

REPORT
OF THE
EXPERT COMMITTEE

*(To Examine Remuneration System for
Insurance Brokers, Agents etc.
in General Insurance Business)*

DECEMBER, 2003



बीमा विनियामक और विकास प्राधिकरण
INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY
HYDERABAD

Contents

PART 1

<u>A. Executive Summary of Issues</u>	3-4
<u>B. Summary of Recommendations</u>	5-17

PART 2

Chapter 1: Introduction	21-29
Chapter 2: Special Discount & Remuneration of Agents & Brokers	31-43
Chapter 3: A Fair & Competitive Market— Role of Agents & Brokers & Regulatory Safeguards	45-58
Chapter 4: Referral Charges for Marketing Intermediaries	59-61
Chapter 5: Other Recommendations	63-66
Note on Important Regulations/Changes proposed by the Committee	67-68

APPENDICES

Appendix 1: Notification and Terms of Reference	70-72
Appendix 4: List of Abbreviations	73
Acknowledgements	74

PART -1

A. Executive Summary of Issues	3-4
B. Summary of Recommendations	5-17

An Executive Summary of Issues

When the insurance market was liberalized in 2000-- with the IRDA issuing licenses to private players to commence business operations-- the distribution and marketing channels consisted of Officers of insurers, Development Officers and an Agency force that was licenced, based more on their ability to produce business rather than on any professional criteria. The general insurance market consisted of the four public sector players viz., National Insurance, New India Assurance, Oriental Insurance, and United India Insurance. The GIC that was their Holding Company facilitated coordination, competition and laid down standards for market conduct, customer service and development of the market. With the liberalization of the market, these four players became autonomous directly answerable to the Ministry of Finance as their owner. The General Insurance Corporation of India was designated as the Indian Reinsurer. Eight private players have since entered the general insurance market and except one, the rest of them have foreign equity participation of 26%.

With these structural developments in the market at the level of providers, the attention of the IRDA was focussed on professionalization of the distribution and marketing channels. Licencing Regulations for agents were issued laying emphasis on qualification, training and passing a prescribed examination. Corporate agency, as another channel to step up the developmental activities, was recognized to enable banks and other companies to take up insurance as a business activity subject to certain norms. The Committee on Reforms In The Insurance Sector, popularly known as Malhotra Committee had recommended in 1994 that brokers, representing the customer, be brought in as another marketing and distribution channel, as prevalent in most of the developed and developing markets to protect the consumer interests, to raise the level of professional standards in risk management and underwriting and to speed up claims settlement. Though a broker represents the interests of the customer and acts as his agent, his remuneration is payable by the insurer. New Regulations were issued specifying the norms for their licencing and remuneration packages in October, 2002.

In the regulations issued for brokers the IRDA has specified the maximum remuneration payable to them by the insurers on statutory, tariff and non-tariff covers. The special discount of 5% enjoyed by certain corporate bodies on paid-up capital norms was allowed to continue, and they had the choice of either availing the discount or approaching the broker for his services, but not have the benefits of both.

On 22/3/2003, the IRDA, through a Notification, modified the remuneration structure for brokers, based on a new set of paid-up capital norms. On 30/5/2003 the special discount of 5% for the corporate customers was removed by the IRDA to enable the brokers to receive a maximum of 12.5% brokerage on tariff covers and 17.5% on non-tariff covers as already specified in the Regulations.

This was strongly protested by a section of the insurers who felt that this would push up their costs steeply and by a section of the insured as well who pleaded that their insurance costs would go up. A few insured expressed that intermediation was being thrust on them. Some insurers represented that the existing tariff structure did not envisage any additional cost burden to be borne by them in the form of additional brokerage or agency commission. If they had to incur additional burden the tariff rates should be raised.

The IRDA taking note of these representations kept the Notification of 30/5/2003 in abeyance on July 16, 2003. The brokers feeling aggrieved that the regulations are often changed to their financial disadvantage have protested in their turn.

Considering the strong, differing viewpoints expressed by various stakeholders, the IRDA has asked the present Expert Committee, under a Notification issued on 1st September 2003, with a set of Terms of Reference, as outlined in Annexure 1, to examine the issues involved and make its recommendations thereon, after it has given an opportunity to all the stakeholders and the public at large to express their points of view. The Committee, after due process of consultations and having considered all the points of view placed before it, has made its recommendations on what it believes to be in the best overall interests of the future of the market and the continued well being of all the stakeholders.

Chapter 1 of the report of the Expert Committee outlines the role and importance of general insurance in shaping the financial, social and economic contours of the nation. It also describes the present market size, composition, set up and the changes taking place in the distribution and marketing channels. In this Chapter the Committee has explained how the report has been structured and how the Committee has evaluated the several issues it was asked to deliberate upon.

Chapter 2 deals with the views presented by the insurers, customers and the brokers and others on the issues of special discount to corporate customers, brokerage and agency remuneration and on whether the public sector bodies should be exempt from intermediary access. It also discusses the major issue of detariffing the market as a part of complete liberalization without which the creative initiatives of insurers and intermediaries do not get opportunities to flourish.

Chapter 3 deals with the development of a fair and competitive insurance market, the role of agents and brokers and the regulatory safeguards that should be in place to eliminate the alleged unhealthy and undesirable business practices.

Chapter 4 deals with the development of insurance market and whether referral fees/ charges would help to speed up the creation of insurance awareness and help rural populace in particular to have access to insurance as a financial net and as a financial security medium. Recommendations have been made on this specific item of the Terms of Reference and also on certain implications that the banks and others desiring to take up the corporate agency should take note of.

Chapter 5 examines issues that are incidental to the Terms of Reference having major implications like Reinsurance, Representative offices, Statutory Cessions etc. in the evolution of the domestic market.

A Summary of recommendations made by the Committee on all the issues referred to above has been attached for the study, examination and consideration by the IRDA.

Summary of Recommendations by the Expert Committee

Terms of Reference 1:

To make specific recommendations:

- Whether the 5% special discount in lieu of agency commission and remuneration presently enjoyed by the certain segment of policyholders should continue or discontinue or modify in any other form in the interest of future growth of insurance market
- Whether any special dispensation is required to be given for Government, PSUs and Corporate Bodies
- Whether there should be linkage of this discount/commission/remuneration with the paid-up capital concept of the insured
- Whether the kind of commission/remuneration encourages rebate and its effects on business development and procurement cost as compared to the services to be rendered by the intermediaries
- Whether there should be a differential rate of commission /remuneration to agents/brokers in general and with special reference to health insurance, personal lines, social and rural sector insurance business.

The Committee has made its recommendations on the Terms of Reference, herein below. It has suggested detariffing of the whole tariff pricing structure as the urgent and pressing need to give a free play to market forces as an essential part of a liberalized market setup. It has also suggested a definite date for the implementation of detariffing so that the necessary infrastructure can be put in place for a smooth change over to a totally non-tariff regime.

Recommendations:

The Committee has made its recommendations on the Terms of Reference as under.

A. Detariffing:

1. To take immediate and urgent steps to move towards detariffing the entire general insurance market that includes the profitable segments like the fire and engineering and the unprofitable business segments like motor. It is strongly recommended that this issue should be addressed on a priority basis and a free market without tariffs and price controls should be organized. IRDA, TAC and the General Insurance Council of the Insurance Association of India should collaborate with each other to ensure a smooth changeover to the non tariff system not later than 1st April 2006.
2. A road map should be drawn up for this purpose. IRDA, TAC and the General Insurance Council should encourage, assist and guide individual insurers to build up statistical bases for their own risk acceptances on all businesses currently under tariffs, category-wise, as is now prevalent in the respective tariffs. This will enable them to be ready for a Pure Risk rate regime (wherein the rates will not include any administration and /or procurement costs or profit margins) proposed by the Committee to operate

at least with effect from 1st April 2006. This will thus prepare the insurers for a completely detariffed market two years later. Involvement of consulting actuaries of insurers in this exercise should be considered.

Insurers should gross up the designated Pure Risk rates to cover for their administration and procurement expenses and profit margins according to their best underwriting judgment. To this extent the market should have floating rates in which the underwriting skills and cost and profit considerations will have a primacy from 1st April 2006.

3. The effect and fall out of the introduction of Pure Risk rate regime in the interim may have an adverse impact on the rates in the short run on profitable segments whereas the rates may go up in the hitherto unprofitable segments. To avoid or mitigate unhealthy competition in pricing, until the market stabilizes, the Pure Risk rates (which will not include any administration and / or procurement costs or profit margins) should be regarded as the minimum benchmark subject to strict discipline and inspection as an intermediate step. Insurers should be alerted on the need to control expenses to achieve appropriate balances in their results.

During such regime of Pure Risk rates, the standard terms and conditions of the tariff wordings should be preserved. The roadmap envisaged must thoroughly dwell on this aspect.

The TAC should be entrusted with the responsibility to prepare Pure Risk rates to be regarded as the minimum for two years commencing from 1st April 2006 or even earlier if possible and such rates should have the status of tariff rates. The TAC should monitor the breaches of Pure Risk rates. Punishment for breaches should be hefty enough to discourage deliberate breaches.

4. Since there is an industry tariff structure currently in force on most portfolios, the Committee is of the view, that there has been very little incentive for individual insurers to build up their individual risk category acceptances and experiences to be able to price risks on claims cost plus basis.

Absence of statistical data would compel an insurer to price risks on assumptions either with a conservative element built into it or force it to follow the rates of any of its aggressive competitor. In a strongly developed broker market, the pressure on underwriters will be intense; and the current competition is still young, just three years old. The Indian insurance market is yet to mature in terms of underwriting skills to be able to face tougher competitive conditions likely to emerge in future.

Underwriting and pricing of risks should, therefore, be based on statistical data to back up the intended pricing structure both at the level of the individual insurer and of the market as a whole. It is time for individual insurers to start building up their statistical data on sound lines to avoid a chaotic situation and price wars later.

The IRDA, TAC and the General Insurance Council should guide and assist individual insurers to adjust to the transformation that a free market situation will impose on their business practices, mindset and procedures. The changeover has to be as smooth as possible and with full awareness of its consequences.

5. Customers do need price competition to experience the full benefits of liberalization. Insurers need to practice underwriting skills and risk management techniques to evaluate risks and price products to fit in with global trends and practices. They should be enabled to learn from international trends and developments. Brokers and agents need to display their professional wares and expertise.

B. Special discount, Intermediary Remuneration, Special dispensation to PSUs and Paid-up Capital norms.

1. To continue with the 5% Special discount (that has been in usage for over 25 years) in the interim for certain Corporate bodies – both in the private and public sector on fire and engineering insurances only- till detariffing of rates by 1st April 2006 or earlier as the case may be. There is no justifiable reason demonstrated to the Committee for its sudden withdrawal.
2. Since the Rs 10 lakh paid-up capital norm for corporate bodies, as defined below, fixed earlier for qualifying for special discount of 5% is very low under the present economic trends, the Committee recommends that the eligibility limit for the special discount of 5% should now be raised to a minimum paid-up capital of Rs 1 crore and above for corporate bodies. The special discount of 5% should be further restricted to such corporate bodies for only fire and engineering insurances.

This will widen the access of corporate client base, below paid-up capital of Rs 1 crore, both to the agents and brokers to display their professional expertise.

There should be no special discount of 5% allowed on any tariff cover either to individuals or corporate bodies whose paid-up capital is below Rs 1 crore. IRDA/TAC may issue suitable instructions in this regard.

Where special discount 5% is not applicable, the agency commission for insurances of individuals and corporate bodies with a paid –up capital below Rs 1 crore should be restricted to a maximum of 10% for agents. The brokerage should be a maximum of 12.5% on tariff covers.

Although not related to the paid-up capital issue, it is recommended that for statutory covers both the agents and brokers should be eligible to a maximum of 10% remuneration, as no special expertise is required to sell and service these covers and further there shall be no special discount payable on this.

For non-tariff covers the brokers should be eligible to a maximum remuneration of 17.5% and the agents to a maximum of 15% as currently specified.

3. The Corporate bodies, whether private limited companies or public limited companies or public sector undertakings or statutory bodies having a paid-up capital of Rs 1 crore and above and up to Rs 25 crores should be allowed to have a choice of availing either a 5% special discount and place fire and engineering businesses directly with an insurer or seek the services of a broker/agent when they will become ineligible for the 5% special discount. The remuneration to brokers in such an event should be limited to a maximum of 7.5%. The agency commission should be restricted to a maximum 6.25 %.
4. The Corporate bodies, whether private limited companies or public limited companies or public sector undertakings or statutory bodies having a paid – up capital of above Rs 25 crores should be allowed to have a choice of availing either a 5% special discount and place the fire and engineering business directly with an insurer or seek the services of a broker/ agent, when they will become ineligible for the 5% special discount. The remuneration to brokers in such an event should be limited to a maximum of 6.25%. The agency commission should be restricted to a maximum of 5%.

In suggesting the above norms and remuneration, the Committee would like to record that these remuneration packages should be regarded only as interim measures pending the detariffing of the market with the introduction of Pure Risk rate regime not later than 1st April 2006. The brokers/agents should be enabled in the interim to get integrated into the system for their future potential gains and the more important professional roles they will be expected to play.

5. The present brokerage/commission structure as it exists in the present regulations on tariff covers, does in the view of the Committee, encourage rebating and malpractices to flourish. It has happened in the past, despite numerous measures discouraging their proliferation by way of social control of insurance and nationalization.

The Regulator at this initial stage of liberalization of markets should be wary of such substantial remuneration to be paid on tariff covers, wherein the professional input is limited, whether it is the broker or the agent. Inducing competition in the market, while controlling prices and product features for most covers will inevitably encourage unhealthy practices to flourish.

Hence the Committee has suggested detariffing the market by the introduction of Pure Risk rate regime not later than by 1st April 2006 as the logical step to create an environment where competition is fair and there is a level playing field.

6. As regards the impact of brokerage and commission on procurement costs of insurers on tariff covers, it is observed that the cost of transacting insurance business in India has remained high at over 30% of the earned premiums

generated for both the public and the private players. Additional costs if imposed suddenly would further burden them.

Insurers have neither actively adopted nor taken any serious measures to reduce costs nor have they any strategies in place to do so that will result in lower premiums to consumers at least in future. Insurers have combined ratios (claims cost plus expenses) in excess of 114% on earned premiums for the year 2002/3 resulting in huge underwriting losses. The Boards of Directors of these insurers should actively encourage drawing up of plans to reduce management costs in order to lower their combined ratios that will ultimately benefit consumers.

The Committee is also of the view that in a tariff market the brokerage and commission structure as recommended above is in keeping with the services that can be rendered by them.

Detariffing should, however, be completed not later than 1st April 2006 in order to allow the Pure Risk rate regime and market forces to decide on prices and intermediation expenses and allow consumers to experience the benefits of liberalization.

C. Remuneration of agents and brokers:

1. There should be a differential maintained between the Agents and Brokers in their remuneration packages. The latter has more onerous responsibilities and functions to discharge. As such the maximum brokerage payable should be a little higher than the agency commission.
2. Agency commission for tariff covers should be revised to a maximum of 10% to maintain a differential of 2.5% in the remuneration structure between brokers and agents / corporate agents.
3. For statutory covers, however, 10% remuneration should be maintained for both of them, as no special expert advice is required in providing or servicing such covers.
4. On non-tariff covers, the maximum remuneration for brokers should remain at 17.5% and that of agents at 15%.

D. Government/Public Sector Undertakings:

1. The Committee recommends that all corporate bodies be treated alike and for intermediation purposes treated under the Special Discount recommendation as mentioned in B - 2 to 4 above. This is irrespective of whether they are in the private sector or public sector. As such, public sector undertakings should be permitted to exercise their choice for intermediary access with stipulations on paid-up capital norms, remuneration and discounts as mentioned under in B - 2 to 4 above.

2. Fairness and equity requires that IRDA should not take a selective view in organizing the market or in limiting the freedom of choice to any sector on its own.

Terms of Reference 2& 4:

To examine the role of intermediaries viz., Agents and brokers in the current insurance market scenario and to make suitable recommendations:

- Clarifying their utility to the future growth of the insurance industry in spreading risk awareness and widening the customer base in respect of both tariff and non-tariff products
- On the value-added services to be provided to justify compensation received in terms of commission and brokerage
- On the regulatory safeguards to be considered to eliminate unhealthy practices of rebating and other undesirable market practices inhibiting competition by fair means
- If any legislative /regulatory changes are needed in pursuit of the above objectives

Recommendations:

The Committee has made its recommendations to the above by examining the interests, responsibilities and duties of various stakeholders in the system and how modification of certain present practices can enhance their effectiveness, thereby leading to improved levels of market standards and conduct.

A. Brokers and Agents:

1. The licencing norms of the direct broker should be reconsidered for the future. A technical insurance qualification recognized by the Insurance Institute of India such as AIII or a qualification recognized as its equivalent by the IRDA or experience of a minimum requirement of 5 years as an insurance practitioner should be the minimum for the principal officer. Those that have been licenced already should meet the revised standards at the time of renewal of the licences. The Regulator can reserve the power to exempt this requirement in exceptional cases. Professionalism needs to be introduced into broking community for it to grow on healthy lines.
2. Brokers should open additional offices only after obtaining the prior approval of the Regulator. The Regulator should be notified of all the new appointments with the qualifications of personnel appointed so as to ensure that the persons recruited to solicit business have passed the required examination.
3. Sub-broking as a proposal was considered and not accepted, as the sub-broker has no privity of contract with the customer and is not liable for professional negligence to the customer. Sub-broking will lead to unintended legal problems and should be avoided.

