2020

REPORT OF THE WORKING GROUP TO REVISIT THE IRDAI (OBLIGATION OF INSURER IN RESPECT OF MOTOR THIRD PARTY INSURANCE BUSINESS), REGULATIONS, 2015

20th April, 2020

Letter of Transmittal

To **20.04.2020**

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Hyderabad

Madam,

Subject: Report of the working group to revisit the IRDAI (Obligation of Insurer in respect of Motor Third Party Insurance business), Regulations 2015

This has reference to the office order no. IRDAI/NL/ORD/MOTP/149/08/2019 dated 28.08.2019 vide which the Working Group to revisit the IRDAI (Obligation of Insurer in respect of Motor Third Party Insurance business), Regulations 2015 was constituted.

The Committee is pleased to submit the report.

1. **Ms. Anita Josyula**, General Manger (Non-Life), IRDAI, Chair
2. **Ms. R Uma Maheshwari,** Deputy General Manager (F&A – Non-Life), IRDAI, Member
3. **Mr. Basudev Sanyal**, Chief Manager, United India Insurance, Member
4. **Mr. K. B. Behera**, Chief Manager, National Insurance, Member
5. **Mr. Loknath Kar**, Chief Compliance Officer and Legal Head, ICICI Lombard, Member
6. **Mr. V. Suryanarayan**, President & COO, Cholamandalam MS., Member
7. **Mr. B. Subramanyam Brahmajosyula**, Head Underwriter and Reinsurance, SBI General, Member
8. **Mr. A. Shrihari**, Manager (Non-Life), IRDAI, Member & Convener

Acknowledgments

The Working Group (WG) formed to revisit the IRDAI (Obligation of Insurer in respect of Motor Third Party Insurance business) Regulations, 2015 ("Regulations"), would, at the outset, like to thank the Chairman, IRDAI, **Dr. Subhash Chandra Khuntia** for giving opportunity to the WG for examining the various aspects of these regulations. The WG would also like to thank the Member, IRDAI, **Ms. T Alamelu** and Chief General Manager (Non-Life), **Ms. Yegnapriya Bharath** for their constant guidance and support. We would also like to give our special thanks to Assistant Manager (Non-Life), IRDAI, **Mr. Sagar Bangal** and Motor-Head, IIBI, **Mr. Jacob Thomas, who have been a backbone** to the WG.

The WG considers it as a privilege to work on this important area of Motor Third Party Insurance and bring out this report.

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CHAPTER I

INTRODUCTION AND BACKGROUND

1. Motor Third Party Insurance is for the larger protection of the citizens of India using the roads and is meant to ensure appropriate compensation to the unfortunate victims of road accidents. However, India is one of the lowest penetrated Motor Third Party Insurance markets in the world, which is paradoxical to the fact that India figures at the top quartile in the list of developed/developing countries when it comes to absolute population of motor vehicles and density of vehicles per kilometer of road. *[For the purpose of this report, penetration is defined as ratio of number of insured vehicles to number of vehicles on road]*

2. As per Section 146 of Motor Vehicles Act [MVA] (1988), Third Party (TP) liability insurance of all motor vehicles is compulsory, but non-insurance of motor vehicles is a hard reality. In a report published by IIBI it is observed that out of around 22 crore vehicles plying on the road in India as on 31st March 2019, the percentage of uninsured vehicles is at nearly 58%. The uninsured vehicles largely comprise of Two Wheelers and this is quite obvious as nearly 70% of the total vehicles in India consist of Two Wheelers. In this class nearly 63% for the vehicles remain uninsured whereas Private Cars are largely insured and the uninsured number is quite low at around 10%. However, the number of uninsured vehicles under Commercial Vehicle category is on a higher side, ranging to around 45%. Ironically, the risk of accidents are high for both Two Wheelers and Commercial vehicles.

3. The percentage of vehicles which do not renew their insurance after the first year is menacingly high at 52% on an average which is again due to the fact that Two Wheelers fall out of the insurance net at the time of first renewal of the insurance policy.

