offset future liabilities of future periods till the contract was terminated.

If the contract was terminated by any party at annual renewal date, the entire positive balance was treated as Profit Commission to GIC Re. For the years from 2002 to 2014, the FWEA had always been positive at 31st March each year and also at annual renewal date of the contract. As on 31st March 2011, the positive FWEA balance of Rs. 682 crores was net of all incurred claims under the contract till that point of time and therefore could not be treated as OSLR.

Thus the Reinsurer contended that the fund balance could not be treated as OSLR due to the following:

- The fund did not belong to GIC Re, it was only held in trust on behalf of reinsurers.
- The balance was net of incurred claims at any point of time and hence represented the profitability of the contract as at that point of time.
- The positive balance at the end of any annual period was used to service any future liabilities which were unknown.
- If the contract was terminated at the annual renewal date, the positive balance was treated as profit commission to GIC Re.

Decision:

Negative entries: The Authority has examined the available documents and the corrective steps taken by the reinsurer to reduce the number of negative entries while calculating "Outstanding Loss Reserves". **The reinsurer is warned for maintaining negative OSLR and directed to strengthen the internal processes to ensure that such negative entries will not recur while calculating "Outstanding Loss Reserve" hence forth.**

Alternate Risk Transfer: It is also noted that the reinsurer has entered into "Alternative Risk Transfer Arrangement" with Swiss-Re w.e.f. 01.05.2002. The documents on record and the submission made by the reinsurer on the date of personal hearing (08.03.2016) do not reveal the true nature of the contract as finite or limited risk transfer contract. The reinsurer refers to the contract as if it is a traditional 100% risk transfer contract and does not reveal the extent of risk transfer in the contract. The reinsurer refers to retain premiums for funding retained risks as savings in premium and further does not reveal about the requirement of letter of credit for any recovery from reinsurers and risk financing charges on such recovery. In its submission the reinsurer does not reveal about the accounting as per IRDA Circular of Ref: IRDA/CIR/F&A/053/Dec. 04 dated 08.12.2004, especially about accounting treatment when net FWEA (fund withheld experience account) is negative.

In this regard the reinsurer is directed:

- To follow the provisions of IRDA Circular Ref: IRDA/CIR/F&A/053/Dec. 04 dated 08.12.2004.
- To account for financing arrangement and reinsurance arrangement separately as per the Generally Accepted Accounting Principles (GAAP) from the year 2011-12 to till date.
- To calculate the reserve as in compliance to regulation 2(ii)b of Schedule II-B of IRDA(ASLM) Regulation 2000, reflecting their liability in a prudent manner.
- To furnish the copies of agreements of "Alternative Risk Transfer" arrangement to F&A department, IRDAI as stipulated in the above mentioned circular(dated 08-12-2004).

5. **Charge – 5**

It was observed that the reinsurer had deviated from the Board approved accounting policy by deducting only commission to arrive at net premium income and thus no OSLR was created against the estimated gross premium income.

This is in violation of Regulation 2 (II)(b) of Schedule II B (Valuation of liabilities general insurance) of IRDA (Asset Liability Solvency Margin of Insurers) Regulations, 2000.

Submission of the Reinsurer:

Estimation for premium & deduction could be achieved to a great level of accuracy as the parameters used for premium estimation were available with them in the master data in the form of EPI & Commission %. There was no certainty on claim occurrence nor could it be estimated across all classes of business and lines of business based on past performance only. In addition to past claims experiences a number of other factors also had an influence on claims estimation. To mention a few, factors like,

- a) Portfolio
- b) Size of the portfolio
- c) Past trends of developments of claims
- d) Past claims experience
- e) Nature of loss affecting the portfolio like attritional, Risk and Catastrophe events
- f) Growth in premium pattern (includes the estimated premium value also) in terms of volume of business, Type of Risks assumed, spread of Risks, source of business from new locations
- g) Implementation of Underwriting Controls, and many more have an impact on the claim estimation.

The estimation of Incurred claims should consider all the above factors and involves complex calculations. The estimation process of claims requires the assistance of a professional in the field of Actuary. The Estimation of IBNR & IBNER exercises carried out by Appointed Actuary encompasses all such factors and was in a position to fairly estimate the incurred claims. The AA's estimation of IBNR and IBNER based on IRDAI guidelines took into account both the provisions relating to inadequate provision for reported claims as well as claims not reported.

Decision:

In view of the submissions made by the reinsurer the charge is not pressed. However, the reinsurer is advised to ensure reserving in line with the relevant Circulars/ Guidelines/ Regulation which calls for prudence in calculation of reserves.

6. **Charge – 6**

It was observed that the reinsurer has not provided any Premium Deficiency Reserve (PDR) as at March 31, 2011. Underwriting losses during 2010-11 being Rs. 1,104 crores.

Violation of

Schedule II B (Valuation of liabilities general insurance) of IRDA (Asset Liability Solvency Margin) Regulation, 2000.

Submission of the Reinsurer:

The underwriting loss of Rs. 1,104 crore as at 31.03.2011 was the total of incurred claims, commission, management expenses and profit/loss on exchange. Therefore, underwriting loss was not the basis for calculation of premium deficiency reserve.

Decision:

As per IRDA Circular reference F&A / CIR/ 017/May 04 dated 18.05.2004, the PDR is to be maintained for the three lines of business – Fire, Marine and Miscellaneous. From the available documents, it is evident that for the year 2010-11 although the balances in these three lines of business were negative, the Re-insurer did not provided for the PDR reserve as per the above referred circular.