4. **Brokers should not be permitted to practice after issuance of licence by IRDA, till a copy of the Professional Indemnity (PI) policy covering the requirements of the IRDA regulations is produced. Till a PI policy is in force, the customers' interests, which are primary, are at risk due to any act of professional negligence of a broker.**
5. **The duties and functions of a Corporate Agent in the case of banks need a reappraisal in view of the conflict of interest situations, wherein a bank is a joint beneficiary of a claim even while representing the insurer as its agent. The Regulator has also to ensure that the bank has an effective claim advisory service in place, in accordance with the terms of the code of conduct. The MOU should incorporate suitable stipulations to cover these aspects.**
6. **Harnessing the Agency potential to the full for the expansion of the market needs a commitment on the part of insurers to make this channel function more effectively than now. The General Insurance Council and the IRDA should spell out in clear terms, the kind of retraining programmes needed to enhance the technical skills and sales techniques of agency force that is an integral part of the marketing and sales force of insurers. Monitoring their performances and mentoring them should be another area of implementation to improve their effectiveness vis-a vis the insuring public.**
7. **Insofar as the brokers are concerned, the code of conduct towards customers is specified in the regulations. It would be useful if a code between the insurers and the brokers is also introduced to develop and maintain best practices and sound conventions in relation to their mutual transactions.**

The Committee recommends that best market practices should be evolved with a give and take attitude and mutual goodwill. The General Insurance Council should assist in this regard by mutual cooperation with the Brokers' Association.

8. **The IRDA has nominated one of its Members on the Disciplinary Committee of the Insurance Brokers' Association of India, as a permanent member. The Committee is of the view that this is `neither a healthy nor a desirable convention, as the presence of the IRDA `member on the Disciplinary Committee would stifle the growth of a self-regulatory mechanism within. Also, it compromises the independent `status that the IRDA currently enjoys in the eyes of the public. This proposal to have `the IRDA member on the Disciplinary Committee should be reconsidered.**
9. **A tri-partite association/ committee comprising representatives of insurers, brokers/agents and consumer activists should be nominated and it should meet half-yearly to consider areas of mutual concern and suggest remedial steps to correct any imperfections in the systems operated by each to the detriment of the market as a whole. Such recommendations should be advisory in nature for the consideration by the IRDA for its feasibility and fairness in implementation.**

10. A self-regulatory mechanism of the brokers laying down a code for their market conduct and service standards for its members, along with the disciplinary code should be publicized for the information of the public.

B. IRDA & Regulations:

1. It is recommended that a separate implementation cell or a Standing Committee on Procedures and Performance Review of Insurers, Brokers and Agents should be set up in the IRDA to identify the regulations that each stakeholder has to observe and assist each in their compliance. There should be a periodic annual check to verify the extent to which the regulations made are complied by each stakeholder.

Implementation of the regulations already on the books is a precursor to making more regulations to guide the market conduct of stakeholders. Compliance requires skilled, knowledgeable and competent staff to enforce regulations. At the same time, building a large bureaucracy is to be avoided, as that would slow down the process of effective implementation.

It is recommended that outsourcing assistance in this connection may be considered. This would enable the IRDA to locate the organizations with the right expertise and experience for the tasks on hand and obtain reports within the time frame fixed for their implementation. This will also add credibility to the image of IRDA for its fairness, equity and a lack of bias. Confidentiality agreements can be drawn up to ensure confidentiality of information shared with the outside experts. Outsourcing has become a common management tool to solve modern day issues. This practice is gaining greater acceptance by international organizations.

2. Any breach of the provisions reported from whatever source, should be investigated, if necessary, with the assistance of an outsourced mechanism for factual verification and reporting within a specified period. The scrutiny of books of accounts and individual questioning on the complaints received should be permitted.
3. IRDA is entrusted under section 20 (1) of the IRDA Act 1999 with the responsibility of development of the Indian insurance industry and it is required to furnish to the Central Government a programme for its promotion and development besides providing a true and fair account of such activities to the Parliament. It must therefore consider preparing a roadmap for the development of the insurance industry which would not only assist the Authority to perform its duties and functions but enable it to achieve the objectives of the legislation and improve on the insurance penetration and density.

C. Insurers:

1. The annual accounts of each insurer should provide full disclosure of expenses incurred under promotional, marketing, developmental, risk management and similar heads to detect if any undesirable inducements

have been made to customers to solicit their business. Such expenses should be brought to the notice of the Boards of Directors of the respective insurers.

2. The Board of Directors should be asked through issuance of a separate regulation by IRDA, to publish quarterly un-audited financial statements from 2004/5, in specified formats, as also the audited annual financial statements in at least two newspapers, one of which should be in English in the interests of policyholders and the general public who need to evaluate the financial soundness of insurers as a matter of best business practice.
3. The Regulator is required to prescribe the form in which the insurer has to provide a summary of financial statements under part II C (5) of the Regulations on General Instructions of Financial statements for the last five years. This form should be prescribed at an early date.
4. Under Schedule C Regulation 3 of the auditor's report the actuarial valuations have to be certified in accordance with the guidelines and norms to be issued by the Regulator. These should be considered for issuance at an early date to maintain standards of evaluating claim liabilities by all insurers in a uniform manner.
5. The Insurance Act 1938 should be amended to make punishments by the IRDA deterrent enough after identifying the category of breaches of regulations applicable to the insurers and brokers.
6. The General Insurance Council of the Insurance Association of India must be activated to perform its designated functions under section 64L of the Insurance Act, 1938.

The Committee recommends that the Council should lay down rules for the conduct of its affairs including the standards and practices for compliance by its members. In case of any difference the majority view should prevail.

These should be reviewed and updated from time to time. It should further publicize the standards and practices for the information and benefit of the insuring public.

It should have a compliance cell and any violations/deviations should attract corrective action.

It may be useful for the Council to examine the standards and practices of the UK General Insurance Standards Council as a guide.

7. A Secretariat should be set up by the General Insurance Council to act on all administrative matters that have an impact on the quality of the services provided to policyholders. Issues of wrong and illegal practices by the insurers should be investigated and reports submitted for decisions by the Council, under advice to IRDA. The Secretariat should also be engaged to arrange market surveys to determine customer preferences and how they perceive the services rendered and to create risk awareness in the public. It could act as a self-regulatory grievance redressal body as well.

8. It is understood that the Chairmanship of the General Insurance Council is currently held by Member (Non-Life) of the IRDA. It is recommended that the IRDA should discontinue this convention in the interests of encouraging self-regulation by the Council and to maintain the status of IRDA as an umpire, advisor and regulator. IRDA should not be seen as taking over the responsibilities of the Council.

D. Policyholders' Protection:

1. Regulation 4 of the Protection of Policyholders' Interests Regulations, 2002 stipulates that a copy of the proposal should be sent to the insured within 30 days of policy issuance free of charge. It is recommended that the proposal, wherever obtained, and the policy document should form one set and should be sent together.

This will ensure that a completed proposal form is obtained and that both the insurer and insured know what the proposal contains and what information the insurer has waived. This will reduce delays in consideration of claims and is a good practice.

2. The definition of 'proposal form' in the regulations should be revised to specify that it is not only a form that is used to ask information from the proposer to determine the risk factors, but the proposal itself should contain and highlight the broad benefits of cover, major exclusions and cancellation conditions offered to the proposer by the insurers. The duty of disclosure has to be reciprocal.

Informational gaps between what is offered and what is accepted and understood needs to be bridged at the stage of completion of a proposal form that forms the basis of contract.

3. Regulation 5 of the Regulations for Protection of Policyholder' Interests Regulations, 2002 needs to be amended and made stringent. The existing in-house Grievance redressal machinery of the insurers should be strengthened to deal with the mounting customer complaints.

It is recommended that external insurance/judicial/technical experts, of the choice of insurers, be compulsorily associated with the in-house committees of grievance redressal officers of insurers, at all major centers of operation and the committees should meet at least once a month, if not more frequently, and review customer complaints received in writing. Such a panel should be encouraged to issue speaking orders on their decisions. The redressal machinery should be empowered to compensate consumers for the hardship when insurers are at fault.

Terms of Reference 3:

- **To examine the feasibility of referral fee/charges arrangements in the context of Cooperatives, Panchayats, Banks, NGOs, and other such marketing intermediaries while specifying their role and duties.**

Recommendations

Referral Fees/ Charges:

1. **The Committee considered the issue of payment of referral fees as a concept, at length, and concluded that an organization, by merely making available its customer database to an insurer should not qualify for receipt of any referral fee. It is difficult to determine the basis on which the fee can be worked out. Further, it is also not possible to determine the extent of converting the prospects into policyholders. Also, since the customer base is heterogeneous it requires special computation in order to work out the commission payable. As such, there are a number of inherent loopholes to misuse the system by either of the parties or both.**

In view of the basic inadequacies in the referral system, the Committee recommends that referral, as an intermediary channel mechanism should be avoided. As such the circular of IRDA issued on 30th January 2003 and subsequent directions in this regard, if any should be withdrawn in respect of banks and similarly placed corporates.

2. **Notwithstanding the above, the Committee recommends the referral fee/charge arrangement to develop mainly rural insurances with certain safeguards in accordance with the revised definition of 'rural' suggested by the Committee. Such an arrangement should be made only with groups that are registered and subject to a written agreement between the insurer and the group and for purposes of making available their customer database for soliciting the business of their members only. The fee should be paid only on the business realized and booked. Such a fee should not exceed 7.5% of the premium charged and collected. No other remuneration or commission should be incurred on such arrangements. The written agreements should have the prior approval of the Head / Controlling ROs of the insurer who will submit quarterly statements to the IRDA giving the names of the groups. The agreement should be limited to a period of one year. The Head / Controlling ROs should approve renewals of agreements based on satisfactory performance. The referral fees should form a part of management expenses.**
3. **Corporate Agents, particularly banks, while entering in to agency arrangements should be made aware of the legal obligations arising out of the conflicting interests and suitable reassurances should be given by the insurers in the MOUs that are signed between them.**
4. **The definition of what constitutes a rural area should be based on census and should be revised to an area with a population upto 30,000.**

5. All insurers should be asked to devise simple standardized identical rural policies, at affordable premium rates, with identical advantages, terms and conditions for rural segments to be made available in local languages, so that these individual policies do not confuse the buyers of what is covered and what is not. Credibility of insurers on product information and settlement of claims without delay are essential to earn the trust and acceptance of the rural folk.

Terms of Reference 5:

- Any other matter as the Committee may consider relevant for the market conduct and long term development of the distribution channels by creating an efficient and viable intermediary channel-mix in the best interests of the future growth of the market the insurers and the insuring public.

Recommendations:

1. The Committee considers that the present system of licencing Composite Brokers that deal with direct broking and reinsurance broking as one arm will prejudice the development of the market and consumer interest. In a non-tariff market the Composite Broker could tie-up reinsurance arrangements at lower rates and bring pressure on the primary insurer to front for the business. Such practices in developing markets are quite common. There is a conflict of loyalty as the composite broker works for the insured and the insurer as well. Hence licencing Composite Broking should be discontinued.
2. Licencing norms for Composite Brokers should be reviewed and no more licences should be granted under this category. Existing Composite Brokers should seek separate licences with separate business structures for the two types of broking, direct and reinsurance, at the time of renewal or before.
3. Regulations currently in place on reinsurance should be effectively enforced with reference to the timing of filing information and the credit rating of reinsurers. National retention capacity should be fully utilized and procedures for its verification should be laid out.
4. Facultative placements abroad should be allowed by IRDA only after an insurer has satisfactorily demonstrated that it has exhausted the domestic market.
5. Breaches of tariff and regulations by the insurers should be reported to the highest corporate level and punishments by IRDA/TAC should be severe.
6. In a liberalized market there should not be any stipulation regarding the statutory cessions to the GIC. Although it is appreciated that this cannot be dispensed with immediately, a scheme of progressive reduction in the levels of statutory cessions should be considered. Suitable enactment should be provided for the same. GIC, as the Indian Reinsurer, needs to redefine its role in a liberalized set up and should develop a strategy wherein it can offer the required reinsurance capacity on a voluntary basis.

- 7. The role, functions, responsibilities and accountability of Representative and Liaison/ servicing offices of foreign insurers as also the foreign reinsurers in India, presently licenced by RBI, need a critical review and reaffirmation of their usefulness in the best interests of the Indian market. For this purpose they should be brought under the jurisdiction of the IRDA for their operational continuance.**

- 8. The Committee is of the view that the Authority should take up the constitution of the Consultative Committee in terms of section 110 G of the Insurance Act, 1938 with the Central Government. It is understood that the Government has already constituted an Appellate Authority under section 110 H of the Act to review the decisions taken by the Authority under section 110 G. This makes it all the more necessary that the Consultative Committee for the Authority is constituted by the Government on a priority basis to examine all matters provided for in the sub-section 3 of Section 110 G. The Authority may consider this matter and take necessary action.**

PART -2

Chapter 1: Introduction	21-29
Chapter 2: Special Discount & Remuneration of Agents & Brokers	31-43
Chapter 3: A Fair & Competitive Market— Role of Agents & Brokers & Regulatory Safeguards	45-58
Chapter 4: Referral Charges for Marketing Intermediaries	59-61
Chapter 5: Other Recommendations	63-66
Note on Important Regulations/Changes proposed by the Committee	67-68

1

Introduction

A thumbnail sketch of insurance and its role in the economic and social spheres of the nation is of considerable importance to understand better the issues that the Expert Committee has been asked to deliberate upon and recommend such changes as it may deem necessary. In the context of a market that is liberalized and yet under substantial price controls that govern product features and distribution, the issues confronting the development of the market assume formidable proportions.

All the stakeholders in the market look to the Regulator to get their individual interests resolved fully, even if it adversely affected the interests of the others. Self-regulation, either among the insurers or the distributors and marketers of products and services, has not been a notable success in the past, leading firstly to the social control of insurance in 1968 and later to the nationalization of the industry itself in 1973. The burden on the IRDA, as an umpire, as a consequence tends to be heavy and unenviable.

Nationalization of general insurance in 1973 led to the rapid growth of infrastructure through the setting up of numerous offices by the General Insurance Corporation of India through its four subsidiaries viz., National Insurance, New India Assurance, Oriental Insurance and United India Insurance for making available insurance products. Development Officers to sell insurance covers were recruited in large numbers. Thrust for sale of rural insurance covers was given by designing several special covers at affordable rates. Mediclaim insurance was introduced and so was overseas mediclaim cover. While the business began to develop rapidly, effective competition among the four subsidiaries failed to take off, giving customers a feeling of lack of prompt service and rigidity in their approach towards business. The Indian domestic market for several decades had insulated itself from the global markets through a strict tariff regime; and the monopolistic setup after nationalization further accentuated the rigidities in several areas concerning consumer interests.

Following globalization of trade and services, pressure was mounted on India to liberalize its financial sector, including insurance, through the entry of private sector players and their foreign partners. Liberalization of the market in 2000 has resulted in the setting up of the IRDA, de-linking the four subsidiaries of the General Insurance Corporation of India from it and the entry of eight private sector players. On the diversification of distribution and marketing channels, corporate agents and brokers have been brought in as new entrants to the market.

While a broad architecture for efficient and effective functioning of the insurance market has been put in place through a number of Regulations enacted subsequently, in the ultimate analysis, it is only the strict observance of ethical standards and good corporate governance standards of the providers and distributors that will determine how fair and competitive the market will become in the future. The Regulator alone cannot be expected to do the whole job. The willingness and cooperation of all the stakeholders with the IRDA is essential to develop a market that could be a future role model for the rest of Asia and Third World countries. With time fast approaching to further liberalize the market through dismantling of tariff rates, the responsibility for ethical behaviour on the part of the stakeholders assume even more importance.

Role of insurance:

1.01 Financial services generally and insurance in particular are of great importance to the economic development of a nation. The more developed and efficient a country's insurance market, the greater will be its contribution to its economic prosperity. Insurers do not merely diversify risk under which the unfortunate few who suffer losses are indemnified from the funds collected from many policyholders. This function is complemented by other fundamental contributions that insurance makes to the prosperity of a nation. Countries that are best at harnessing these contributions give their people and businesses greater economic opportunities. Insurance performs and promotes several indirect activities.

Activities insurance promotes:

1.02 Insurance encourages and promotes entrepreneurship by lending financial stability for risk taking activities. It complements security programmes by encouraging its citizens to arrange for their security needs; life insurance and its growth testifies to the role insurance plays. It facilitates trade and commerce at local and international levels. By investing judiciously and ensuring liquidity of the policyholders' funds, insurers are playing an important role in the financial system even while the investment incomes generated tend to lower the premium rates or provide enhanced benefits to their policyholders. As pricing of risks is based on the principles of risk management, insurers do encourage better risk management procedures to be practiced by the insuring community. Evaluation of loss occurrences and their causes enables insurers to use it as an important source of information and guidance to prevent national waste through their recommendations and stipulations on prevention and mitigation of losses.