4. This issue has been on high priority for the Authority and various regulatory interventions have been introduced at various periods in time to redress it. The General Insurance business was de-tariffed in the year 2007

but the Motor Third Party Liability (TP) insurance was still regulated in line with the compulsory nature mandated by Motor Vehicle Act. It was also a fact that Insurers were focusing their efforts on the other products but due to high losses in the TP segment there was inertia on distribution, for this line of business. The basic premise of the problem for insurers was that premium were limited but the liability was unlimited which made assessing liability quite difficult and on the whole a severe adverse claims ratio for this segment.

5. To address the supply side issues, a pooling mechanism called Indian Motor Third Party Insurance Pool (IMTPIP) was introduced in the Financial Year 2007-08 as an instrument to increase availability of TP insurance at reasonable rates to commercial vehicle owners. The basic premise was that no insurer should refuse writing TP business and all the premiums & losses could be pooled to create a common multi-lateral reinsurance mechanism.

6. The premiums of TP for commercial vehicles were to flow into this pool and claim pay-outs were to be done from this pool. This mechanism had its own limitations and challenges. One, the pooling mechanism was based on the market share of the individual insurers for allocating losses and Two, there was an incentive to underwrite vehicle imprudently in an effort to increase the market share especially for the newer companies. This resulted in mixing of good and bad business and companies had no control or incentive over the portfolio and this led to further deterioration in the performance of the segment.

7. In light of the above, IMTPIP was dismantled and was replaced by the Motor Declined Pool. It was a more focused pooling mechanism which gave the companies independence and responsibility to write business as per their underwriting guidelines but at the same time non-refusal to write any business. Therefore all declined proposals by a company in line with their underwriting guidelines could send such business to this common pool.

8. Meanwhile the Authority issued regulations which specified the insurers to underwrite minimum obligations in respect of Motor Third Party Business in line with the section 32D of the Insurance Laws (Amendment) Act of 2015. The Section 32 D of the Insurance Amendment Act, 2015, prescribes an obligation on part of the General insurers of the country to ensure underwriting at least a minimum motor third party business every year. The provision reads as under:

   "32D. Every insurer carrying on general insurance business shall, after the commencement of the Insurance Laws (Amendment) Act, 2015, underwrite such minimum percentage of insurance business in third party risks of motor vehicles as may be specified by the regulations: Provided that the Authority may, by regulations, exempt any insurer who is primarily engaged in the business of health, re-insurance, agriculture, export credit guarantee, from the application of this section."

9. While prescribing the abovementioned provision, the intent of the legislature is obviously to eliminate supply side scarcity of Motor third party insurers for the purpose of driving penetration of motor third party insurance in India. Therefore, the regulation to be prescribed by IRDAI under the provision (as envisaged under the statue i.e. *…as may be specified by the regulations")* has to ensure the same is in line with the prescriptions in the statute and intent of the legislature.

10. Therefore, to merge the two mechanisms of ensuring availability of TP coverage, the Declined Pool was dismantled from 1st April 2016 and it was decided that defining TP obligations of each insurer would be the way forward thereby giving rise to the IRDAI (Obligation of Insurer in respect of Motor Third Party Insurance business) Regulations, 2015.

CHAPTER II

NEED FOR REVISITING THE EXISTING REGULATIONS

1. The existing Regulations notified by the Authority on 2nd June, 2015 have provided an experience of more than 4 years. Also, in light of the recent Supreme Court judgement on issuance of Long-Term Motor Third Party (TP) policies as well as certain concerns raised by various stakeholders on the current structure, need for review of the Regulations has emerged.

2. The concerns raised / observed being:

   a. The present formula does not indicate or monitor the penetration i.e. percentage of insured vehicles to total vehicles plying on the road
   b. The present formula does not ensure increase in penetration under each category of vehicles
   c. The treatment of Long term Motor TP policies is not addressed
   d. Motor TP obligations are not known to the General Insurance companies until middle of the financial year, thereby making it difficult for the insurer to plan their obligations well in advance.

3. The prevailing annual motor third party obligation of the insurers under these regulations is based on the quantum of premium collected by the insurers on any given year out of motor third party business. However, keeping in view the facts narrated below, the premium collected by the insurers out of motor third party business was considered neither representative of the market penetration of motor third party insurance nor to drive the impetus for increasing penetration desired in the motor third party insurance:

a. The premium difference between vehicle segments are very high. Therefore, collection of larger premium does not necessarily represent insuring larger number of vehicles, and
b. It did not consider the class of vehicles and the number of policies being done. Thus, Two Wheelers which formed the bulk of vehicles plying in the country could not be brought into the insurance net, implying the issues of demand and supply side still remained.

