

Role of Insurance Regulatory and Development Authority in Monitoring Insurance Sector in India

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ABSTRACT

Insurance Regulatory and development Authority is an autonomous and statutory authority established by the Government of India, which has been provided whole authorities of the Controller of Insurance in order to regulate, control and direct the different activities of the Insurance sectors India. It was constituted by a parliament of India act called Insurance Regulatory and development Authority Act, 1999 and duly passed by government of India. The agency operates its headquarter at Hyderabad, Andhra Pradesh where it shifted from Delhi in 2001. IRDA is engaged in bringing reforms in the different parts of the Insurance sector in India by way of regular monitoring, directing and controlling over different activities of the Insurance sector at the different places across the country, which can be directly observed by comparing in the previous scenario of the Indian Insurance sector to the present scenario. IRDA issue the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration and Protect the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance. Further, it regulates investment of funds by insurance companies, regulating maintenance of margin of solvency, adjudication of disputes between insurers and intermediaries or insurance intermediaries..

INTRODUCTION

The IRDA Act, 1999 was passed as per the major recommendation of the Malhotra Committee report (1994) which recommended the establishment of an independent regulatory authority for insurance sector in India. Later, it was incorporated as a statutory body in April, 2000. The IRDA Act, 1999 also allows private players to enter the insurance sector in India besides a maximum foreign equity of 26 per cent in a private insurance company having operations in India. Considering some of the emerging requirements of the Indian insurance industry, IRDA was amended in 2002. As stated in the act mission of IRDA is "to protect the interests of the policyholders, to regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto. IRDA issue the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration and Protect the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance. Further, it regulates investment of funds by insurance companies, regulating maintenance of margin of solvency, adjudication of disputes between insurers and intermediaries or insurance intermediaries¹.

ESTABLISHMENT OF IRDA

The IRDA Act, 1999 was passed as per the major recommendation of the Malhotra Committee report (1994)

1

<http://unpan1.un.org/intrdoc/groups/public/documents/apcity/unpan025798.pdf>

which recommended the establishment of an independent regulatory authority for insurance sector in India. Later, it was incorporated as a statutory body in April, 2000. The IRDA Act, 1999 also allows private players to enter the insurance sector in India besides a maximum foreign equity of 26 per cent in a private insurance company having operations in India. Considering some of the emerging requirements of the Indian insurance industry, IRDA was amended in 2002. As stated in the act mission of IRDA is "to protect the interests of the policyholders, to regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto." Indian insurance industry is regulated by the terms and conditions of the IRDA. Indian law has certain expectations from the IRDA to perform in the Indian insurance industry. IRDA should protect the interest of policyholders by ensuring fair treatment by the insurance companies. The growth of insurance companies in a speedy and orderly manner should be taken care by the IRDA. It should monitor and implement quality competence and fair dealing of the insurance companies in the industry. IRDA should make sure that the insurers are providing precise and correct information about the products offered by them for the insurance customers. IRDA should also ensure speedy settlement of genuine claims of the policyholders and prevent malpractices in the process of claims settlement. IRDA controls all the Insurance business in India. They are setting structure and boundaries for the insurance companies to act upon. Starting from licensing to approving the products, IRDA directs the companies in India. They also protect customer interests in the country. As per current guidelines issued by IRDA, Insurance Companies are not permitted to invest in Indian Depository Receipts (IDR), while they are permitted to invest in Equity shares/ Bonds/

Debentures. IRDA needs to remove this disparity to open up investment opportunity by Insurance Companies and thereby also enhance the liquidity of IDRs (Contributed by Sanjay Banka, FCA FCS) Hence, the present work made an attempt to study the Role of IRDA in Indian Insurance sector².