Insurance market:

1.03 Insurance, particularly general insurance is an intangible product/service, contingent on the happening of an event that may or may not happen and tested for its utility or otherwise at a future date. Insurance promises future performance. There is an informational gap between the provider and the served throughout the contract period that needs to be bridged in a fair manner. Insurance marketing, therefore, is more onerous than its counterparts in many other trades and services. The sheer variety of insurance products available can confound the best professional. Insurance specialization in specific areas of a portfolio has also become a new trend.

1.04 In a competitive market model, buyers and sellers of insurance should be well informed on what is sold and what is bought and on the terms of its availability etc. In such a market, consumers usually exercise control over providers by the freedom of choice they can exercise in the selection of the provider, the product, the service and the price. Service providers have to be cost-efficient and innovative and ensure customer satisfaction to promote their financial interests. The customer rather than the provider becomes the focus of attention in such a business transaction.

1.05 Having chosen a competitive business model through liberalization of the insurance market and yet retaining a tariff structure that governs the product features and pricing in a significant number of portfolios, the consumer and the provider are both inhibited in the exercise of their full choice. In such a restrictive state of the market, letting in new

players like the brokers and corporate agents in the distribution channels to promote the interests of the consumers has added to the difficulties of the providers in innovating competitive advantages in tariff governed insurance covers.

Not only are the established players required to compete with the new private players but they also have to contend with the business challenges posed by the intermediaries, like brokers, who perform the role of spokesmen for the existing customers of insurers. A new mindset is needed to accept the changing roles of each in a market that is not yet fully competitive. A changeover from a stable, monopolistic market to one that is growing competitive, driven both by the private players and the new breed of brokers, has not been easy for the established players to adjust to.

Development of the Insurance market:

1.06 General insurance business in India has developed to a large extent as a lender-driven market. Banks and financial institutions have been the major drivers of wealth creation and insurance as a necessary collateral has grown along side, particularly the fire, marine and engineering portfolios. To a significant extent, the market has also been a customer-driven one, as the consumers themselves have given an additional thrust to the development of the market, particularly in the rapid growth of motor and health insurances. The statutory requirement of TP insurance for motor vehicles has opened up another field for the providers. The rising incomes of the middle-class have given a boost to the growth of health insurance through the exercise of consumer choice in their own interests.

While the insurers carrying on general insurance business have reacted well to these opportunities that have been put in their way by the lenders and customers, they have not yet created a marketing force of sufficient motivation and technical capability to pioneer their organizations to organize the unorganized markets in personal insurances and in rural markets that are fast developing. It is the insurer-driven initiatives and sale of need-based covers at affordable premiums that have to gain ascendancy if the current insurance market has to develop in terms of widening and deepening the customer base by creating insurance awareness. Is it the insurers who will lead this initiative through their organizations? Or is it the uninsured public who will lead?

Market Size and Growth:

1.07 With the present retentions of premiums quite low for private players, it is the public sector players that contribute significantly to earned premiums. Provisional estimates show that the earned premiums for public sector players is about Rs 9200 crores in 2002/3, and it has been growing at 9% annually for the last two years, aided by the growth in motor and health insurance businesses, both of which are regarded as unprofitable. There has been a rise of only 4% in earned premiums in fire in the last fiscal; there is premium stagnation in the marine. The growth rate in miscellaneous is about 11% in earned premiums.

The management and procurement costs on earned premiums for the public sector players is above 32%, rather high in any context, and up from about 30% for last year. The investment income in 2002/3 grew by about Rs 190 crores to reach about Rs 2300 crores. The net worth of the four players is about Rs 6,750 crores. Due to the increase of premium rates in motor from July 2002, and since no major losses were reported in fire

and marine businesses, the underwriting losses have reduced dramatically to about Rs 1,500 crores from Rs 2000 crores. in the previous year. The public sector players have reported a PBT of about Rs 850 crores in 2002/3 against Rs 36 crores previous year. It was in 1999/2000 that the PBT had touched Rs 760 crores.

The private sector players that are still new and fledglings in their operations, equally faced the strain of management costs of 35% on their earned premiums. They had a PBT of Rs 19 crores in 2002/3 against a loss of Rs 68 crores in the previous year. Their gross premiums were Rs 1340 crores up from Rs 470 crores. Their claims ratio was down to 75% from 102% in the previous year.

The number of outstanding claims of public sector players has risen to about 15 lakhs with the outstanding amount standing at about Rs 12,000 crores and this is rising at the rate of about Rs 1000 crores per annum. Over 50% of the claims outstanding are in courts. The rising trend in outstanding claims should be a matter of concern.

1.08 In a market of the size of Rs 14,000 crores gross premiums (2002-2003) in general insurance, the share of the gross fire insurance business is 20% and the engineering business 6%. Marine constitutes 8%, health insurance 7% and motor about 40%. The share of the private sector corporate bodies entitled to special discount for fire and engineering business is estimated at about 15% of Rs 14, 000 crores, approximately Rs 2,200 crores. It is this segment for which there is severe competition, as these are the most profitable segments and are compulsory, tariff driven and of sizeable volumes. They are relatively 'easy pickings'.

1.09 The market at gross levels is currently growing at about 12% in 2003-2004. The growth rate of the public sector players is only about 5%, while it is nearly 90% for the private players. The market share of the public sector players is hovering around 85%.

All the insurers are currently incurring substantial underwriting losses and they depend on investment and other income to generate profits. The insurers, already burdened as they are under a heavy cost input, are loath to pay for higher procurement costs on fire and engineering, as this would cut in to their profits that subsidize the loss making motor and health insurance segments. That it should be so in a market that has a strong tariff regime should make one ponder about what would happen to the market situation if price controls were lifted or if procurement costs are allowed to go up suddenly due to the introduction of new distribution channels. A stable market would need strong distribution channels, a financially strong insurer and a demanding customer for the best in quality of products and services at an economic cost.

Marketing Channels:

1.10 The IRDA has specified regulations for licencing and business conduct of the agents, corporate agents and brokers—all a part of the distribution and marketing network to professionalize the intermediary system between the customer and the insurer. The objectives, it would appear, are to raise the professional standards in the insurance-selling interface and to provide the highest possible standards of independent professional advice to the customer of what is best in his interests.

1.11 In the case of agents and corporate agents, the remuneration is paid by the insurer as they are his direct representatives, as prescribed in the Insurance Act 1938 and as notified

by the IRDA from time to time. In respect of brokers, the broker regulations of October 2002 have prescribed the maximum remuneration to be paid to him by the insurer although the broker represents the insured and him alone. The agency remuneration and broker remuneration have been revised from time to time by the IRDA. The circulars issued on 22nd March 2003 and 30th May 2003 by the IRDA have been a subject matter of discussion and debate among the insurers, insuring public, the brokers and the agents.

1.12 The remuneration to brokers and the special discount of 5% given to certain corporate bodies on tariff covers in lieu of commission, based on paid-up capital norms, particularly in fire and engineering businesses, have generated differing view points on what is fair to all concerned.

1.13 Competition is currently focused mostly on the businesses already created, particularly in the fire and engineering portfolios, affecting the financial interests of the insurers. Customers, brokers and agents differ on what constitutes the best interests of the customers and of themselves.

Role of brokers:

1.14 The institution of brokers is new to the Indian market. Brokers build experience and expertise, over a period of time that will provide value to the insurers and customers alike. The buying culture presently dominated by direct sales and through agents is up against a new entrant. Since brokers, over a period of time, become bulk purchasers of insurance on behalf of their several customers, they will be able to extract a better deal and price as opposed to a single buyer. They possess a better knowledge of the market and also of the people who work within the system. Thus, they are better placed not only to offer professional advice but can execute the advice so offered. They can leverage on the relationships that they build with the insurer community. Since a broker is asked constantly for risk solutions, he builds a special expertise that is available to the insuring public, apart from the specialist negotiating skills that he is required to develop and which gives him a superior bargaining power with insurers.

1.15 It is therefore inferred that a customer when he is served by a specialist who has all the skills and knowledge as above will get a better solution to his risk problems than anyone else can offer. At the same time, the broker, having knowledge of the market, should not use his 'countervailing power' to squeeze deals that are patently unfair to the insurer, lest he should lose the goodwill of the insurer community. A broker has to manage his relationship successfully with the insurer, even while managing his customer expectations within reason.

1.16 Since broking is new to the Indian scene, there are many misapprehensions on all sides, as neither the brokers nor the insurers nor have the customers tested each other enough to build mutual goodwill as necessary to become supporters of each other rather than as adversaries who are bent upon outsmarting each other.

Corporate bodies' view of brokers:

1.17 The corporate bodies who are used to enjoying the special discount of 5% in lieu of agency commission on their premium rates on tariff products for over 25 years, now restricted to fire and engineering, have felt that with the introduction of brokers into the distribution system and with the likely withdrawal of the special discount, their insurance

costs would go up; particularly so as the fire and engineering businesses are tariff driven and no cost reduction in covers is reasonably possible. Many of them have expressed that intermediation was being thrust on them only to help the middlemen. As corporate bodies they have long-term budgets and since their financials would be put under strain, they should have the choice of whether or not to use a broker. They have further submitted that 5% special discount is used to build up internal expertise within the firm, and this facility should be continued to encourage the customer to equip himself in deciding on his insurance needs with the help of the insurer of his choice.

Insurers' view of brokers:

1.18 Insurers, who have currently a management cost ratio of over 32% on earned premiums, and are incurring substantial underwriting losses, have expressed that the brokerage costs of 12.5% on tariff covers are too high for them to incur as they will be unable to absorb these costs in their budgets, and particularly so, as these are required to be paid for existing businesses on their books, with no special advantage either to the customer or to the insurer. It has been pointed out that 12.5% brokerage would also encourage the customers to demand and receive kickbacks and rebates from the brokers and also inter se, any amount of self-regulation by the brokers would not be able to weed out these practices, that were earlier the bane of the intermediation process, even in the pre-nationalization era. The financial viability and solvency norms of insurers will otherwise come under undue strain.

Brokers' view of their role:

1.19 The brokers have expressed that their decision to enter the broking distribution system was based on the Regulations announced earlier in October 2002 and since each one of them had invested a substantial capital of Rs 50 lakhs or more, any restriction on brokerage as announced in regulation 19 would make them lose expected returns on their invested capital and their venture would be thus frustrated. In a competitive environment, brokers alone should not be accused of likely rebating as even insurers can and do resort to it to win business. Their self-regulatory mechanism is a sufficient safeguard against rebating practices. Brokers need encouragement as new fledglings and not restrictions. Restoration of Regulation 19 of the IRDA (Insurance Brokers) Regulations, 2002 is necessary in their view.

General Comments:

1.20 Since each party to the relationship viz., the customer, the broker and the insurer feels that their individual interests are threatened by the current situation or in alteration of it, a state of impasse has been reached though the situation has been attempted to be corrected through issuance of Notifications by the Regulator from time to time.

Brokers perform their best in a market where there are no price or product feature controls; also where the broker has knowledge and expertise of insurance and underwriting at a level equal to if not superior to that of an underwriter with whom he deals. In the Indian context, the problems pertaining to brokers have been compounded since the bulk of insurance covers are tariff driven; and the current brokers' licencing norms do not stress expertise, experience and knowledge as much as one would wish for.

1.21 The agents who have been trained under stringent licencing norms feel that the brokers merely by virtue of capital norms have been given undue advantage over them in terms of dealing with corporate bodies that are denied to them now.

1.22 These polarized points of view of various parties and interest groups need to be understood on their merits. At one extreme end, the brokers feel that the brokers' regulations as announced in October 2002 should hold good, as they have invested a capital of Rs 50 lakhs each or more in starting the brokerage firms; at the other end, the corporate bodies and the insurers feel that they do not want to give up on their current relationships that will add to their costs of buying or selling insurance respectively; particularly in a tariff market, where the value addition of professional services offered by the brokers is questionable and of little consequence.

1.23 Between these extreme viewpoints, the Expert Committee is required to be pragmatic in its approach and consider various viewpoints put before them by a very large number of interest groups and parties to arrive at their recommendations under the current situation viz., the dominant tariff market particularly in fire and engineering sections that are the target portfolios of contention. Brokers, as intermediaries, have an important place in the distribution and servicing of insurance products but the various tariff requirements and concessions currently offered to corporate bodies place a sort of a barrier to their effective integration with the market as it now exists.

Terms of Reference:

1.24 The Terms of Reference given to the Expert Committee are attached to this report as Annexure I.

A perusal of the terms of reference of the Expert Committee shows that it is entrusted to look into six key aspects of distribution channels under Reference I viz., (a) to make specific recommendations on the continuation, discontinuation or modification of 5% special discount in lieu of agency commission currently enjoyed by certain corporate bodies, and (b) whether it should be linked to their paid-up capital (c) whether the public sector and statutory Government bodies should continue to enjoy special dispensation of direct placement of business, as is currently done, (d) whether the remuneration packages in force to agents and brokers encourage demands for rebates and kickbacks from the customers; and the effect such remuneration packages have on business development and procurement costs in relation to the services rendered and (e) whether there should be a differential rate of commission between the agent and the broker with reference to social and rural sectors.

1.25 The second term of reference is a general one that deals with four key aspects: (a) role and utility of agents and brokers in creating risk awareness, widening customer base and in the development of future markets (b) the regulatory safeguards to be considered for elimination of undesirable and unhealthy market practices (c) referral fee /charges to be paid to rural based organizations such as Cooperatives, Panchayats, Banks (rural), NGOs, and other such marketing intermediaries (d) if any legislative/regulatory changes are needed to pursue the objectives, and (e) any other matter relevant for the market conduct and long-term development of distribution channels in the best interests of future growth of market and the interested parties.

1.26 The Expert Committee has held sittings at all the four metro centers to personally hear the representatives of all stakeholders who wished to meet the Committee during the months of September and October 2003 that included insurers, trade and professional bodies, Brokers' associations, Agents' associations, consumer activists, field workers' associations and others. A separate list is attached (Annexure 2) of the various parties who interacted with the Committee as also the several views received on Internet and by post from individuals and others (Annexure 3).

Structure of the Report:

1.27 Chapter two of this report deals with the feature of special discount and the recommendations thereon in respect of corporate bodies and public sector undertakings. It also deals with recommendations on the remuneration packages payable to brokers and agents for tariff and non-tariff businesses, keeping in view that illegal and undesirable practices should be discouraged. The impact of the present remuneration on rebating and on procurement costs has also been examined therein.

Chapter three discusses the subject of shaping up a fair and competitive market, the role of agents and brokers and the regulatory checks and balances to be introduced for elimination of undesirable market practices along with the recommendations.

Chapter four of the report deals with the subject of referral fee payable to encourage expansion of rural business and the responsibilities of banks as corporate agents along with the recommendations.

Chapter five deals with recommendations on matters of regulatory and legislative interest for the orderly growth of the market.

A note on the important regulatory and other changes proposed by the Committee is attached for a quick perusal by the IRDA.

Approach of the Committee:

1.28 Before dealing with the issues in each chapter, it is necessary to clarify the approach taken by the Committee in framing its recommendations. The role of a broker/ agent in a tariff driven market is constrained by the limitations that the tariff structure imposes on price, product features and availability. Almost all the stakeholders have suggested detariffing as the best solution under the circumstances. Apart from ensuring that the market is fully liberalized, such a step would enable the market forces to determine what is in the best long-term interests of each other. The present partial liberalization has enabled the creation of a competitive environment. But with prices and product features controlled, such a competition has encouraged unhealthy practices to flourish.

The Committee strongly endorses the suggestion to detariff all the tariff rates. A road map for this purpose has also been indicated in its recommendations. Certain preparations are needed to condition the stakeholders for migrating from a tariff to a non-tariff regime.

1.29 In arriving at the recommendations, the Committee has kept the interests of the customer as primary, and the development of the future market in the under-served and unorganized sectors as a close second. The financial health of the industry in the context of the huge underwriting losses and the relative high costs of doing business has been

another consideration. The role and value that the distribution channels render to customers as well as to insurers has been kept as a priority item of consideration as well and acknowledged as such. The Committee has endeavoured to reconcile the totality of the interests of all the stakeholders, in the fairest manner possible, given the powerful arguments each stakeholder has made out. The recommendations the Committee has made need to be looked at as an integrated package in the best interests of all the parties involved in the insurance market.

1.30 This introduction, it is hoped, would provide a broad framework of the current scenario of the industry to understand better the issues that the Committee has been asked to deliberate upon.

1.31 In the next few chapters the issues raised in the Terms of Reference are discussed in their relative context. If there is any repetition of ideas, it is more so due to highlighting or emphasizing the specific points in relation to the Terms of Reference.

Special Discount & Remuneration of Agents & Brokers (Corporate & Public Sector Bodies)

This chapter seeks to examine in detail the specific issues raised in the Terms of Reference number 1 asking the Committee to make its recommendations thereon. One of the issues raised deals with the question of continuation or otherwise of the special discount of 5% enjoyed on a few tariff covers by certain corporate bodies. Another issue raised relates to the linkage between the special discount and the paid-up capital norms and its continuation. Should public sector bodies be denied intermediary access by Regulation is another issue for consideration. Since agents/ corporate agents and brokers are both intermediaries for insurance selling, and as their responsibilities towards their respective principals vary, should there be a differential in the compensation structure permitted for them? Does the present compensation structure permitted encourage rebates and kickbacks to flourish?