4. In an environment where the demand side is weak, requires efforts to pad up the supply side and therefore insurers focusing on distribution and reach of Motor TP business become the key. The flip side of the supply side weakness is the chronic problem of uninsured vehicles in the country, especially Two Wheelers.

5. India today is one of the largest auto markets in the World with nearly 20 million vehicles sold annually, simultaneously it is also one of the leading countries in terms of road accidents and the fatalities arising from it. In this grim scenario, it is a double whammy when more than half of the vehicles in the country are uninsured. Two Wheelers contribute a major chunk of uninsured vehicles and yet nearly 25% of the total TP claims reported are caused by Two Wheelers. This is a major concern and menace.

6. As mentioned in section 2 of chapter I, the rate of un-insurance is astonishingly high in India. Therefore, the key to addressing this issue is to increase diffusion of insurance based on the class of vehicle and lay a roadmap to cover all uninsured vehicles over a period of time. In the chapters later, a formula has been suggested which takes care of the uninsured vehicles that needs to be brought to the insurance net which becomes the obligation of the Industry and thereby based on the market share the obligation is shared by the individual insurers. An effort has been made for the formula to be equitable, pragmatic and flexible so that the underlying objectives as enumerated above are achieved.

7. Also, the current MTP Obligation is not known to the Insurers in advance as the audited data required for the formula is not available till the middle of the financial year thereby making it difficult for the Insurers to have a well set out plan for MTP obligations in advance. Therefore, a standard and static formula which will help the insurers to self asses their obligation at any point of time in the year without any regulatory intervention was needed.

8. Taking the above into consideration, it was necessary to revisit the existing regulations and streamline them to achieve the larger goal of increase in MTP insurance penetration, keeping the convenience of all the stakeholders

CHAPTER III

PROCEDURE FOLLOWED AND FORMULA

Part A

1. While determining obligation of insurers and prescribing the same by way of a regulation for insurers to underwrite minimum percentage of motor insurance business year on year, it is expected and obvious that the method of determination has to be **simplistic, equitable, consistent and time tested**. The only approach possible to ensure the same could be a method of determination by way of a **standard formula**. A formula devised with appropriate consideration to the prevailing environment and that delivers the intended result consistently for a considerable period of time without any need for frequent changes.

2. In view of the above and the needs as mentioned in chapter II, a new formula was warranted that would truly reflect enough supply side motivation to facilitate increase in the penetration. Besides, all vital ratios of the Government of India with respect to monitoring motor vehicles are in terms of the count of the vehicles such as vehicular population, vehicular density etc. Therefore, motor third party insurance being an integral part of every individual vehicle, the monitoring of insurance of such vehicles (by every insurer) most appropriately should be on the basis of count of such insured vehicles rather than (indirect/derivative) evaluation of premium derived out of insurance of such vehicles. **In short, <u>Obligation should be a function of "number of vehicles insured/uninsured" instead of "premium derived from motor third party insurance business"</u>**

3. Obligation by segments/Classes of vehicles

3.1 It has been observed that the problem of uninsured vehicles in India is mostly because of non-renewal insurance. Insurance being a pre-requisite for registration of the vehicles, every vehicle owner invariably subscribes to insurance during the year of registration.

3.2 However, following the year of registration, the number of uninsured vehicles increases. Such non-renewal of Motor third party insurance has been observed to be different for different class/category of vehicles.

3.3 There is higher possibility that a formula with a cumulative approach would leave the most underpenetrated and risky segment unattended. Therefore, a need is felt to have a broad class/category of vehicles approach with independent emphasis proportionate to the percentage of uninsured vehicles in that class/category of vehicles.

3.4 Further, the natural drive of the insurers to pursue the class of vehicles relatively profitable also creates imbalance and asymmetry in favour of those vehicles. As a result of which, the class of vehicles with lower premium size (that requires higher indulgence and cost) or the class of vehicles with relatively higher loss behavior is left neglected and unattended with increasing numbers of uninsured vehicles in that segment. This might also lead to an imbalance in the distribution of risk among the insurers.