COMPOSITION OF AUTHORITY

The Authority shall consist of the following members, namely:-

- a) a Chairperson;
- b) not more than five whole-time members; and
- c) not more than four part-time members,

to be appointed by the Central Government from amongst persons of ability, integrity and standing who have knowledge or experience in life insurance, general insurance, actuarial science, finance, economics, law, accountancy, administration or any other discipline which would, in the opinion of the Central Government, be useful to the Authority. Provided that the Central Government shall, while appointing the Chairperson and the whole-time members, ensure that at least one person each is a person having knowledge or experience in life insurance, general insurance or actuarial science, respectively³.

FUNCTIONS OF IRDA

Main duties, powers and functions of IRDA are laid down in section 14 of IRDA Act, 1999 as:

- ✓ To regulate, promote and ensure orderly growth of the insurance business and re-insurance business.
- ✓ Issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration.
- ✓ To Protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance.
- ✓ To Specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents and Specifying the code of conduct for surveyors and loss assessors⁴.
- ✓ To Control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938).
- ✓ To Regulating investment of funds by insurance companies, regulating maintenance of margin of solvency, adjudication of disputes between insurers and intermediaries or insurance intermediaries.
- ✓ Specifying the percentage of premium income of the insurer to finance schemes for promoting and

regulating professional organizations referred to in clause 2.6 and

- ✓ Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector⁵.

INSURANCE SECTOR IN INDIA

Insurance business has emerged as one of the prominent financial services during recent times, particularly in developing countries where it could not grow before globalization. But it is very difficult to trace exactly when insurance originated. If we go back to ancient times, we realize that the first insurers of life were the marine insurance underwriters. They used to issue life insurance policies on the lives of their master and the crew of the ship and the merchants. These policies were issued only for short periods. The first life insurance policy was issued on 18th June 1583 on the life of William Gibbons, for a period of 1 year. People always felt the need to have security of their lives and the property they owned. Somewhere in 18th century, societies like the Amicable Society, Equitable Life Assurance Society, Hand in Hand Society etc. were formed for issuing life insurance policies. At end of September 2011, there are forty-nine insurance companies operating in India; of which twenty-four are in the life insurance business and another twenty-four are in general insurance business⁶. In addition, GIC is the sole national re-insurer. Of the forty-nine companies presently in operations, eight are in the public sector: two specialized insurers, namely ECGC and AIC, one in life insurance, four in general insurance and one re-insurance. The remaining forty one companies are in the private sector⁶. During the early 19th century, a large number of life insurance companies were formed in India as well, which eventually became part of today's Life Insurance Corporation of India. As far as the evolution of non-life insurance is concerned, it all began with the boycott of British goods and the British administration. These nationalists' movements made Indians come together for the common cause of protection of life and goods. This was the time when the swadeshi movement began. Thus over the years it forced the Government to have it's own autonomous bodies like LIC and GIC taking care of the life and the general insurance in India. Insurance today is not restricted just to life alone. But it has become the trend or the need of the hour to insure each and everything one has. So the different areas wherein insurance business can be done are - Life insurance, Health insurance, Automobile insurance, Property insurance, Casualty insurance, Liability insurance, Title insurance, Credit insurance, Terrorism insurance, Political risk insurance⁷.

MONITORING ROLE OF IRDA

IRDA is playing very significant role while insurance penetration and density of insurance which reflects the level of development of insurance sector in a country. The insurance penetration is measured as the percentage of insurance premium to GDP. Similarly, insurance density is calculated as the ratio of premium to population (per capita premium) India has achieved a commendable performance in insurance density since insurance sector opened for private players. Similarly insurance penetration, which surged consistently till 2009, slipped for the first time in 2010 due to slower rate of growth in

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³ "Insurancefrauds," Wikipedia, accessed 09 November 2010, http://en.wikipedia.org/wiki/Insurance_fraud

⁴ Section 4, *Insurance Regulatory And Development Authority Act, 1999*.