Special Discount of 5%:

2.01. The system of the principal agency was discontinued in 1957. By an amendment in 1950 to the Insurance Act 1938, the commission payable on marine business was reduced to 10% from the earlier 15%, while for other classes of business the maximum commission payable was retained at 15%.

In 1968, following the introduction of social control on insurance, the maximum commission was reduced to 5% for fire and marine business, and 10% for miscellaneous business. It is evident from these several changes in the commission structure that the remuneration payable to the agents has always been a subject of concern, as a possible source of rebating and kickbacks in general insurance business, particularly in a tariff environment.

2.02 The Expert Committee understands that the Government of India on 2nd August 1969 introduced the system of special discount in lieu of agency commission in respect of public sector bodies, when the Life Insurance Corporation of India (LIC), which at that time was a composite insurer, had exclusive rights to underwrite the non-life business of the Government, Semi-Government and Public Sector Undertakings. LIC, owned by the Government of India, continued to enjoy such monopoly rights to underwrite business of these units till the 31st December 1972, when the LIC's general insurance business, following the nationalization of general insurance business in 1973, was merged with the businesses of the four nationalized insurers. The Government, Semi-Government and PSU businesses till then were treated as direct, by the LIC, without any intermediation costs; hence the special discount in lieu of agency commission payable to them was justified. This practice continues till today.

2.03. In 1977, the General Insurance Corporation of India again reviewed the commission structure, in particular in respect of specified Corporate bodies in the private sector, whose business was not permitted to be canvassed by agents. Corporate bodies, whose paid-up capital was Rs 10 lakhs and more, Co-operatives with a capital of Rs 5 lakhs and more, business under the control of banks, where bank advances exceeded Rs 25,000 and more, hire-purchase vehicles, and income-tax exempted charitable trusts were to get a

special discount of 5% in lieu of agency commission. The 5% special discount in lieu of agency commission structure appears to have been created for the private sector, more with a view to discourage the benami agency system that continued to operate even after nationalization for discouraging rebating of agency commission and to prevent the company's marketing force from creating such a system.

2.04 In 1980, the commission structure was further reduced on the engineering and motor businesses from 10% to 5%. Commission on business relating to the economically deprived sections and for personal lines was raised to 15% from 10%. In effect the structure stood revised for fire, marine, engineering and motor businesses—all tariff businesses—at the commission rates of 5%, where eligible, with the certain specified corporate bodies having the option of availing 5% special discount in lieu of agency commission.

Even after the merger of non-life insurance business of the Government, Semi-Government, and PSUs' with those of the nationalized insurers, the practice of giving these units 5% special discount in lieu of agency commission continued indefinitely. While the TAC has this 5% special discount incorporated in the fire and engineering tariff, it was removed from the Motor Tariff effective from 1st. July 2002, when the new tariff was brought in.

The feature of special discount of 5% (the nomenclature in lieu of agency commission has been dropped now) is peculiar to the Indian market, not encountered in other markets. In addition the special discount so permitted was required to be shown on the policy document. This was done possibly as the Indian insurance market is under a tariff regime and to impress upon the customers who were entitled to special discount that they should not be engaging any agents for servicing their business.

Agency Changes:

2.05 In 2000, following the liberalization of insurance business and the incorporation of IRDA, new Regulations have been formulated for licencing agents based on qualifications, training and passing of an examination. Agents too are expected to observe a code of conduct in how they should conduct their business. Agency structure is recognized as an important instrument of distribution and marketing channels to spread the message of insurance and to render improved services to customers.

2.06 On the 7th March 2002 by a Notification, the Regulator, after ascertaining the views of insurers, amended the agency commission norms for corporate bodies by giving a choice to those bodies with a capital of up to Rs 10 crores either to avail the special discount of 5% or to route the business through an agent, who will then be eligible for 5 % agency commission. The other restraining eligibility norms for other categories of parties such as hire purchased vehicles etc., for special discount purposes were removed. For those with a capital falling in between Rs 10 crores and Rs 25 crores, the special discount or agency commission as applicable was pegged at 2.5%, subject to the client so directing insurers in writing. The corporate bodies with a paid –up capital of Rs 25 crores and above had no option but to avail the 5 % special discount, and an agent would not be eligible for any remuneration, even if the client wished for it.

2.07 Providing further clarifications on the notification of the 7th. March 2002, it was pointed out on the 19th. March 2002 that where the client, whose paid-up capital was up

to Rs 10 crores, waived in writing the 5 % special discount that he was eligible, the agent was entitled to get 5 % commission on the tariff business. Similarly in respect of those bodies, whose paid-up capital was above Rs 10 crores but less than Rs 25 crores, the agent was entitled to get 2.5% subject to the customer expressing his preference in writing. Above Rs 25 crores, only 5% special discount was to be given; and the agent as such had no incentive to canvass for such business. Corporate bodies included both the public and private sector companies and Cooperatives.

The agency commission rate for motor was raised to 15 % from the previous rate of 5% fixed in 1980. It was also reiterated that the linkage between the special discount and the paid-up capital of the insured remained unaltered, making it indirectly explicit that all corporate customers above Rs 10 lakhs paid-up capital would be eligible for the special discount of 5% as before on tariff covers. The agency commission for non-tariff products for which the agents had a right of access was raised to 15%, the maximum prescribed under the Insurance Act 1938.

Structure of Marketing Channels:

2.08 The agency system of distributing non-life insurance products is perhaps a century old. Reinsurance brokers in India appeared on the scene about 60 years ago. Retail direct broking was unknown to the Indian market until a new set of Regulations was announced in October 2002, though broking and brokers as an institution existed both in the developed and developing markets for long.

2.09 The Regulator in October 2002 brought in a new set of Regulations to widen the distribution and marketing channels by permitting brokers, reinsurance brokers and composite brokers and Corporate Agents. This perhaps was done to equip the market with a more motivated and more focussed marketing force that would hasten the business development. While the brokers are agents of insured in law they get remunerated through brokerage from insurers who accept the business. Brokers are required to have certain qualifications, undergo training and pass an examination to be eligible to apply for a licence. In addition, they are required to have capital norms, insurance cover for professional liabilities, observe codes of conduct, implement accounting regulations and other compliance norms with Regulations as befits a professional body. The idea appears to be that each link in the distribution channel, depending on the expertise it may develop would assist in spreading risk awareness to the hitherto uninsured public apart from rendering improved services to those already buying insurance products.

2.10 Corporate agency Regulations were also brought in simultaneously to assist corporate bodies and banks to use their inherent strengths in leveraging their familiarity with their customers to develop insurance business. In their case too, qualifications, training and passing of an examination are similar to those of any individual agent with some modifications. Their remuneration is similar to that of an agent. Elsewhere, the Expert Committee has examined a few implications of corporate agency regulations and made recommendations to tighten them.

2.11 A direct broker, under the Regulations prescribed in October 2002, was entitled to brokerage of 10% on statutory covers, 12.5% on tariff covers and 17.5% on non-tariff covers. The special discount of 5% was allowed to continue, and such customers that enjoyed it had a choice either to forego the special discount or avail the services of brokers, but not both. Complaints, we understand, were received that the differential of

7.5% (between 12.5% and the 5%) was large enough to encourage rebating and kickback practices to flourish, particularly in a business, which is under tariff wherein value addition of professional services had serious limitations. The earlier bane of misuse of intermediary remuneration had raised its head despite semi-professionalization of the system.

2.12 On the 22nd March 2003, the Regulator issued a Notification in the general interests of consumers and for regulating costs of intermediaries (direct brokers) and for the smooth and proper growth of the market, specifying certain guidelines for brokerage for fire and engineering businesses only, and modifying the broker regulation 19 that governed their remuneration structure. As a result the corporate bodies with a revised paid-up capital norms had a choice of availing either the special discount of 5% and placing their business directly with an insurer or taking up the intermediation of the licenced direct broker. In the latter event, the paid-up capital norms and brokerage terms were specified. Those with a paid-up capital of Rs 1 crore and below and who exercised the choice of foregoing the special discount of 5 % could avail of brokerage services and the remuneration payable to the broker was 12.5%. Between Rs 1 crore and Rs 25 crores capital, it was 7.5% and above Rs 25 crores it was 5%. Public sector undertakings were kept out of the purview of the brokers.

2.13 Another Notification was issued on the 30th May 2003 by the Regulator-- having been assured by the brokers that they will deal with complaints about rebating through a self-regulatory mechanism — withdrawing the special discount of 5% for all private sector corporate bodies based on the above paid-up capital norms. Only public-sector bodies were exempt from this measure and they continued to enjoy the 5% special discount hitherto available to them. Brokers and agents were not allowed to earn any remuneration from the public sector units on tariff covers. The remuneration to brokers in accordance with Regulation 19 was also restored.

This Notification has now been kept in abeyance from 16th July 2003 following various representations from the interest groups. The Expert Committee has been asked to examine these issues and make its recommendations in view of the conflicting strong opinions the Notifications have generated.

2.14 No mention has been made of agents at all in either of these two Notifications quoted above; it therefore would imply that agents would be eligible to earn agency commission on all businesses on the paid-up capital norms prescribed in the circular of the 7th March 2002 of the IRDA.

The views of stakeholders on the Terms of Reference

Brokers' Views:

2.15 The Brokers have represented through their Association that (1) there are anomalies between the remuneration paid to agents and brokers with the former getting 2.5% more for tariff covers and 5% more for statutory covers (2) that the corporate bodies are discouraged from employing brokers because of the either/or provisions relating to special discount (3) that the 5% special discount is in violation of existing laws and (4) that corporate bodies have incorrectly perceived the special discount of 5% as compensation for building their in-house risk management expertise.

They have suggested (1) that the tariffs should be reduced across the board by 5% to annul the effect of the special discount (2) that no option for availing discount should be provided to the client vis-à-vis his using the services of a broker (3) that the public sector bodies should be opened up for brokers (4) that there should be no linkage of special discount with paid –up capital (5) that de-tariffing should take place in due course and (5) sub-brokers and agents should be allowed to be engaged by the brokers to develop business.

They also informed the Committee that some insurers themselves indulge in rebating.

A few other brokers have pointed out that the industry is currently run at an unacceptable cost and insurers should not use the cost argument to grudge paying appropriate brokerage. The industry should use its energies to reduce its management costs instead of zeroing in on distribution and marketing costs and should encourage professional brokers as their sales harbingers. The industry has never encouraged intermediaries in the past and as such the market has not grown to the extent it otherwise would have. Brokers will promote competition that the industry has not been used to and hence the unwillingness of the industry to pay the brokerage prescribed. The industry has not optimized its professional expertise even in tariff covers and as such a number of lapses are brought to light by consultants engaged by the insured. The number of claims outstanding and/ or disputed is another piece of evidence to show that independent intermediaries like the brokers could better serve the insured.

Insurers' views:

2.16 The insurers have represented individually their points of view. A broad consensus can be taken as representing their views. (1) 'Either /or' choice should continue for the corporate customers, as they do have special risk management cells that specialize in insurance placements (2) linkage of special discount and brokerage/ commission on turnover basis and not necessarily paid –up capital (3) to continue with special discount of 5% to corporates (4) that public sector bodies have been directed by CVC to discontinue usage of middlemen (5) to keep remuneration of agents and brokers low to prevent them from rebating a part of their remuneration (6) to de-tariff the market (7) that the brokers in the present tariff conditions do not bring in any value addition but would only add to costs (8) that the present remuneration encourages brokers to rebate and give kickbacks (9) the reduction of 5% in tariffs proposed by some would compel private sector corporate bodies to use middlemen that would push up their procurement costs dramatically threatening the viability of insurers (10) the current tariffs in fire and engineering do not include the brokerage/agency component in their pricing (11) brokers are targeting only creamy layers of fire and engineering, as they exist now, and they unduly raise expectations of customers, leading to reduced rates in non-tariff covers (12) the current licencing norms for brokers do not make them professional experts, as they claim to be in relation to the staff employed by the industry and (13) brokers could be paid 2.5% more than the agents.

The private sector players indicated in general terms that the market expansion would be facilitated by the entry of brokers. Brokers do not, as a matter of professional routine, provide inspection reports and other underwriting information, for tariff covers, and ask that insurers should do such work themselves or pay additional costs for it, as it is not mandatory to furnish such data. A few private players turn away such business offers.

The present system of distribution and marketing of products/services having been dominated by the insurers through the medium of Development Officers and Agents for decades do not seem to welcome any other new intermediary, such as a broker, to be brought into the system, as a means of challenging their existing business practices. That such an interaction would make the market more competitive, bringing efficiency, cost reduction, addition of new products and expansion of the market appears not sufficiently appreciated by the insurers.

Consumers' views:

2.17 Quite a few of the trade bodies are composed now of brokers and consumers. As such a few represented both of them in discussions with the Expert Committee. Also, a few other associations representing solely the customers made out that (1) the special discount of 5% should continue and they should have the choice of whether or not to use brokers/agents and the system should not be thrust on them. (2) that they cannot afford to pay higher premiums, which a withdrawal of special discount would cause them (3) the discount should be linked to the paid-up capital norms, as higher the capital, the more the outgo on premium payout and (4) high remuneration to any intermediary would encourage malpractices to flourish. In fact many of them seemed to prefer the status quo ante prior to the introduction of licencing of brokers.

Insurance Division's view:

2.18 The Joint Secretary representing the Insurance Division of the Ministry of Finance, who was also a member of the TAC had expressed a view at some stage that brokerage should be on a graded scale whether based on paid-up capital norms or not, and irrespective of whether the 5% special discount is withdrawn or not. The question to be dealt with was one of absorbing sudden and steep increase in procurement costs, by the public sector insurance players, questionable value addition by brokers on tariff products and encouragement of rebates and kickbacks that such a large amount of 12.5% brokerage payable would cause to the market.

Analysis of viewpoints:

2.19 The main issue of contention among the various parties appears to be the fire and engineering businesses that form about 15% (excluding the share of public sector bodies) of the total market of about Rs 14,000 crores. Withdrawal of 5% special discount would cause market premiums to go up by about Rs 120 crores for corporate bodies; payment of 12.5% brokerage without graded scales on capital norms would cause the insurers to pay about Rs 250 crores in cost additions through brokerage payments. The larger the premium base of the policy of a customer, the more is the brokerage earned.

2.20 In a market that is strongly tariff driven, the competitive advantage that a broker brings to the market is questionable, according to many. On what basis do the brokers compete among themselves? On the quality of professional advice offered alone or will the clients expect more than that? Will the market that is making huge underwriting losses absorb this additional cost to insurers without causing financial distortions in the market? The brokerage earned on a larger premium base should be relatively less and a uniform scale should not be applied in a tariff regime. Would not such large brokerage payments for tariff business encourage rebates and kickbacks in our system prone to such

scams? Is not a market of 75% large enough (if 25% of fire and engineering is excluded) for brokers to scout and enhance their business potential? In the existing legal systems and processes, will it be possible at all to check malpractices?

2.21 Admittedly brokers do have a role as professionals. They need to be encouraged as fledglings even in the tariff market, keeping their role in view when the market is likely to be detariffed. The Committee is strongly in favour of such a step towards detariffing to be taken at the earliest for which necessary preparations should commence right now. Competition on pricing would encourage better risk management practices to be adopted, ensure development of innovative products, improve underwriting skills and ingrain a global perspective in the market. Customers would get cheaper products, and those with good claims record will find their insurance costs going down and vice versa. The brokers can leverage their expertise, experience, negotiating skills and knowledge of the markets to develop the Indian insurance market in the best interests of the providers and the insuring public.

2.22 Reconciling the interests of various stakeholders, who have provided excellent logic and reasoning for their respective views has been a difficult task. Taking into account the interests of all the stakeholders, particularly the current state of the market and its future development, and keeping in view that the market should develop along healthy lines and that competition should be fair, that brokers need to be allowed 'some elbow room at the joints' to get an entry into insurances of corporate sector and with the expectation that the market would move towards a non-tariff regime sooner than later, the following recommendations have been made. Controlling rebating and kickbacks, particularly in the insurance sector, has always been a source of concern to the authorities. Failure to control them led to the agency system being downgraded. The distribution system is now on a path of professionalization and needs to be given a reasonable chance to rectify the old practices.

Views of the Expert Committee:

2.23. The Committee has examined whether the 5% special discount currently offered is within the existing laws, and if providing for it amounts to unfair discrimination between those that received it and those that did not. The Committee has been assured that it is not so in terms of law, tariff and usage. The insurer can always decide how his agent should function and circumscribe his authority. It was the reported directive of the Government that initially barred the Public Sector Undertakings from dealing with agents, and enabled them to get the special discount as a result. As an agent was precluded from canvassing for such business, the question of rebating did not arise at all. The question whether it amounted to a breach of the tariff was examined, and the Expert Committee has been assured that the current provisions do permit for such deviations.