3.5 In view of the above, it may be most appropriate to monitor penetration and motivate insurers to underwrite motor third party insurance on the basis of a broad classification of vehicles such as:

a. Two-wheeler,
b. Private Car, and
c. Others.

Part B

4 Formula for determining the annual motor third party obligation of the insurers

4.1 The most appropriate way to devise a formula for determination of annual obligation of each non-life insurer to underwrite minimum motor insurance business is to start with the insurance policies already underwritten by each insurer individually and the non-life insurance industry cumulatively.

4.2 The number of vehicles insured by any insurer in the previous year or a year before should appropriately be the starting point. However, there could be a situation that the given insurer might have written either more or less than its obligation for that year. In order to ensure symmetry, it may be proper to consider the obligatory number of the insurer in the previous year as the starting point for determination of obligation of any current year.

4.3 Insurance information Bureau of India (IIBI) monitors the number of insured vehicles under different classification and the data so maintained by the IIBI has matured over a period of time to a reasonable accuracy. Based on data available with IIBI, it is in a position to determine the number of uninsured vehicles in the country for any given year.

4.4 In addition to the previous year obligation of any insurer, a small part of the cumulative unregistered vehicles thus determined by IIB should be distributed amongst insurers in proportion of their overall market share (in the year previous to the year of consideration) to arrive at the obligation of the insurer for the year of consideration.

4.5 The vehicles categorized as in the above section 3.5 may have separate obligation as per the formula proposed in the under section 4.6

4.6 In order to express the concept by way of a mathematical formula, the desired formula to determine the motor third party obligation of any insurer for the **"n"th** financial year, in each of the categories shall be:

O(n)	=	**O(n-1)**	+	**{M(n-2)**	x	**V(n-2)**	x	**I }**

Where,
'O(n)' represent the obligations of the insurer in the **n^{th}** financial year

'O(n-1)' represent the obligations of the insurer in the $(n-1)^{th}$ financial year and as explained above it does not refer to the actual number of insured policies in the $(n-1)^{th}$ year;

'M' represents the Gross Domestic Premium Income (GDPI) Market Share of the insurer as on 31st March of the (n-2)th financial year (expressed in the form of a percentage);

'V' represents the number of uninsured vehicles as determined by IIB for the (n-2)th financial year expressed in absolute numbers independently for each broad class of vehicles;

'I' represents the percentage of the uninsured vehicles intended to be insured in the year under consideration.

The Insurance factor '**I**' shall be determined and declared by IRDAI every year for different broad class of vehicles in due consideration to the contribution of that class to the total uninsured vehicles in the country in the (n-2)th financial year.

Therefore, the Insurance factor **'I'** may vary for each category of vehicle defined in the above section 3.5

<u>General Clarification</u>

(a) No separate formula is proposed for long term policies.

(b) For long term policies, the Insurers may take credit for

i) five/three/two years for two wheelers depending on the remaining tenure of the policy for which it is in force and,
ii) three years for private cars depending on the remaining tenure of the policy for which it is in force

Example:

1) Say, a long-term policy of three years is issued in FY 2018-19 and the new regulations come into force in FY 2020-21. Then, the Insurer can take credit of this policy for the following years:

   i. only for FY 2020-21

2) Similarly, if a long-term policy of three years is issued in FY 2019-20 and the new regulations come into force in FY 2020-21. Then, the Insurer can take credit of this policy for the following years:
    i. FY 2020-21
    ii. FY 2021-22

3) In the same way, if a long-term policy of three years is issued in FY 2020-21 and the new regulations come into force in FY 2020-21. Then, the Insurer can take credit for the following years:
    i. FY 2020-21
    ii. FY 2021-22
    iii. FY 2022-23

iii) MTP Obligations in each category for the 1st year (say for the FY 2020-21): Since obligations in terms of number of policies for the (n-1)th financial year (i.e. in this case 2019-20) are not available, the actual MTP policies of the (n-2)th financial year may be considered for calculating the MTP obligations for the year 2020-21.

4.7 Choice of 'M'

4.7.1 One of the issues faced by insurers in the existing formula was that the sudden jump in seasonal businesses like Crop, Govt. Schemes etc., resulted in an increased MTP obligation. To address this issue in the formula, several iterations were done on the data to come out with a market share excluding such businesses. But the results were randomized and there was huge uneven distribution in the obligation.