⁵ www.irda.gov.in

⁶ <http://ijarcsms.com/docs/paper/volume1/issue3/V1I3-0009.pdf>

⁷ www.ijarcsms.com

⁸ Annual Report of IRDA 2009-10

the life insurance premium as compared to the rate of growth of the Indian economy. Insurance density had gone up from USD 11.5 in 2001 to USD 64.4 in 2010. Similarly, insurance penetrations had gone up from 2.71 per cent in 2001 to 5.10 per cent in 2010. Within the insurance sector, the density of life insurance shows a predominant and which was USD 9.1 against non-life insurance density USD 2.4 in 2001. The density of life insurance rose by USD 55.7 against the non-life density USD 4.40 in 2010, which impetrates that the density of life insurance is more than that of the non-life insurance. It is concluded that growing population with mass poverty cannot afford the insurance. On the other hand, with life insurance penetration, life insurance penetration was significant than that of the non-life insurance, it is evident from table 4 that the life insurance penetration was consistently increased from 2.15 percent to 4.40 percent against the 0.56 percent to the 0.71 percent during 2001 to 2010. However, this much of growth happened in the insurance sector due to the establishment of IRDA.⁸

INSURANCE FRAUD MONITORING FRAMEWORK

Financial fraud poses a serious risk to all segments of the financial sector. Fraud in insurance reduces consumer and shareholder confidence and can affect the reputation of individual insurers and the insurance sector whole. It has also the potential to impact economic stability. It is, therefore, required that insurers understand the nature of the fraud and take steps to minimize the vulnerability of their operations to fraud. Due measures also have to be laid down to address possible frauds in each line of business viz., life, general and health as threats/vulnerabilities posed under each one of them vary significantly. Under the Regulatory Framework put in place for insurance companies, the Authority has stipulated a number of measures to be taken by insurance companies to address the various risks faced by them. Some of these include⁹

- ✓ The Corporate Governance guidelines mandate insurance companies to setup a Risk Management Committee (RMC). The RMC is required to lay down the company-wide Risk Management Strategy.
- ✓ As part of the Responsibility Statement which forms part of the Management Report filed with the Authority under the IRDA (Preparation of Financial Statements and Auditors' Report of Insurance Companies) Regulations, 2002, the management of an insurance company is required to disclose the adequacy of systems in place to safeguard the assets for preventing and detecting fraud and other irregularities, on an annual basis.¹⁰

In order to provide regulatory supervision and guidance on the adequacy of measures taken by insurers to address and manage risks emanating from fraud, the Authority has laid down the guidelines requiring insurance companies to have in place the Fraud Monitoring Framework. Reinsurers can reduce their exposure to fraudulent claims from ceding insurers and reinsurance intermediaries by understanding the fraud risk management systems these counterparties have in place. Accordingly, these guidelines apply mutatis mutandis in case of

Reinsurers. The Guidelines mandate insurance companies to put in place, as part of their corporate governance structure:

- Fraud detection and mitigation measures;
- and submit periodic reports to the Authority in the formats prescribed herein.

All insurers are required to ensure that their management function is organized in such a way that the insurer is able to monitor all the risks across all lines of business on a continuing basis and to initiate measures to address them suitably.¹¹

SCOPE AND CLASSIFICATION OF INSURANCE FRAUDS

Fraud in insurance is an act or omission intended to gain dishonest or unlawful advantage for a party committing the fraud or for other related parties. This may, for example, be achieved by means of:

- misappropriating assets;
- deliberately misrepresenting, concealing, suppressing or not disclosing one or more material facts relevant to the financial decision, transaction or perception of the insurer's status;

abusing responsibility, a position of trust or a fiduciary relationship.

In order to adequately protect itself from the financial and reputational risks posed by insurance frauds, every insurance company shall have in place appropriate framework to detect, monitor and mitigate occurrence of such insurance frauds within its company. The said framework shall, at the minimum, include measures to protect the insurer from the threats posed by the following broad categories of frauds:

- ✓ Policy holder Fraud and/or Claims Fraud—Fraud against the insurer in the purchase and/or execution of an insurance product, including fraud at the time of making a claim.
- ✓ Intermediary Fraud—Fraud perpetrated by an insurance agent/Corporate Agent/intermediary/Third Party Administrators (TPAs) against the insurer and/or policy holders.
- ✓ Internal Fraud—Fraud! Misappropriation against the insurer by its Director, Manager and/or any other officer or staff member (by whatever name called).¹²

ANTI-FRAUD POLICY

All insurance companies are required to have in place an anti-fraud policy duly approved by their respective boards. The policy shall duly recognize the principle of proportionality and reflect the nature, scale and complexity of the business of specific insurers and risks to which they are exposed.