As far as the basis for providing the special discount of 5% for fire and engineering businesses, the Committee concluded that the paid-up capital norm is the best under the circumstances, as it has been in vogue and is understood well by the insuring public; in addition the paid-up capital norm is the only verifiable factor at the time of giving the special discount. Any other norm, it was felt, would create more confusion and would lead to interpretative malpractices to occur.

The remuneration of agents and brokers in respect of Corporate bodies should be regulated on paid-up capital norms till de-tariffing takes place; as otherwise the

remuneration suggested in regulation 19 will lead to unhealthy and undesirable practices to flourish.

It has been brought to the notice of the Committee that a few insurers are indiscriminately allowing the 5% special discount on tariff and non-tariff covers to individuals, and corporate bodies irrespective of the paid-up capital norms, if the business was placed direct with them. Such an arrangement is evidently a breach of the provisions. The IRDA should inform insurers suitably to amend their business practices to fall in line with the Regulation/Notification about the paid-up capital norm and the related 5% special discount.

The Committee is of the view that there should not be any isolation of Public Sector Undertakings from access to agents/ brokers for canvassing, at least by a regulatory mechanism, as that would amount to discrimination. Public sector Undertakings should be allowed to experience the benefits of liberalization for improved professional services. As such the present bar should be lifted.

Payment of remuneration as indicated in regulation 19 on tariff covers will increase the cost structure of insurers that is already very high at about 32% on earned premiums. Insurers need to make deliberate efforts to reduce costs to enable consumers to get lower premium rates. The Committee is of the view that on tariff covers, there should be lower intermediary remuneration as recommended below.

There should be a differential in remuneration between the agent and the broker with the broker entitled to a higher remuneration, as his responsibilities are more onerous in law and in practice.

In the view of the Expert Committee, payment of brokerage on tariff business of 12.5%, without taking into consideration the premium spread broadly determined by the paid-up capital norms, would induce wittingly or otherwise unhealthy practices to develop. Even if the brokers were to play the game according to rules, the ground realities of consumer behaviour have to be taken into account. Since these are tariff covers that are the subject of intense competition, inevitably the competitive edge one would emphasize is the price differential either in a direct or indirect way. One cannot wish away or shut one's eyes to what is happening all around. Since a new setup of distribution channel is just emerging, it is better to be prudent now than to feel sorry later. Pragmatic gradualism under the prevailing circumstances would appear to be a better solution rather than adopting an immediate high-profile radicalism.

2.24 Recommendations Of The Expert Committee:

The Committee has made its recommendations, on the Terms of Reference, herein below. It has suggested detariffing of the whole tariff pricing structure as the urgent and pressing need to give a free play to market forces as an essential part of a liberalized market setup. It has also suggested a definite date for the implementation of detariffing so that the necessary infrastructure can be put in place for a smooth change over to a totally non-tariff regime.

A. Detariffing:

- 1. To take immediate and urgent steps to move towards detariffing the entire general insurance market that includes the profitable segments like the fire and engineering and the unprofitable business segments like motor. It is strongly recommended that this issue should be addressed on a priority basis and a free market without tariffs and price controls should be organized. IRDA, TAC and the General Insurance Council of the Insurance Association of India should collaborate with each other to ensure a smooth changeover to the non tariff system not later than 1st April 2006.**
- 2. A road map should be drawn up for this purpose. IRDA, TAC and the General Insurance Council should encourage, assist and guide individual insurers to build up statistical bases for their own risk acceptances on all businesses currently under tariffs, category-wise, as is now prevalent in the respective tariffs. This will enable them to be ready for a Pure Risk rate regime (wherein the rates will not include any administration and /or procurement costs or profit margins) proposed by the Committee to operate at least with effect from 1st April 2006. This will thus prepare the insurers for a completely detariffed market two years later. Involvement of consulting actuaries of insurers in this exercise should be considered.**

Insurers should gross up the designated Pure Risk rates to cover for their administration and procurement expenses and profit margins according to their best underwriting judgment. To this extent the market should have floating rates in which the underwriting skills and cost and profit considerations will have a primacy from 1st April 2006.

- 3. The effect and fall out of the introduction of Pure Risk rate regime in the interim may have an adverse impact on the rates in the short run on profitable segments whereas the rates may go up in the hitherto unprofitable segments. To avoid or mitigate unhealthy competition in pricing, until the market stabilizes, the Pure Risk rates (which will not include any administration and / or procurement costs or profit margins) should be regarded as the minimum bench-mark subject to strict discipline and inspection as an intermediate step. Insurers should be alerted on the need to control expenses to achieve appropriate balances in their results.**

During such regime of Pure Risk rates, the standard terms and conditions of the tariff wordings should be preserved. The roadmap envisaged must dwell on this aspect.

The TAC should be entrusted with the responsibility to prepare Pure Risk rates to be regarded as the minimum for two years commencing from 1st April 2006 or even earlier if possible and such rates should have the status of tariff rates. The TAC should monitor the breaches of Pure Risk rates. Punishment for breaches should be hefty enough to discourage deliberate breaches.

- 4. Since there is an industry tariff structure currently in force on most portfolios, the Committee is of the view, that there has been very little**

incentive for individual insurers to build up their individual risk category acceptances and experiences to be able to price risks on claims cost plus basis.

Absence of statistical data would compel an insurer to price risks on assumptions either with a conservative element built into it or force it to follow the rates of any of its aggressive competitor. In a strongly developed broker market, the pressure on underwriters will be intense; and the current competition is still young, just three years old. The Indian insurance market is yet to mature in terms of underwriting skills to be able to face tougher competitive conditions likely to emerge in future.

Underwriting and pricing of risks should, therefore, be based on statistical data to back up the intended pricing structure both at the level of the individual insurer and of the market as a whole. It is time for individual insurers to start building up their statistical data on sound lines to avoid a chaotic situation and price wars later.

The IRDA, TAC and the General Insurance Council should guide and assist individual insurers to adjust to the transformation that a free market situation will impose on their business practices, mindset and procedures. The changeover has to be as smooth as possible and with full awareness of its consequences.

5. Customers do need price competition to experience the full benefits of liberalization. Insurers need to practice underwriting skills and risk management techniques to evaluate risks and price products to fit in with global trends and practices. They should be enabled to learn from international trends and developments. Brokers and agents need to display their professional wares and expertise.

B. Special discount, Intermediary Remuneration, Special dispensation to PSUs and Paid-up Capital norms.

1. To continue with the 5% Special discount (that has been in usage for over 25 years) in the interim for certain Corporate bodies – both in the private and public sector on fire and engineering insurances only- till detariffing of rates by 1st April 2006 or earlier as the case may be. There is no justifiable reason demonstrated to the Committee for its sudden withdrawal.
2. Since the Rs 10 lakh paid-up capital norm for corporate bodies, as defined below, fixed earlier for qualifying for special discount of 5% is very low under the present economic trends, the Committee recommends that the eligibility limit for the special discount of 5% should now be raised to a minimum paid-up capital of Rs 1 crore and above for corporate bodies. The special discount of 5% should be further restricted to such corporate bodies for only fire and engineering insurances.

This will widen the access of corporate client base, below paid-up capital of Rs 1 crore, both to the agents and brokers to display their professional expertise.

There should be no special discount of 5% allowed on any tariff cover either to individuals or corporate bodies whose paid-up capital is below Rs 1 crore. IRDA/TAC may issue suitable instructions in this regard.

Where special discount 5% is not applicable, the agency commission for insurances of individuals and corporate bodies with a paid –up capital below Rs 1 crore should be restricted to a maximum of 10% for agents. The brokerage should be a maximum of 12.5%.

Although not related to the paid-up capital issue, it is recommended that for statutory covers both the agents and brokers should be eligible to a maximum of 10% remuneration, as no special expertise is required to sell and service these covers and further there shall be no special discount payable on this.

For non-tariff covers the brokers should be eligible to a maximum remuneration of 17.5% and the agents to a maximum of 15% as currently specified.

- 3. The Corporate bodies, whether private limited companies or public limited companies or public sector undertakings or statutory bodies having a paid-up capital of Rs 1 crore and above and up to Rs 25 crores should be allowed to have a choice of availing either a 5% special discount and place fire and engineering businesses directly with an insurer or seek the services of a broker/agent when they will become ineligible for the 5% special discount. The remuneration to brokers in such an event should be limited to a maximum of 7.5%. The agency commission should be restricted to a maximum 6.25 %.**
- 4. The Corporate bodies, whether private limited companies or public limited companies or public sector undertakings or statutory bodies having a paid – up capital of above Rs 25 crores should be allowed to have a choice of availing either a 5% special discount and place the fire and engineering business directly with an insurer or seek the services of a broker/ agent, when they will become ineligible for the 5% special discount. The remuneration to brokers in such an event should be limited to a maximum of 6.25%. The agency commission should be restricted to a maximum of 5%.**

In suggesting the above norms and remuneration, the Committee would like to record that these remuneration packages should be regarded only as interim measures pending the detariffing of the market with the introduction of Pure Risk rate regime not later than 1st April 2006. The brokers/agents should be enabled in the interim to get integrated into the system for their future potential gains and the more important professional roles they will be expected to play.

- 5. The present brokerage/commission structure as it exists in the present regulations on tariff covers does in the view of the Committee encourage rebating and malpractices to flourish. It has happened in the past, despite**

numerous measures discouraging their proliferation by way of social control of insurance and nationalization.

The Regulator at this initial stage of liberalization of markets should be wary of such substantial remuneration to be paid on tariff covers, wherein the professional input is limited, whether it is the broker or the agent. Inducing competition in the market, while controlling prices and product features for most covers will inevitably encourage unhealthy practices to flourish.

Hence the Committee has suggested detariffing the market by the introduction of Pure Risk rate regime not later than by 1st April 2006 as the logical step to create an environment where competition is fair and there is a level playing field.

6. As regards the impact of brokerage and commission on procurement costs of insurers on tariff covers, it is observed that the cost of transacting insurance business in India has remained high at over 30% of the earned premiums generated for both the public and the private players. Additional costs if imposed suddenly would further burden them.

Insurers have neither actively adopted nor taken any serious measures to reduce costs nor have they any strategies in place to do so that will result in lower premiums to consumers at least in future. Insurers have combined ratios (claims cost plus expenses) in excess of 114% on earned premiums for the year 2002/3 resulting in huge underwriting losses. The Boards of Directors of these insurers should actively encourage drawing up of plans to reduce management costs in order to lower their combined ratios that will ultimately benefit consumers.

The Committee is also of the view that in a tariff market the brokerage and commission structure as recommended above is in keeping with the services that can be rendered by them.

Detariffing should, however, be completed not later than 1st April 2006 in order to allow the Pure Risk rate regime and market forces to decide on prices and intermediation expenses and allow consumers to experience the benefits of liberalization.

C. Remuneration of agents and brokers:

1. There should be a differential maintained between the Agents and Brokers in their remuneration packages. The latter has more onerous responsibilities and functions to discharge. As such the maximum brokerage payable should be a little higher than the agency commission.
2. Agency commission for tariff covers should be revised to a maximum of 10% to maintain a differential of 2.5% in the remuneration structure between brokers and agents / corporate agents.

3. For statutory covers, however, 10% remuneration should be maintained for both of them, as no special expert advice is required in providing or servicing such covers.
4. On non-tariff covers, the maximum remuneration for brokers should remain at 17.5% and that of agents at 15%.

D. Government/Public Sector Undertakings:

1. The Committee recommends that all corporate bodies be treated alike and for intermediation purposes treated under the Special Discount recommendation as mentioned in B - 2 to 4 above. This is irrespective of whether they are in the private sector or public sector. As such public sector undertakings should be permitted to exercise their choice for intermediary access with stipulations on paid-up capital norms, remuneration and discounts as mentioned under in B - 2 to 4 above.
2. Fairness and equity requires that IRDA should not take a selective view in organizing the market or in limiting the freedom of choice to any sector on its own.

A Fair And Competitive Market

- Role of Agents & Brokers

- Regulatory Safeguards

3.1 This chapter deals with those aspects of the second and fourth Terms of Reference relating to the role of intermediaries viz. Agents and brokers in the current insurance market scenario in spreading risk awareness and widening the customer base for all insurance products marketed. Also, it examines the value-added services provided by them to justify their remuneration compensation. It deals, in addition, with the regulatory safeguards that should be in place to develop the market on fair and healthy lines while keeping competition fair; in particular, the elimination of unhealthy practices of rebating and other undesirable practices that inhibit fair competition.

3.2 It is the insurers who are the prime movers and shakers of the market and who are vitally responsible, in their self-interest, for market expansion and creation. The distribution channels are an adjunct to the market system complementing the efforts of the insurers in enabling the market to expand, but on terms, which the insurers are prepared to allow and accept. Since insurance selling involves technical complexities, and as insurers want to pre-determine their costs of marketing their products, agents and brokers have been recognized as significant players in spreading risk awareness and for spreading the insurance net far and wide.

The present marketing structure of public sector insurers to sell insurance covers relies on the officer cadre, Development Officers and agents/corporate agents. With the VRS of Development Officers over, and the VRS of other officials in the offing, the insurers have no alternative but to rely on the agency force as their main marketing arm of the future. The other channel, of course, is that of brokers. Insurers do not yet seem to have recognized or appreciated of how constrained they are in their marketing tools to widen the market. They are now overwhelmed with the business of consolidation through retention of accounts and expect growth to come about by customer-driven and lender-driven efforts. The initiatives to drive the markets through pro-active measures from insurers themselves are yet to emerge or take shape.

3.3 The Development Officers of public sector insurers who were relied upon by them as a major marketing force earlier to widen and create new markets have by and large not fulfilled the high expectations of the Insurers. In this context the present role of agents and brokers assumes importance. Insurers are now required to change their mindset from their Development Officer –orientation to accept the new breed of distribution entities as essential to their efforts for market expansion.

Command and control distribution systems that existed earlier in the monopolistic regime have to necessarily yield to collaborate and co-exist systems now in a liberalized market environment, based on a higher degree of professionalism on either side. The new distribution channels need to be accepted by insurers as a part of an inevitable growth process of the market, as they, under the circumstances, are not in a position to render the instant services that customers have now begun to expect.

Duties of Agents & Brokers in Law:

3.4 The remuneration packages paid to the agents and brokers are usually differentiated based on their respective professional responsibilities to their principals as also the duties entrusted to them. To his principal, the agent owes duties such as: (1) the duty of carrying out the transaction for which he is employed to carry out (2) to obey his instructions and to act strictly in terms of his authority (3) to act with reasonable and proper skill (4) to account to the principal for the money received (5) to deal honestly with the principal.

The broker has, in addition, the duties of (1) ascertaining the needs of his client by instruction or otherwise (2) using reasonable skill and care to procure the cover his client has asked for, and (3) if he cannot obtain what is required he is expected to report in what respects he has failed, and seek his client's alternative instructions. The broker is judged by a standard as a person of experience, skill and reasonable information and not merely that he has acted with reasonable and proper care. He has also an additional role to perform in the post-sale period.

Role of Agents:

3.5 Agents, though recruited according to Licencing Regulations, are not nurtured enough through proper mentoring by the insurers. There is a lack of perceptual clarity on how to harness the agency potential. Personal lines insurances, excluding motor, are not easy to sell; a demand for it has to be created by the insurer through a well thought out strategy and an operational plan in which the agent has a role.

Since the insurer, through its self-interest, primarily drives the market, the best a Regulator can do is to ensure that the agent is trained to be a better professional by exposing him to continuous training programmes at regular intervals and monitoring his performance for enhancing his sales capabilities. Regulations need to be tightened on the insurers to ensure that agents should be exposed to continuous training on and off the field, in order to professionalize his role by improved insurance and sales literacy. With the diminished role for Development Officers the marketing capabilities of agents need to be rebuilt and enhanced.

Agents are usually at their best in accomplishing sale of policies to individuals in rural and urban sectors. They, however, depend on the support of the insurers they represent to create a demand for such covers to be sold. Widening the customer base and creating risk awareness among individuals at present is left to a substantial extent to the agents. Creating a market environment for the agent to be effective is the responsibility of the insurers. Considering these demands, insurers need to be alive to the fact that the market potential can be tapped best not only by enhancing the professional and sales capabilities of the agents but develop a market environment in which risk awareness is heightened for the insurance covers.

A few private players have suggested that Agents should be selectively licensed to do selling in specific portfolios, as the sheer variety of available covers is vast. It is an interesting suggestion to examine, particularly in general insurance business. Specialization in the sale of specific covers should enable agents to acquire special skills and knowledge that would benefit consumers. The Committee endorses the

suggestion for further consideration of the Regulator. Insurers and the General Insurance Council should be consulted for the proposal to be put in place. The key ingredient in the implementation of the proposal is the field of specialization and insurers commitment to harness the agency potential for expanding markets that are not organized.

An issue that came up before the Committee was the payment of service tax by insurers on the commission paid to agents. Where the regulator has prescribed the maximum commission payable to agents, would payment of service tax in addition by insurers amount to a breach of regulations. This aspect may be examined and suitable instructions issued clarifying the position.