4.7.2 The idea of taking only motor business was also considered but again it resulted in larger obligations for Insurers doing higher Motor business, thus disincentivizing the companies doing higher Motor business.

4.7.3 As with the proposed structure, the Insurers will be in a position to know their MTP obligations well in advance thereby giving them adequate and reasonable time to devise their business plans accordingly. Therefore, it is decided to take the actual GDPI Market share without any modifications.

5. **Illustration with actual numbers:**

Obligation for FY 2018-19 = Number of MTP policies for FY 2016-17 + M * V * I

The following is a worked-out example of Obligation for FY 2018-19 (for Industry) based on the proposed formula:

O – Number of MTP policies for FY 2016-17
M – 100%
V – Number of uninsured vehicles on road for FY 2016-17 (provided by IIBI)
I – Insurance factor (Indicative)

Sr. No	Category	MTP policies (FY 2016-17) **(O)**	Market Share **(M)**	Uninsured vehicles (FY 2016-17) **(V)**	% of Uninsured Vehicles	Insurance factor **(I)**	Obligation FY 2018-19	Actual Policies for FY 2018-19	%age Difference (Obligation – Actual)
1	Private Cars	2,28,14,630	100%	16,98,222	7%	100%	2,45,12,852	2,57,79,360	-5%
2	Two-wheelers	5,48,98,542	100%	9,06,11,735	62%	20%	7,30,20,889	5,90,45,220	24%
3	Others	1,30,97,063	100%	77,02,937	37%	40%	1,61,78,238	1,38,43,591	17%
4	Total	9,08,10,234	100%	10,00,12,894	52%	23.00%	11,37,11,979	9,86,68,171	15%

CHAPTER IV

RECOMMENDATIONS

The following is a summary of the recommendations made by the Working Group:

1) The existing Obligations may be replaced by the following:

   A) The Obligation of an Insurer **O(n)** in respect to Motor Third Party insurance business for a **Financial Year(n)** should be arrived, for each category of vehicles defined in (B), as below:

   (i) Obligation of the insurer in the $(n-1)^{th}$ financial year = **O(n-1)***

   (ii) Percentage Market Share of the insurer as on 31^{st} March of the $(n-2)^{th}$ financial year based on Gross Domestic Premium Income (GDPI) = **M(n-2)**

   (iii) Number of uninsured vehicles as determined by IIB for the $(n-2)^{th}$ financial year expressed in absolute numbers independently for each category of vehicles defined in (B) = **V(n-2)**

   (iv) Percentage of the uninsured vehicles (Insurance factor) intended to be insured in the financial year under consideration. The Insurance factor shall be determined and declared by the Authority every year for each category of vehicles defined in (B) taking into consideration the contribution of that class to the total uninsured vehicles in the country in the $(n-2)^{th}$ financial year = **I**

   (v) Obligation of the insurer to be met in a financial year

$$\mathbf{O(n) = O(n-1) + \{ M(n-2) \times V(n-2) \times I\}}$$

* *MTP Obligations in each category for the 1^{st} year (say for the FY 2020-21): Since obligations in terms of number of policies for the $(n-1)^{th}$ financial year (i.e in this case 2019-20) are not available, the actual MTP policies of the $(n-2)^{th}$ financial year may be considered for calculating the MTP obligations for the year 2020-21.*

B) The categories of Vehicles on which the above obligations shall be applicable are:

i) Two-wheelers,
ii) Private cars, and
iii) Others

2) For long term policies, the Insurers may take credit for

   i) five/three/two years for two wheelers depending on the remaining term of the policies for which it is in force and,
   ii) three years for private cars depending on the remaining term of the policies for which it is in force.

3) As category-wise number of policies is required, the same may be provided by IIBI for the first year.

4) The new insurer writing motor insurance business licensed to underwrite motor insurance for the first time may be exempted from the application of the obligatory requirement during first two financial years of its operations including the financial year in which its operations are started.

   Such insurer may also be excluded from the calculations for GDP Market Share for other existing insurers for such period till which the minimum obligatory requirements are not applicable to that insurer.

5) A Motor third Party Credit system in lines with the Carbon credit system may be introduced for the first two years.

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