The anti-fraud policy shall broadly cover the following aspects:

¹¹ Goyal, K. (2004), "Growth of Private Insurance companies," journal of economics, vol.3, pg no.233-241, Jain, A.K. (2004), "Indian Life insurance industry: After LPG,"

¹² https://www.irda.gov.in/admincms/cms/LayoutPages_Print.aspx?page=PageNo1871

⁸ Impact Analysis of IRDA Guidelines. - Gautam Vaidya

⁹ Insurance Regulatory Development Authority Act - Peter Lancett

¹⁰ IRDA Journal 2011

- i. Procedures for fraud monitoring should be well defined procedures to identify, detect, investigate, and report insurance frauds shall be laid down. The head of this unction should be placed at sufficient senior management level and should be able to operate independently.
- ii. Identify areas of business and specific departments of the organization that are potentially prone to insurance fraud and lay down a detailed department wise anti-fraud procedures.
- iii. Lay down the procedures for Co-ordination with law enforcement agencies for reporting frauds on timely and expeditious basis and follow-up processes thereon.
- iv. Lay down the procedures for exchange of the necessary information on the frauds, amongst all insurers the life and general respective councils.
- v. Lay down the procedures for due diligence on the personnel before their appointments and agreements with them.
- vi. FMF shall ensure effective implementation of anti-fraud policy of company and company reports to the authority in FMR1 and FMR2 form of all frauds cases statistics¹³

Protection of the interest of general insurance policy holders

IRDA has the responsibility of protecting the interest of insurance policyholders. Towards achieving this objective, the Authority has taken the following steps:

- ✓ IRDA has notified Protection of Policyholders Interest Regulations 2001 to provide for: policy proposal documents in easily understandable language; claims procedure in both life and non-life; setting up of grievance redressal machinery; speedy settlement of claims; and policyholders' servicing.
- ✓ The Regulation also provides for payment of interest by insurers for the delay in settlement of claim.
- ✓ The insurers are required to maintain solvency margins so that they are in a position to meet their obligations towards policyholders with regard to payment of claims.
- ✓ It is obligatory on the part of the insurance companies to disclose clearly the benefits, terms and conditions under the policy. The advertisements issued by the insurers should not mislead the insuring public.
- ✓ All insurers are required to set up proper grievance redress machinery in their head office and at their other offices.
- ✓ The Authority takes up with the insurers any complaint received from the policyholders in connection with services provided by them under the insurance contract¹⁴.

CONCLUSION

Establishment of IRDA has brought about revolutionary changes in Insurance sector. In the last 10 years of its establishment insurance industry in India has seen tremendous growth. Before IRDA's establishment LIC single handily ruled life insurance sector and satisfied the needs of its customers, whereas GIC and its 4 subsidiaries were the sole players in non-life insurance. With advent of IRDA and opening of insurance sector for private insurers, the number on insurers increased to 24 for life and 28 for non-life insurance. Role of IRDA is very prominent in growth in insurance penetration and density, increase in number of insurers, number of policies issued, speed of claims settlement and many more aspects. It can be said that IRDA has been successful in dealing with the discrepancies in this sector and has very well supervised and controlled the business of entire insurance industry.

¹³The Journal of Insurance Institute of India, Vol.XXX, July-Dec.2004, Page No.53. Krishnamurthy, S. (2005), "Insurance Industry in India: Structure, Performance, and Challenge," vol.30 No.3, pp 85-96,

¹⁴Rajendran, R, Natarajan,(2009), "The Impact of LPG on Life Insurance Corporation of India," ZENITH International Journal of Multidisciplinary Research Vol.1 Issue 7, November 2011, ISSN 2231 5780