Corporate Agents:

3.6 Corporate banks/ rural banks/ grameen banks are adopting the corporate agency model to leverage their customer base to sell insurance products to their customers. An agent in terms of his appointment letter has certain obligations to his principal and to the customers whose business he solicits. In the event of disputes on claim-related issues, it is possible that the bank, as an agent, may find itself with conflicting loyalties between the two. A Corporate Agent has a code of conduct to implement that includes claims servicing. The bank should check if it has the necessary infrastructure to administer this responsibility.

3.7 In addition, the bank in most cases is a joint beneficiary of a claim, even while it is performing the duties of an agent. In the event of any error or mistake committed by an agent (the bank) to the prejudice of the bank's customer, a claim is rendered not admissible will the bank as an agent be subject to professional negligence? Will such liabilities be transferred to the bank as a corporate entity? These need examination viz., the infrastructure to service claims; and agency responsibilities as a beneficiary of a claim as representing the insured and that of an agent representing the insurer simultaneously. These dual legal obligations are likely to create problems for the bank as a corporate agent and need fuller examination.

3.8 The Reserve Bank of India has cautioned banks not to have obligations or liabilities brought on to their balance sheets as a result their taking up the corporate agency of an insurer.

Role of Brokers:

3.9 Brokers will be more effective in dealing with the private insurance players, who presently do not have a marketing force to distribute their insurance covers. As independent professionals with access to many insurers, brokers are better placed to serve customers' interests. On considerations of cost, they are expected to be less venturesome to market retail insurance covers. Individual insureds too may not get the same attention, as the corporate bodies would. While the brokers would perhaps enhance the degree of professionalism and product innovation in the market, they may not be effective in widening the customer base. Brokers are better placed to sell group insurance covers and could transform urban and semi-urban markets in the non-tariff businesses.

It was pointed that brokers render services such as risk inspections and professional consultancy guidance to customers/ prospects and such services may not always result in realized business for them. Would the brokers in such instances be entitled to charge consultancy fees from the beneficiaries of such services? It is the view of the Committee that such rendering of services are a part of the marketing efforts by brokers and they should not claim any fees or remuneration for them. The duties and functions of brokers are clearly laid down. The IRDA may clarify the intended position in the interests of all concerned.

The licencing norms for entry of brokers appear to be based more on capital requirements than professional expertise and experience. Neither a compulsory insurance qualification nor length of insurance experience as a practitioner has been made mandatory. These entry norms need to be reviewed to ensure a greater degree of professionalism to prevail. To the extent that the norms are relatively easy to fulfill, there is a view that commercial players find the field attractive compared to insurance professionals.

Brokers' licencing norms have to be revised to bring in a greater degree of professionalism in terms of professional qualifications, expertise and experience. The present licensing norms should be held in abeyance till new norms are brought in, as the market now has a sufficient number of brokers to cater to its present needs. The performance of those that have been licenced need close monitoring for results. It would appear that the collection of broker data is slow in coming to review their performance.

Pitfalls to be avoided:

3.10 Brokers should mention the licence number given to the firm or the individual by the IRDA on their letterheads and visiting cards to identify that the person and the firm are licensed to canvass business.

1. Customers often do give underwriting information and mandate letters to several brokers to obtain quotes from several insurers. This will create confusion in the market, as several of them would approach an insurer for quotes. An insurer should be encouraged as matter of convention to quote only for one broker and not all to help develop healthy precedents. Otherwise competition among brokers generated by customers will intensify. While it is not avoidable, this will make the market more confused and needlessly more competitive.
2. Brokers do also approach different offices of the same insurer without disclosing the names of the offices they have accessed. The result is each office quotes different rates to different brokers creating confusion in the market and loweing the market credibility of the insurer.
3. If insurers were to revise a quotation for one broker, are they obliged to inform all the other brokers to whom they have made quotations available of the changes?

The code of conduct for brokers need to be revised to take in to consideration the likely misuse of the system in the above circumstances, in the interest of future growth of the market.

Insurers:

3.11 While the Regulations for agents and brokers have served the purpose of creating an environmental structure for their role, it is for insurers to decide on how to manage their relationships with the distribution channels. Unless the insurers, as a body through the General Insurance Council of the Insurance Association of India, recognized under section 64 L of the Insurance Act 1938, set up the ground rules for market conduct as their mandated responsibility, it will inevitably be the agents and brokers, who will dictate terms and create divisions among the insurers. Fundamentally, it is the leadership of insurers or the lack of it that will dictate the roles and the utility of the new distribution channels in future.

The brokers, more than the agents, have a greater financial incentive to perform aggressively. They are self-employed, enjoy freedom of operation, access to all insurers and are expected to have with them an expertise that can challenge the best in the industry. The agents, constrained by apathy of neglect and depending on one insurer, do not enjoy the same degree of freedom. But the insurers have an opportunity to train them to sell particular products of their choice. Harnessing agency force requires a higher degree of empathy and focussed efforts from insurers. They have even a more important role to play than brokers in developing personal lines and rural insurances that are the sources and targets of future markets. Life insurance business has remarkably grown in India due to the extraordinary work done by agents who are mostly individuals. A similar but more challenging opportunity awaits those agents in the general insurance industry. Insurers have to consciously work towards raising the agency force's effectiveness through mentoring and nurturing them.

Regulations & Fair Competition:

3.12 Insurance in India has an elaborate architecture of laws and regulations on pricing and product offerings to ensure that the market stays fair and competitive. Administrative controls and mechanisms are still relied upon to maintain fairness, and competition is restricted to service standards. Price competition is restricted by a tariff regime in respect of most covers including rating norms, terms, advantages and conditions of product features.

While India is host to excellent rules and regulations on its statute books, the Regulatory Authority is inadequately staffed and lack sufficient number of skilled people to detect breaches and enforce regulations on the books. Even where breaches committed are noticed, the deterrent punishments are inadequate and lack a sting. This has led to less than credible detection and enforcement in the past.

Regulations can be categorized under three parameters; those that are made to ensure good corporate governance, financial stability of providers and orderly growth of business; those that govern and regulate the conduct of distribution and marketing channels and those that ensure that the consumers get a fair deal, from both the providers and the intermediaries to insurance contracts, and that insurance covers and services are made available to the consumers at reasonable cost.

Awareness of regulations:

3.13 Though Regulations are carefully crafted to govern fairness and equity and are largely pro-consumer they are found to be not effective enough to serve consumer interests due to their selective implementation by the insurers. The beneficiaries of these Regulations, the consumers, are often unaware of how well they are protected and what remedies are available to them to fight unfairness and delays in resolving the contractual obligations. The question necessarily arises of who should publicise the regulations that protect their interests to create consumer awareness? The Insurers who are marketing their products? The distributor? The Regulator? Or the Consumer himself by accessing the Internet to know his rights?

3.14 In a market where customers interact with providers directly, without intermediaries, it is the responsibility of the provider. By bringing in a broker in to the distribution system, this differential has been bridged. However, the accountability for highlighting the rights and responsibilities of contractual parties should be that of the providers. A fair and competitive market should restore visibility to the Regulations made in the interests of the consumers. This aspect should be considered in the interests of the consumers.

Enforcement of regulations

Corporate governance:

3.15 As far as the financial soundness of insurers is concerned, the Regulations should be constantly kept under review and updated to ensure that there is a greater degree of transparency and more disclosures of financial information. The insuring public and the brokers, apart from the Regulator, should judge the financial soundness of the insurer, not necessarily only when the annual financial statements are published but through the compulsory publication of un-audited quarterly financial statements as well as the annual financial statements for public information. It is not the legal compulsions but the adoption of the best and sound practices that should be the guiding principle.

The Committee recommends that from the financial year 2004-2005 the publication of quarterly un-audited accounts in newspapers should be made compulsory along with the publication of annual financial statements. Brokers have a professional responsibility to advise their customers on the financial soundness of the insurers and in the absence of compulsory rating of insurers by recognized agencies this measure assumes special importance.

The Regulator is also required to examine the Annual Financial Accounts of insurers in relation to the comments made by the Statutory Auditors to ensure that the insurers have observed in law and in spirit all the Regulations and legal provisions in addition to those specifically outlined for the preparation of financial statements. To ensure Regulatory compliance, it is proposed that either the job of verification be outsourced to maintain impartiality and fairness or performed in-house, which may delay the completion of the exercise. It may be possible to avail of both the facilities as may be deemed convenient and effective.

3.16 The Boards of Directors should also enhance their present standards of corporate governance to encompass the due observance and compliance of all the Regulations made in the interests of the financial stability of the insurers, market development and in the interests of the consumers by making a specific statement to that effect in the financial statements. The Boards should be regularly kept informed by their respective managements on the details of expenditure incurred for promotion, development, risk management and marketing towards soliciting business. This will enable the Boards to evaluate if any rebating or undesirable practices have been resorted to directly or indirectly. Considering the rising noise of complaints made by each other on this score, the Boards may satisfy themselves that no such practices to the best of their knowledge have been resorted to. This measure will serve as a deterrent to those managements that would wish to skate on thin ice. In this context it is recommended that the IRDA may prescribe specified corporate governance norms.

General Insurance Council:

3.17 The General Insurance Council of the Insurance Association of India, under section 64 L of the Insurance Act 1938, has the responsibility to lay down standards of market conduct and sound practices to be followed by its members in rendering service to policyholders; in addition it has to coordinate with the IRDA on activities of insurers that are prejudicial to the market with regard to matters of commission payments and the interests of policyholders. Rebating, kickbacks and grievance redressals do come under these provisions. It has also the authority to collect fees from Insurers, if necessary, to enforce and carry out its laid-down responsibilities.

The Council should set up a self-regulatory mechanism to govern the market conduct of its members, including a disciplinary mechanism. It should draw up a set of rules and provisions including a claims settlement code to guide the market conduct among its members towards policyholders and also to deal with erring insurers on rebating issues. Lack of a Secretariat facility is probably hampering the implementation of its responsibilities. A Secretariat of the Council should be set up to provide it with a framework with defined roles, functions and responsibilities that befits an Institution.

3.18 It may be useful for the Council in India to examine the procedures, systems and rules practiced by the UK General Insurance Standards Council in laying down the standards and codes of practice that it expects its members to adhere to. This can serve as a role model for consideration.

Breaches of rules and guidelines by insurers should be investigated and deterrents prescribed by a disciplinary committee that should include co-opted experts to maintain impartiality and fairness in the conduct of investigation and recommending the deterrents. The Regulator should ensure and promote that such mechanisms are put in place quickly in the best interests of the market.

3.19 A fair and competitive market depends on the how effective and efficient the Regulatory Authority is in detecting, investigating and punishing the errant parties of any breaches of law, as enacted, and how rigorously the regulations it has laid out are observed in spirit and deed. Admittedly, implementation of regulations is a cost-input item for the one required to observe them. Since the market has been asked to follow several Regulations for governing their business operations, it has become quite important that these are observed without deviation or disregard to ensure the credibility

and the authority of the Regulator. Regulations are made to ensure that the market performs in a fair and competitive manner, without any undesirable and unhealthy practices that can easily creep into the system except under the watchful eye of the Regulator. No business is more prone to such practices, as insurance business is, if the past precedents are any indication to go by. The active and willing discouragement by insurers is necessary for rebating and kickbacks to be put down with a heavy hand.

Regulations on Distribution Channels:

3.20 The question of rebating and kickbacks that high levels of agency and brokers' remuneration would provide needs examination. It is reported that even without the intervention of intermediaries, there is illegal rebating by insurers themselves. In either case the undesirable practices are known to exist; and a total obliteration of such unhealthy practices may be impossible, since human ingenuity is always ahead of any new law that may be brought in to eliminate them. But attempts to check or discourage them should be vigorous, and punishments for guilty should be exemplary to prevent others from resorting to illegal shortcuts.

3.21 Composite Broking has the inherent disability of conflict of loyalty and interests as the broker simultaneously represents the risk producer and the risk carrier. Such an arrangement could in addition lead to proliferation of fronting arrangements. Further the duties, responsibilities and functions of the two roles are in contradiction to each other. As such the Committee recommends that the licencing of Composite Broking should be discontinued immediately. Those that have been licenced should be informed that such licences would not be renewed. This subject has been dealt with in Chapter 5 with a view to make a specific recommendation.

3.22 Brokers' licencing norms should be revised to enhance the quality of their expertise and value-added services they are expected to offer to the insuring public. A professional technical qualification of AIII or an equivalent of it recognized by the IRDA for the Principal Officer should be made mandatory; or he/she should have had an experience of at least 5 years as an insurance practitioner.

3.23 Brokers should be permitted to open additional offices only after prior approval of the IRDA which will ensure that the officers soliciting business have passed the prescribed training and examinations. IRDA should have a record of the list of offices of each broker and the list of employees that are authorized to solicit business for better regulation.

3.24 The Committee has dealt with certain business practices that could create market confusion between the brokers and the insurers elsewhere in the report. While these cannot be eliminated, it is important that ethical and moral precedents and conventions are evolved by mutual consultation. A joint consultative body of insurers and brokers should be encouraged to be set up

3.25 Brokers even when licenced should not be permitted to practice unless they have filed the PI policy in the best interests of the policyholders on whose behalf they act. The grace period of 15 months for its production in selective cases as permitted in the Regulations should be removed, as otherwise the IRDA would have to take upon itself the responsibility for the breaches of negligence they may commit.

3.26 Sub-broking was considered but rejected as a medium, as the system is prejudicial to the interests of policyholders who have no privity of contract with sub-brokers. There is no reason adduced as to why brokers cannot get more employees to qualify for soliciting business in their long-term interests. It is also cumbersome to regulate sub-brokers even while the broking system has not been put on an even keel.

3.27 Implementation of regulations and codes of conduct should primarily be left to self-regulatory bodies of insurers and distribution channels. In fact, the aims and objectives of the functioning of representative bodies should be amended to make Regulations and codes of conduct enacted as a part of their charter/memorandum of objectives. Breaches should be investigated and erring members disciplined with intimation to the Regulator by the respective bodies.

Regulations on Consumers and their protection:

3.28 While the code of conduct prescribed for each channel is quite explicit and detailed, the responsibility to monitor their compliance falls yet again on the Regulator. There is a need to activate consumer bodies to act as prime agencies to safeguard the interests of the consumers by enabling them to oversee the implementation of the safeguards enacted for them. Consumers have to deal not only with the insurers but with the agencies of distribution channels as well. They have to ensure that both the parties play fair with their interests.

3.29 The Regulator should set up a tripartite advisory body consisting of representatives of insurers, agents/ brokers and the consumers to meet half-yearly to discuss their common interests, problems and the future direction. Their deliberations and views could form a valuable input for the IRDA to develop healthy conventions, guidelines and precedents.

3.30 The in-house grievance redressal mechanisms of the insurers need to be restructured to give them a content of credibility, impartiality, and utmost dispatch. The IRDA should encourage insurers to become more customer-sensitive in their own self-interest. Grievance redressals within specified time limits for settlement of customers' concerns/complaints should be at the top of the agenda for creating a positive image of insurers at the market place. The Committee has made recommendations on this issue.

Implementation of Regulations:

3.31 There are a host of regulations in the books and these can be considered virtually as a role model for any other Regulatory Authority in the world. Deservedly these have been welcomed and appreciated. The hard part of the business is their implementation that lends authenticity and credibility to the functioning of the Authority. Since the inspection mechanism requires skilled, knowledgeable and competent persons to perform the tasks of inspection, the IRDA should consider the option of outsourcing these tasks to external experts or develop a staff structure to do them in-house or a combination of both.

3.32 Since the latter option is time consuming and requires more efforts, and as it is likely to create a bureaucracy, it may lose its cutting edge in course of time. The Committee is of the view that the inspection tasks should be outsourced, with specific functional references and a time frame, to external agencies to be empanelled. Time is of the essence in implementation of regulations already made.

3.33 Confidentiality agreements or similar such other instruments should be devised, as is prevalent in the developed markets, to keep the information made available, as sensitive and which should not be used or parted with, without specific authorization. Outsourcing of services has now been recognized as an important management and business tool and the IRDA should use it effectively for its assistance in carrying out its duties and responsibilities, with suitable safeguards.

3.34 The market behaviour can only be shaped along the lines envisaged if the regulator is able to demonstrate for inculcating public confidence that there are rules laid down for each player in the best and ultimate interests of the consumers, and that the market game is played according to them. Self-regulatory mechanisms should be actively encouraged, if only to lessen the burden on the regulator itself. But the ultimate responsibility for the smooth functioning of the market cannot be left solely to the self-regulatory mechanisms of either the General Insurance Council or the Insurance Brokers' Association of India or the Consumer activists. The Regulator has to form its own judgment, as an umpire, of what constitutes the best balance of interests of all the stakeholders.

3.35 Recommendations on Regulatory Compliance:

The Committee has made its recommendations to the above by examining the interests, responsibilities and duties of various stakeholders in the system and how modification of certain present practices can enhance their effectiveness, thereby leading to improved levels of market standards and conduct.