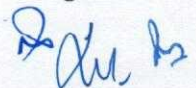
The reinsurer is directed to confirm that the provision of PDR for all the years starting from 2011-12 onwards were in compliance of the said circular within a period 30 days from the date of the issue of this order.

7. Charge – 7

The reinsurer was accepting Aviation inward direct business, predominantly through foreign insurance brokers, without a ceding company and the same was shown as facultative inward business. In all such cases, the amounts receivable from the insured were shown as amounts receivable from brokers involved.

The Board of GIC of India in its meeting held on 14-08-2001 has resolved that "*the provisions of IRDA Act, 1999 extends to India only and states that the Indian Reinsurer means an insurer who carries exclusively reinsurance business. This does not prohibit the Corporation from underwriting direct business through intermediaries abroad. Reinsurance therefore accepted through the intermediaries without a ceding company does not contravene the provisions of the Act*".

The acceptance of foreign direct inward business (aviation) and treating it on par with reinsurance business, even though the reinsurer is licensed by IRDA to carry out reinsurance business only, is objectionable. Also, the reinsurer has not ensured the compliance of Sec. 64VB(1) of the Insurance Act, 1938 with respect to such foreign direct inward business. In this



regards, it was also observed that the reinsurer has not established any mechanism to review the performance of aviation direct business portfolio, as to its viability and profitability.

Violation of

The reinsurer is procuring reinsurance business directly from foreign brokers without involvement of ceding company.

This is violation of:

- a) Section 9 (1) of General Insurance Business (Nationalization) Amendment Act, 2002 to be read with Regulation 17 of IRDA (Registration of Companies) Regulations, 2000.
- b) Section 64 VB (1) of the Insurance Act, 1938.

Submission of the Reinsurer:

The reinsurer submitted that this book of business of GIC Re is the International Aviation Risk book of business, which was a limited and highly specialized book of business with the business concentrated in certain markets viz. the London market and the European Market. As a consequence most of the International Aviation Risk Book of Business was underwritten through intermediaries/specialized brokers operating in that market. Regulators in the respective markets therefore were sensitive to the special nature of Aviation Risk Business.

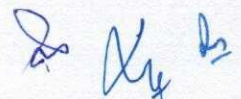
Since most International Aviation Risk was underwritten through intermediaries and specialty brokers, it was common practice for such intermediaries and specialty brokers to issue a cover note that serves as the insurance policy and/or legal contract with the insured. The said broker thereafter allocated the risk amongst various reinsurer's and carriers from around the world. It was also that at times the intermediaries/brokers would utilize the services of an insurer/cedant authorized to write business in the jurisdiction where the cover-note, i.e. the contract of insurance with the insured had been issued

It was submitted that GIC did not enter into any contract of insurance to any of the customers and therefore, might be deemed to be considered as not doing any Direct Insurance. Further, this had been the practice & conducts of their international operations ever since inception and was conventionally and traditionally taken as part of their Aviation business.

The reinsurer submitted that Rule 59(g) and (m) specifically exempted aviation risks and reinsurance policies from the requirements of Section 64 VB (1) of the Insurance Act of 1938. Section 64 VB was applicable only for Insurance business conducted within the shores of India and not applicable to business done abroad.

Decision:

Section 9 (1) of General Insurance Business (Nationalization) Amendment Act, 2002 about formation of General Insurance Corporation of India states that as soon as may be after the commencement of this Act, the Central Government shall form a Government company in accordance with the provisions of the Companies Act, to be known as the General Insurance Corporation of India for the purpose of carrying on reinsurance business. Further, for the purpose of obligatory cession to Indian reinsurer as per Section 101A, the GIC enjoyed the




status of Indian Reinsurer as per 101A(8) (ii) which defines the Indian Reinsurer as an Indian insurance Company which has been granted a certificate of registration under sub-section (2-A) of Section 3 by the Authority to carry on exclusively the re-insurance business in India. Thus GIC is mandated to undertake only the reinsurance business. Whereas the contention of the Board is that the GIC can do reinsurance business without the ceding company. If that is the case such a business cannot be termed as reinsurance but only as direct business which the GIC is not mandated to underwrite as per GIBNA 1972 as amended from time to time and also as per the IRDA regulation on registration of companies. Thus the stand of the GIC is not legally tenable.

In view of this, the reinsurer is violating Section 9 (1) of General Insurance Business (Nationalization) Amendment Act, 2002 by procuring "Direct Aviation Business", for which they are not registered. The Re-insurer is warned for the violation and directed to discontinue any of the direct business which is not in compliance with Section 9 (1) of General Insurance Business (Nationalization) Amendment Act, 2002.

Further,

- a) The reinsurer shall confirm compliance in respect of all the directions referred to in this Order, within 15 days from the date of issuance of this order. Timelines, if any as applicable shall also be communicated to the Authority.
- b) The Order shall be placed before the Audit committee of the insurer and also in the next immediate Board meeting and to provide a copy of the minutes of the discussion.
- c) If the reinsurer feels aggrieved by any of the decisions in this order, an appeal may be preferred to Securities Appellate Tribunal as per Section.110 of the Insurance Act, 1938.

Place: Hyderabad
Date: 26.04.2016


(V R IYER)
Member (F&I)