A. Brokers and Agents:

- 1. The licencing norms of the direct broker should be reconsidered for the future. A technical insurance qualification recognized by the Insurance Institute of India such as AIII or a qualification recognized as its equivalent by the IRDA or experience of a minimum requirement of 5 years as an insurance practitioner should be the minimum for the principal officer. Those that have been licenced already should meet the revised standards at the time of renewal of the licences. The Regulator can reserve the power to exempt this requirement in exceptional cases. Professionalism needs to be introduced into broking community for it to grow on healthy lines.**
- 2. Brokers should open additional offices only after obtaining the prior approval of the Regulator. The Regulator should be notified of all the new appointments with the qualifications of personnel appointed so as to ensure that the persons recruited to solicit business have passed the required examination.**
- 3. Sub-broking as a proposal was considered and not accepted, as the sub-broker has no privity of contract with the customer and is not liable for professional negligence to the customer. Sub-broking will lead to unintended legal problems and should be avoided.**
- 4. Brokers should not be permitted to practice after issuance of licence by IRDA, till a copy of the Professional Indemnity (PI) policy covering the requirements of the IRDA regulations is produced. Till a PI policy is in force,**

the customers' interests, which are primary, are at risk due to any act of professional negligence of a broker.

5. The duties and functions of a Corporate Agent in the case of banks need a reappraisal in view of the conflict of interest situations, wherein a bank is a joint beneficiary of a claim even while representing the insurer as its agent. The Regulator has also to ensure that the bank has an effective claim advisory service in place, in accordance with the terms of the code of conduct. The MOU should incorporate suitable stipulations to cover these aspects.
6. Harnessing the Agency potential to the full for the expansion of the market needs a commitment on the part of insurers to make this channel function more effectively than now. The General Insurance Council and the IRDA should spell out in clear terms, the kind of retraining programmes needed to enhance the technical skills and sales techniques of agency force that is an integral part of the marketing and sales force of insurers. Monitoring their performances and mentoring them should be another area of implementation to improve their effectiveness vis-a vis the insuring public.
7. Insofar as the brokers are concerned, the code of conduct towards customers is specified in the regulations. It would be useful if a code between the insurers and the brokers is also introduced to develop and maintain best practices and sound conventions in relation to their mutual transactions.

The Committee recommends that best market practices should be evolved with a give and take attitude and mutual goodwill. The General Insurance Council should assist in this regard by mutual cooperation with the Brokers' Association.

8. The IRDA has nominated one of its Members on the Disciplinary Committee of the Insurance Brokers' Association of India, as a permanent member. The Committee is of the view that this is `neither a healthy nor a desirable convention, as the presence of the IRDA `member on the Disciplinary Committee would stifle the growth of a self-regulatory mechanism within. Also, it compromises the independent `status that the IRDA currently enjoys in the eyes of the public. This proposal to have `the IRDA member on the Disciplinary Committee should be reconsidered.
9. A tri-partite association/ committee comprising representatives of insurers, brokers/agents and consumer activists should be nominated and it should meet half-yearly to consider areas of mutual concern and suggest remedial steps to correct any imperfections in the systems operated by each to the detriment of the market as a whole. Such recommendations should be advisory in nature for the consideration by the IRDA for its feasibility and fairness in implementation.
10. A self-regulatory mechanism of the brokers laying down a code for their market conduct and service standards for its members, along with the disciplinary code should be publicized for the information of the public.

B. IRDA & Regulations:

- 1. It is recommended that a separate implementation cell or a Standing Committee on Procedures and Performance Review of Insurers, Brokers and Agents should be set up in the IRDA to identify the regulations that each stakeholder has to observe and assist each in their compliance. There should be a periodic annual check to verify the extent to which the regulations made are complied by each stakeholder.**

Implementation of the regulations already on the books is a precursor to making more regulations to guide the market conduct of stakeholders. Compliance requires skilled, knowledgeable and competent staff to enforce regulations. At the same time, building a large bureaucracy is to be avoided, as that would slow down the process of effective implementation.

It is recommended that outsourcing assistance in this connection may be considered. This would enable the IRDA to locate the organizations with the right expertise and experience for the tasks on hand and obtain reports within the time frame fixed for their implementation. This will also add credibility to the image of IRDA for its fairness, equity and a lack of bias. Confidentiality agreements can be drawn up to ensure confidentiality of information shared with the outside experts. Outsourcing has become a common management tool to solve modern day issues. This practice is gaining greater acceptance by international organizations.

- 2. Any breach of the provisions reported from whatever source, should be investigated, if necessary, with the assistance of an outsourced mechanism for factual verification and reporting within a specified period. The scrutiny of books of accounts and individual questioning on the complaints received should be permitted.**
- 3. IRDA is entrusted under section 20 (1) of the IRDA Act 1999 with the responsibility of development of the Indian insurance industry and it is required to furnish to the Central Government a programme for its promotion and development besides providing a true and fair account of such activities to the Parliament. It must, therefore, consider preparing a roadmap for the development of the insurance industry which would not only assist the Authority to perform its duties and functions but enable it to achieve the objectives of the legislation and improve on the insurance penetration and density.**

C. Insurers:

- 1. The annual accounts of each insurer should provide full disclosure of expenses incurred under promotional, marketing, developmental, risk management and similar heads to detect if any undesirable inducements have been made to customers to solicit their business. Such expenses should be brought to the notice of the Boards of Directors of the respective insurers.**
- 2. The Board of Directors should be asked through issuance of a separate regulation by IRDA, to publish quarterly un-audited financial statements**

- from 2004/5, in specified formats, as also the audited annual financial statements in at least two newspapers, one of which should be in English in the interests of policyholders and the general public who need to evaluate the financial soundness of insurers as a matter of best business practice.
3. The Regulator is required to prescribe the form in which the insurer has to provide a summary of financial statements under part II C (5) of the Regulations on General Instructions of Financial statements for the last five years. This form should be prescribed at an early date.
 4. Under Schedule C Regulation 3 of the auditor's report the actuarial valuations have to be certified in accordance with the guidelines and norms to be issued by the Regulator. These should be considered for issuance at an early date to maintain standards of evaluating claim liabilities by all insurers in a uniform manner.
 5. The Insurance Act 1938 should be amended to make punishments by the IRDA deterrent enough after identifying the category of breaches of regulations applicable to the insurers and brokers.
 6. The General Insurance Council of the Insurance Association of India must be activated to perform its designated functions under section 64L of the Insurance Act, 1938. The Committee recommends that the Council should lay down rules for the conduct of its affairs including the standards and practices for compliance by its members. In case of any difference the majority view should prevail. These should be reviewed and updated from time to time. It should further publicize the standards and practices for the information and benefit of the insuring public. It should have a compliance cell and any violations/deviations should attract corrective action. It may be useful for the Council to examine the standards and practices of the UK General Insurance Standards Council as a guide.
 7. A Secretariat should be set up by the General Insurance Council to act on all administrative matters that have an impact on the quality of the services provided to policyholders. Issues of wrong and illegal practices by the insurers should be investigated and reports submitted for decisions by the Council, under advice to IRDA. The Secretariat should also be engaged to arrange market surveys to determine customer preferences and how they perceive the services rendered and to create risk awareness in the public. It could act as a self-regulatory grievance redressal body as well.
 8. It is understood that the Chairmanship of the General Insurance Council is currently held by Member (Non-Life) of the IRDA. It is recommended that the IRDA should discontinue this convention in the interests of encouraging self-regulation by the Council and to maintain the status of IRDA as an umpire, advisor and regulator. IRDA should not be seen as taking over the responsibilities of the Council.

D. Policyholders' Protection:

- 1. Regulation 4 of the Protection of Policyholders' Interests Regulations, 2002 stipulates that a copy of the proposal should be sent to the insured within 30 days of policy issuance free of charge. It is recommended that the proposal, wherever obtained, and the policy document should form one set and should be sent together.**

This will ensure that a completed proposal form is obtained and that both the insurer and insured know what the proposal contains and what information the insurer has waived. This will reduce delays in consideration of claims and is a good practice.

- 2. The definition of 'proposal form' in the regulations should be revised to specify that it is not only a form that is used to ask information from the proposer to determine the risk factors, but the proposal itself should contain and highlight the broad benefits of cover, major exclusions and cancellation conditions offered to the proposer by the insurers. The duty of disclosure has to be reciprocal.**

Informational gaps between what is offered and what is accepted and understood needs to be bridged at the stage of completion of a proposal form that forms the basis of contract.

- 3. Regulation 5 of the Regulations for Protection of Policyholder' Interests Regulations, 2002 needs to be amended and made stringent. The existing in-house Grievance redressal machinery of the insurers should be strengthened to deal with the mounting customer complaints.**

It is recommended that external insurance/judicial/technical experts, of the choice of insurers, be compulsorily associated with the in-house committees of grievance redressal officers of insurers, at all major centers of operation and the committees should meet at least once a month, if not more frequently, and review customer complaints received in writing. Such a panel should be encouraged to issue speaking orders on their decisions. The redressal machinery should be empowered to compensate consumers for the hardship when insurers are at fault.

Referral Fee/Charges for Marketing Intermediaries

This chapter deals with the Terms of Reference number three i.e. referral fees/charges for Cooperatives, Panchayats,, Banks, NGOs and other marketing intermediaries with specific reference to their roles and functions.

4.1 Designing affordable and need-based insurance products of value and benefit to those living particularly in the rural areas, has been a priority goal of the insurance industry ever since general insurance was nationalized in 1973. Numerous initiatives taken by financial institutions and banks, and the unrelenting emphasis of the Government on raising the living standards of rural population by creation of self-employment opportunities, have led to development of rural markets. The thrust of these efforts was to provide income-earning opportunities, not related to farm incomes, for a majority of the population that was willing to take loans, subsidies and ultimately become self-reliant.

4.2 The rural scene has changed dramatically with exposure to modern television and cellular telephony. With emphasis on educating the young and organizing the women folk to be centres of productive enterprises through self-help groups (SHG), the non-farm income generation has taken a big leap forward. With micro-credit facilities, made available at concessional rates of interest, over a million SHGs, covering 12 million poor households, have sprung up all over the country, accessing credit from rural banks. The total credit disbursed is Rs 21,100 crores.

4.3 The SHG linkage programme has emerged as the largest and fastest growing micro business programme in the world. The repayments have been over 95%, and 90% of the beneficiaries are women, who are otherwise deprived of any credit. The banks have realized that there is a strong business opportunity for them in dealing with the poor. Even the banks have touched only 37 million productive enterprises against a total estimated of 145 million. There are over 500 NGOS arranging micro-finance facilities. Various firms like the Hindustan Lever, ITC, TTK, Nirma, Arvind Mills etc., have already revolutionized the rural segment creating demand for the consumer durables and FMCGs they market. Statistics abound demonstrating that the non-farm income is 50% of the total income.

4.4 Though insurers started off well in the 80s and early 90s to get involved in selling rural insurance covers, backed by advances from financial institutions, their interest in tapping rural markets seems to have waned in recent times. The agency commission for rural business was raised to 15% while pegging it to 10% or 5% for urban segments. When the private sector multinational giants are optimistic of creating opportunities to make the rural market sales even bigger than the urban segments, wherein competition for goods and services is proving costly, tough and crowded, the insurers have yet to survey the market opportunities and the potential for rural business.

4.5 The rural markets for insurance can be tapped primarily with the help of the groups and committed organizations already entrenched in rural pockets such as rural banks, District Cooperative banks, NGOs, SHGs, multinationals etc., that are already selling their products in rural areas. It is neither easy nor realistic to offer agency appointment incentives to these organizations. Also, it is the insurers that are in need of

their assistance and not vice versa. For development of rural insurances, a referral fee arrangement is the best as a concept easily understood without strings attached and can be immediately implemented with suitable safeguards.

4.6 In a referral system, even though the customer database is made available to an insurer, it is for the insurer to leverage the advantage into realizable business. The proper method of referral fee/ charge payable is on the business realized and not on obtaining the customer database. The IRDA circular issued on 30th January 2003 permits insurers to pay banks a referral fee equal to the agency commission. How this agency commission is to be determined in the absence of realized business is not spelt out.

4.7 The Expert Committee considers that the referral fee equivalent to agency commission payable to banks and other similar corporates is inappropriate. Under the referral arrangement the bank does not perform either the functions of an agent in advising customers or render any claims servicing. Nor is it easy to determine the amount of business realized to justify such a referral payment. Also, the composition of the customer base is heterogeneous consisting of corporate bodies, individuals and others making the realized business difficult to determine. Either or both can misuse such a referral system.

The Committee recommends that referral system should not be permitted in the case of banks and similar corporates. The circular of IRDA issued on 30th January 2003 should, therefore, be withdrawn.

Rural Agencies:

4.8 The Expert Committee has been asked to examine the feasibility of referral fee/charges arrangements in the context of Cooperatives, Panchayats, Banks, NGOs and other such marketing intermediaries. Referral fee is a suitable method instead of corporate agency for these intermediaries to spread insurance awareness.

The basis of payment of the referral fee is spelt out in the recommendation made. Referral agencies have been treated as 'Centres of Influence', but of their own membership. This has been done to avoid malpractices in payment of referral fees. NGOs and other similar social service organizations were considered for eligibility for referrals, but since they do not have a defined membership of their own, the Committee felt that there could be misuse of the referral system by interested parties. This is because such organizations could always promote other beneficiaries of defined groups to buy insurance through referral procedures.

4.9 Recommendations on Referral Fees/ Charges:

1. The Committee considered the issue of payment of referral fees as a concept, at length, and concluded that an organization by merely making available its customer database to an insurer should not qualify for receipt of any referral fee. It is difficult to determine the basis on which the fee can be worked out. Further, it is also not possible to determine the extent of converting the prospects into policyholders. Also, since the customer base is heterogeneous it requires special computation in order to work out the commission payable. As such, there are a number of inherent loopholes to misuse the system by either of the parties or both.

In view of the basic inadequacies in the referral system, the Committee recommends that referral, as an intermediary channel mechanism should be avoided. As such the circular of IRDA issued on 30th January 2003 and subsequent directions in this regard, if any should be withdrawn in respect of banks and similarly placed corporates.

2. Notwithstanding the above, the Committee recommends the referral fee/charge arrangement to develop mainly rural insurances with certain safeguards in accordance with the revised definition of 'rural' suggested by the Committee. Such an arrangement should be made only with groups that are registered and subject to a written agreement between the insurer and the group, and for purposes of making available their customer database for soliciting the business of their members only. The fee should be paid only on the business realized and booked. Such a fee should not exceed 7.5% of the premium charged and collected. No other remuneration or commission should be incurred on such arrangements. The written agreements should have the prior approval of the Head / Controlling ROs of the insurer who will submit quarterly statements to the IRDA giving the names of the groups. The agreement should be limited to a period of one year. The Head / Controlling ROs should approve renewals of agreements based on satisfactory performance. The referral fees should form a part of management expenses.
3. Corporate Agents, particularly banks, while entering in to agency arrangements should be made aware of the legal obligations arising out of the conflicting interests and suitable reassurances should be given by the insurers in the MOUs that are signed between them.
4. The definition of what constitutes a rural area should be based on census and should be revised to an area with a population up to 30,000.
5. All insurers should be asked to devise simple standardized identical rural policies, at affordable premium rates, with identical advantages, terms and conditions for rural segments to be made available, in local languages, so that these individual policies do not confuse the buyers of what is covered and what is not. Credibility of insurers on product information and settlement of claims without delay are essential to earn the trust and acceptance of the rural folk.

Other Recommendations

The Committee has been asked to make recommendations under Terms of Reference number five on any other matter considered relevant for the market conduct and its long-term development. Quite a few matters, even indirectly impinging on the terms of reference, have been dealt with under the respective topics on which recommendations have been sought more specifically.

Matters that were raised before the Committee but have not been dealt with till now are Reinsurance and the present business practices, the role of Representative and Liaison offices of foreign players, tariff breaches by insurers, statutory cessions of 20% to the GIC and IRDA as an adjudicator on claims. The Committee has dealt with them in this chapter. The subject of Composite Broking has been dealt with to make a specific recommendation.

Composite Brokers:

5.1 It is not uncommon for composite brokers to deal with customers, particularly of mega risks, as direct brokers and collect underwriting information and present it directly to reinsurers, circumventing or marginalizing the direct insurer. That this has happened even in the earlier monopolistic regime is known. But licencing them in the current regime gives them recognition. The licensing norms of composite brokers should, therefore, be amended, and no further licensing of composite brokers should be permitted. Those that have been permitted should be informed that at the time of renewal they should seek separate licenses with separate business structures.

The composite broker represents the insured as a direct broker, and simultaneously represents the insurer as its reinsurance broker. He gets paid twice for his services and advices to two risk carriers on the same risk.

National Retention Capacity:

5.2 One of the objectives of the Reinsurance programmes of insurers is to maximize retention capacity that is desirable for the development of the national market. Reinsurance brokers, aided occasionally with the help of international insurance companies and reinsurers, ask the direct insurer to front for them on marginal commissions. This practice renders the national insurance and reinsurance retention capacities underutilized, causes an outflow of foreign exchange and prevents the market from learning to underwrite complex and highly technical risks.

According to the Regulations enacted on reinsurance placements, both for treaty and facultative placements, every insurer is directed to submit its reinsurance programme within 45 days, before the commencement of the financial year; and subsequently file the finalized programme with the IRDA within 30 days of the commencement of the financial year. The reinsurance arrangement should be concluded with reinsurers who have a rating of at least BBB (with Standard & Poor or a similar agency) for five years. No reinsurance on facultative or treaty is to be placed outside unless it is offered to the domestic market first as matter of routine.

It was brought to the notice of the Committee that there have been frequent breaches of the above regulations. It is not made known if the IRDA has been advised of the difficulties encountered in their implementation by the insurers concerned and whether its permission has been sought for the unavoidable infringement of Regulations.

Since reinsurance markets abroad are currently in a state of turmoil, it is important that the regulations are scrupulously implemented in the interests of the financial health of the insurers themselves who are answerable to the policyholders. No regulations assume as much importance as those made on reinsurance. The attention of the IRDA is drawn by the Committee to ensure strict compliance of the reinsurance Regulations in the future in order to exhaust the available national insurance capacities.

Facultative placements:

5.3 Facultative placements, the Committee was informed, are occasionally placed abroad, without either offering them first to the domestic market or getting the market exhausted as required. Looking into the fact that the existing regulation has been observed in breach occasionally, it is proposed that the said regulation be reworded to ensure that all facultative placements are compulsorily circulated to all the market players in writing by offering reinsurance, and any failure to receive a reply within 48 hours of the offer should be taken as proof of their declinature. Such facultative placements abroad should be routinely informed to the IRDA by way of information per risk. It is imperative that the market facility should be exhausted before placements are sought to be made abroad.

It would appear that the market is lacking in cooperative efforts, and individual insurers' interests over those of the market seem to prevail in placements on occasions. Such misplaced emphasis of carrying on insurance business will be prejudicial to the reputation of the market, apart from harming its future interests.

Tariff breaches:

5.4 It is also reported that serious breaches of tariff involving substantial amounts are committed, depriving the market of premium and making the market lose credibility with reinsurers abroad in respect of cessions made to them. Such lapses need to be identified and dealt with severely. The penalties to be levied for such breaches should be severe. The Board of directors of insurers should be made aware of the breaches committed for corrective action.

Statutory Cessions:

5.5 20% of each risk underwritten in India is offered to the GIC as a statutory cession. This practice has worked well in the past. With the de-linking of the four public players from the GIC, differences in the approach amongst them and the GIC and as between the private players and the GIC on the statutory cessions seem to have cropped up. There has been no mechanism to mediate and settle the differences amicably. Within the existing laws and Regulations, it is the General Insurance Council that should resolve the differences within a time frame. If not settled, they

should be compulsorily referred to the IRDA for final rulings that shall be binding on them.

It is also necessary to consider if the statutory cessions in a liberalized market is in keeping with the spirit of it. The GIC, as the national reinsurer, should develop business on its own. Compulsory cessions have created a readymade market for it. If national insurers have to develop their premium retention levels in keeping with their net worth, they should be encouraged to devise reinsurance programmes as needed by their requirements. The objective should be to ensure national retention capacities are fully utilized both for treaty and facultative reinsurances. As long as this principle is upheld, there is a strong case for progressive reduction of statutory cessions from the level of 20% to taper off at the rate of 5% annually to commence from a date to be agreed upon.

In such an event insurers must cooperate even more with the GIC and with each other in exhausting the combined national retention capacities before making placements abroad.

Representative Offices of foreign players:

5.6 Reinsurers, insurers and brokers and their affiliates from abroad are allowed to set up representative /service offices in India by the RBI with the limited objective of studying the market. But in practice a possibility does exist that they could carry out functions beyond their mandate. IRDA should consider bringing them under its regulatory jurisdiction to monitor their operations. The context under which these offices have been allowed to be set up need revalidation by the IRDA.

IRDA & claims settlement:

5.7 Section 64 UM (E)(3) and (4) The Insurance Act 1938 provide for IRDA to act as a sole arbitrator on claims. There are a host of legal mechanisms available to deal with delays in settlement of claims. With the known preference of claimants to get the attention of the IRDA, its offices will be flooded with several complaints needing more attention than it could handle with a reasonable speed and efficiency. With brokers added as an independent entity, the brokers themselves could be active participants in lodging complaints against insurers. The Committee understands that a Consultative Committee for the Authority is required to be set up under section 110 G by the Government. An Appellate Authority under section 110 H has already been set up. It is therefore necessary that the Consultative Committee is set up on a priority basis to deal with issues specified in section (3) of the section 110 G.

5.8 Recommendations:

- 1. The Committee considers that the present system of licencing Composite Brokers that deal with direct broking and reinsurance broking as one arm will prejudice the development of the market and consumer interest. In a non-tariff market the Composite Broker could tie-up reinsurance arrangements at lower rates and bring pressure on the primary insurer to front for the business. Such practices in developing markets are quite common. There is a conflict of loyalty as the composite broker works for the insured and the insurer as well. Hence licencing Composite Broking should be discontinued.**

- 2. Licencing norms for Composite Brokers should be reviewed and no more licences should be granted under this category. Existing Composite Brokers should seek separate licences with separate business structures for the two types of broking, direct and reinsurance, at the time of renewal or before.**
- 3. Regulations currently in place on reinsurance should be effectively enforced with reference to the timing of filing information and the credit rating of reinsurers. National retention capacity should be fully utilized and procedures for its verification should be laid out.**
- 4. Facultative placements abroad should be allowed by IRDA only after an insurer has satisfactorily demonstrated that it has exhausted the domestic market.**
- 5. Breaches of tariff and regulations by the insurers should be reported to the highest corporate level and punishments by IRDA/TAC should be severe.**
- 6. In a liberalized market there should not be any stipulation regarding the statutory cessions to the GIC. Although it is appreciated that this cannot be dispensed with immediately, a scheme of progressive reduction in the levels of statutory cessions should be considered. Suitable enactment should be provided for the same. GIC, as the Indian Reinsurer, needs to redefine its role in a liberalized set up and should develop a strategy wherein it can offer the required reinsurance capacity on a voluntary basis.**
- 7. The role, functions, responsibilities and accountability of Representative and Liaison/ servicing offices of foreign insurers as also the foreign reinsurers in India, presently licenced by RBI, need a critical review and reaffirmation of their usefulness in the best interests of the Indian market. For this purpose they should be brought under the jurisdiction of the IRDA for their operational continuance.**
- 8. The Committee is of the view that the Authority should take up the constitution of the Consultative Committee in terms of section 110 G of the Insurance Act, 1938 with the Central Government. It is understood that the Government has already constituted an Appellate Authority under section 110 H of the Act to review the decisions taken by the Authority under section 110 G. This makes it all the more necessary that the Consultative Committee for the Authority is constituted by the Government on a priority basis to examine all matters provided for in the sub-section 3 of Section 110 G. The Authority may consider this matter and take necessary action.**

A Note on Important Regulatory and Other Changes Proposed by the Expert Committee

The Committee has made a number of recommendations that would need a review and amendments to the present regulations. While the list below is not an exhaustive one, it was felt an indication should be provided for a quick perusal of the same by the IRDA.

1. Linkage of special discount with the revised paid-up capital norms of corporate bodies, the revised agency/ brokerage remuneration and access to Public Sector clients needs an appropriate decision and follow-up action.
2. Licensing norms for brokers on qualifications and experience to be revised. Composite broking to be discontinued. Opening of additional offices by brokers, recruitment of persons for soliciting business need to be regulated. Brokers should be allowed to practice, though licenced, only after the PI policy has been filed. Collection of data and information from brokers to be regulated and a database to be built up in the office of IRDA on insurers and brokers.
3. It was pointed that brokers render services such as risk inspections and professional consultancy guidance to customers/ prospects and such services may not always result in realized business for them. Would the brokers in such instances be entitled to charge consultancy fees from the beneficiaries of such services? It is the view of the Committee that such rendering of services are a part of the marketing efforts by brokers and they should not claim any fees or remuneration for them. The duties and functions of brokers are clearly laid down. The IRDA may clarify the intended position in the interests of all concerned.
4. Harnessing agency force for developing insurance markets through revised regulatory training and retraining norms, and tightening of regulatory systems for monitoring their performances with a view to enhancing its capabilities for the future. Insurers should file annual reports on the efficacy of the force as a distribution channel.
5. An issue that came up before the Committee was the payment of service tax by insurers on the commission paid to agents. Where the regulator has prescribed the maximum commission payable to agents, would payment of service tax in addition by insurers amount to a breach of regulations. This aspect may be examined and suitable instructions issued clarifying the position.
6. A road map for dismantling the tariff regime needs to be pursued on a priority basis. Insurers to start building statistical bases on their acceptances by regulation in an accepted format and to cooperate on Pure Risk rate computations. TAC to be mandated on its specified responsibilities to organize the system.
7. Corporate governance norms for insurers to be specified, which should also inter alia include disclosing the expenditure on such category of expenses that may be used to channelize rebates and kickbacks along with confirmation about their satisfaction on the expenses so incurred. Boards should also certify on the compliance of Regulations in force governing the conduct of insurers.

8. Quarterly un-audited financial statement within 60 days of the quarter ending and annual financial statements with disclosures as per the provisions of the Companies Act to be published in newspapers as a best practice.
9. Actuarial valuation norms for computation of outstanding claims and incurred but not reported claims to be spelt out for uniformity of accounting incurred claims.
10. A Secretariat for General Insurance Council of the Insurance Association of India should be set up as a self-regulatory mechanism for laying down standards for market conduct, control of expenses and redressal of customer complaints and improving customer services.
11. A Tripartite Consultative Council, brokers and consumers to be set up as an advisory body to recommend setting up conventions, guidelines and precedents for the healthy growth of market. The role and functions of such a body to be developed by IRDA after a consultative process.
12. A Standing Committee on Procedures and Performance Review to be set up by IRDA for internal monitoring and reviewing the effective implementation of all current regulations in addition to suggesting amendments on a continuing basis. Outside specialists in each area should be associated with the Committee.
13. IRDA should be enabled to outsource monitoring the implementation of regulations with suitable safeguards built in to protect confidentiality of information shared. Breaches of regulations, when reported in writing should be investigated for action.
14. Protection of Policyholders Interests Regulations, 2002 to be amended for proposal to accompany policy, redefine what a proposal form is, reorganize the in-house grievance redressal mechanisms for effective functioning and revision of the definition of what constitutes a rural area.
15. Referral fees/charges and eligibility norms to be notified.
16. Tighten regulations on placement of reinsurance by insurers within the country to utilize the national retention capacity by expanding the procedures on their implementation.

At Hyderabad
12th day of December 2003.

G.V. Rao
(Member)

A.C. Mukherji
(Chairman)

K.N. Bhandari
(Member)

APPENDICES

Appendix 1: Notification and Terms of Reference	70-72
Appendix 2: List of Abbreviations	73

Appendix 1 Notification and Terms of Reference

1st September 2003

IRDA/CIR/023/2003

RE: Constitution of an Expert Committee for examination of remuneration structure of insurance brokers, agents and other intermediaries in general insurance business-Terms of Reference

The Authority has been in receipt of representations from various interests such as insurers, insurance consumers, field officers of insurers, chambers of commerce and Members of Parliament on its Notification/Order dated 30/05/2003 which modified its earlier notification of 22/03/2003. The impugned notification was made effective from 15/06/2003 and it withdrew the facility of 5% discount earlier being paid in all classes of business to non-public sector entities and also stopped brokerage or commission payment in respect of business emanating from public sector undertakings (defined as Government companies under Companies Act). The insurer, in the later case was permitted to grant 5% discount on the face of the policy if he so chooses.

We examined the representations and concerns shown on the subject and decided to keep the said notification under abeyance with immediate effect and issued orders to that effect vide notification dated 16/07/2003. Since, the subject in question relates not only to special discount, agency commission, brokers' remuneration, differential rates/scales of procurement of insurance business, rebates etc but to wider range of issues, it has been decided to constitute the following Expert Committee with immediate effect to deliberate **on the enclosed Terms of Reference** with all the relevant sections and parties interested to the said terms.

- 1) Shri A.C. Mukherjee, Chairman of the Committee
- 2) Shri K.N. Bhandari, Member
- 3) Shri G.V. Rao, Member

The committee is requested to furnish its recommendations by 31/10/2003 in respect of Term No.1 and for the remaining terms by 31/12/2003 to enable the Authority to take appropriate decision to protect the interests of policyholders and for orderly development of insurance market.

The Chairman and members of this committee will be paid a sitting fee of Rs. 1000/- and conveyance of Rs. 400/- per day in addition to reimbursement or payment of expenses towards their stay and air travel (economy class) at the venue of the meetings and usual telephone expenses incurred in connection with the conduct of business on the terms of reference.

Secretarial services to the committee would be provided by the Authority. The Committee shall have its headquarters in Hyderabad and may hold meetings at other centres within India. Mr. Prabodh Chander, Executive Director and Mr. Arup Chatterjee, Deputy Director would be the nodal officers of the Authority to coordinate and provide necessary assistance to the committee.

(C.S. Rao)
Chairman

Copy to:

- 1) Shri A.C. Mukherjee, Chairman of the Committee; Address: 10/2, Hungerfort Street, Kolkata 700 017
- 2) Shri K.N. Bhandari, Member; Address: 5, New Power House Road, Jodhpur-342 003
- 3) Shri G.V. Rao, Member; Address: 106, Shanti Nagar, Hyderabad-500 028
- 4) Shri Prabodh Chander, Executive Director and Shri Arup Chatterjee, Deputy Director, IRDA
- 5) CEOs of all Non-life Insurance Companies - with a request to render the necessary cooperation, assistance and have interaction with the committee on a priority basis for better market conduct to be practiced.

(C.S. Rao)
Chairman

**Expert Committee to examine remuneration system
For insurance brokers, agents etc. in general insurance business**

**Terms of Reference
1st September, 2003**

1. To make specific recommendations:

whether the 5% discount in lieu of agency commission and remuneration presently enjoyed by the certain segment of policyholders should continue or discontinue or modify in any other form in the interest of future growth of insurance market.

Whether any special dispensation is required to be given for Government , PSUs and Corporate Clients.

Whether there should be linkage of this discount/commission/remuneration with the paid up capital concept of the insured.

Whether the kind of commission/remuneration encourages rebate and its effects on business development and procurement cost as compared to the services to be rendered by the intermediaries.

Whether there should be a differential rate of Commission/remuneration to agents/brokers in general and with special reference to health insurance, personal lines, social and rural sector insurance business.

2. To examine the role of intermediaries viz. Agents and brokers in the current insurance market scenario and to make suitable recommendations -

clarifying their utility to the future growth of the insurance industry in spreading risk awareness and widening the customer base in respect of both tariff and non-tariff business.

On the value added services to be provided to justify compensation received in terms of commission and brokerage.

On the regulatory safeguards to be considered to eliminate unhealthy practices of rebating and other undesirable market practices inhibiting competition by fair means.

3. To examine the feasibility of referral fee/charges arrangements in the context of Co-operatives, Panchayats, Banks, NGOs and other such marketing intermediaries while specifying their role and duties.

4. If any legislative / regulatory changes are needed in pursuit of the objectives.

5. Any other matter as the committee may consider relevant for the market conduct and long term development of the distribution channels by creating an efficient and viable intermediary channel-mix in the best interests of the future growth of the market, the insurers and the insuring public.

(C. S. Rao)
Chairman

List of Abbreviations

CVC	Central Vigilance Commission
FMCG	Fast Moving Consumer Goods
GIC	General Insurance Corporation
IRDA	Insurance Regulatory And Development Authority
LIC	Life Insurance Corporation
MOU	Memorandum of understanding
NGO	Non Government Organisation
PBT	Profit Before Tax
PI	Professional Indemnity
PSU	Public Sector Undertaking
RBI	Reserve Bank of India
RO	Regional Office
SHG	Self Help Group
TAC	Tariff Advisory Committee
TP	Third Party
VRS	Voluntary Retirement Scheme

Acknowledgements

The Expert Committee wishes to thank the Chairman IRDA in having agreed for it to produce one report instead of two, as envisaged earlier. It was felt that the two terms of reference are inter related and the objectives of the study would be better served if the time gap for the final submission was reduced for the second term of reference while extending it for the first one.

The Expert Committee wishes to acknowledge the help, assistance and co-operation it has received from several sources.

In particular, the officials in the offices of the IRDA at Hyderabad and New Delhi have been helpful in supplying the information required by the Committee.

The GIC at Mumbai and the National Insurance at Kolkata have made their offices available for the personal discussions between the Committee and other parties wishing to make representations.

Many persons, who could not meet the Committee in person, have sent e-mails and letters explaining their viewpoints. Several others have taken the trouble to personally meet the Committee to represent their views and have offered valuable suggestions in person.

Since the Committee has met individuals and representatives of associations in the four metros only, many others have not had the opportunity to meet the Committee in person. But the benefit of their correspondence has assisted the Committee immensely.

The Committee would like to make a specific mention of the contribution made by its member Mr. G. V. Rao in the collection of the background information and providing the Committee with valuable analysis. He has also accepted the onerous responsibility of producing the first draft of the report. This has facilitated and helped in the early completion of the report to the standards that we wished to achieve.

The Committee would like to thank Mr. Prabodh Chander and Mr. Arup Chatterjee of IRDA for the excellent support and assistance given to it. They have been of invaluable assistance to the Committee.

The Committee thanks all the persons, associations and trade bodies that have so generously given us their time and shared their viewpoints quite candidly in their meetings with it.