UNIT 19 FORMS OF REGULATION

Structure

19.0 OBJECTIVES

In this unit, the learner is introduced to the whys and how of insurance regulation abroad. After going through this unit you will be able to appreciate

- why do governments found it necessary to regulate insurance;
- which particular features of insurance business needs to be regulated;
- which level of government must take up the task of regulating insurance business – the State Governments or the Central Government; and
- what are effects of regulation on insurance rates.

19.1 INTRODUCTION

Insurance industry is a major segment of the finance sector. In countries like United States of America, this industry is by and large, regulated by different state governments through their own laws designed for this purpose. However, they have also created the institution of National Association of Insurance Commissioners (NAIC) to bring about coordination at national level. In this NAIC, each State has one vote. But it has ***no*** enforcement powers and mechanisms. It can only issue advisories and ultimately, individual States are left to own devices. The insurance commissioners are supposed to represent all the citizens in the state and the firms operating there have to be regulated. The problem is that insurance firms are flush with huge sums of money and have a large number of employees and agents and business associates who are well organized and enjoy enormous clout. The ordinary citizens who buy insurance policies, on the other hand, are highly disorganized lot. They have voting power which they exercise at the time of elections to legislatures but in day to day life and in relation to the insurance business firms, each citizens appears to be a rather helpless entity. Thus, the task of regulators is to balance the interests of highly organized and articulate insurance industry enjoying enormous financial clout and amorphous collection of individual citizens having no collective voice and power.

19.2 WHY INSURANCE NEEDS TO BE REGULATED?

The insurance industry is different in many respects from other industries manufacturing tangible goods. That is why, the rules and regulations, which apply to other industries, are found unsuitable to and inadequate for insurance regulations. This is one reason for special interest exhibited by governments. The special features of insurance industry necessitating government control are:

(i) Future Performance

(ii) Complex nature of insurance agreements

(iii) Unknown future costs

(iv) Violations of public trust, and

(v) Control over enormous financial resources, basically collected from the ordinary policyholders.

(i) **Future Performance:** The most distinguishing feature of insurance industry is that it gets paid in advance for a service it may be called upon to render in future. Note the words "may be". It is not really necessary that everyone who buys an insurance policy benefit from that policy. Getting 'benefit' of the policy is confined to situation when a mishap one is 'insured' against becomes a reality. But most policyholders do their best to avoid that eventuality, in fact the contract of insurance enjoins upon them to do everything within their control to avoid that eventuality.

The insurers are managers of policyholders' funds entrusted to them in the good faith that if some mishaps occurs, the insurer will cover the costs of recovery/compensate as has been specified in policy agreement. However, the insurers may be tempted to so use and deploy those funds which enrich them personally rather be available to the customers those funds legitimately belong to.

Even if unscrupulous utilization is avoided, ability of an insurer to serve the policyholders will really be dependent on future performance of the assets created by insurer with those funds. The regulator has to find ways and means of doing justice to the policyholders when the insurer fails to discharge his side of the contract.

(ii) **Complex nature of insurance agreement:** In general, insurance contracts are couched in a language which may be beyond comprehension of an ordinary insured. Even if the insured is capable of understanding all the legalities in the contract, he may not be aware of typical practices/customs followed by insurance industry which are never mentioned in the documents. Still, more serious are the problem created by company's ability to hire best legal brains to brow beat the customers and wriggle out of its own liabilities. The regulators have to ensure that insurance contracts are not framed in a way which make them look appealing, but under which insurer can avoid payments to the insured.

(iii) **Unknown future costs:** Insurer has to price his services in advance of actual rendering of that service. The full costs of services are usually not known in advance. These costs are subject to many random fluctuations. If insurer under estimates the costs, he ends up pricing services very low and gains more business but also takes upon huge liabilities which he may not be able to discharge at a future date. There may be a temptation to indulge in under-pricing. The other side of the coin may be overestimation of costs leading to deliberate overpricing which exclude many possible customers (who cannot afford to pay those high prices).

Hence, some outside control over pricing of the insurance products is found desirable.

(iv) **Violations of public trust:** Many types of violations of public trust are possible in insurance business: failure to live up to the contract obligations; making misleading offers of benefits that actually do not accrue to the policyholder; refusal to pay even legitimate claims; delaying tactics adopted in settlement of claims to tire out the helpless policyholders etc. Improper deployment of policyholders' funds can be a significant violation of the public trust.

The regulators must put in place a system under which the policyholders can seek quick redressal of their grievances. They are needed to ensure that some deterrent action is initiated against the defaulting insurers so that general public faith in the insurance is not eroded. Such an action is rather urgently called for in cases where getting insurance cover is mandated by law (vehicle insurance for instance).

In USA, some insurance companies have been found to be denying insurance covers to properties located in certain areas/persons living in certain localities etc. The courts have found this behaviour to be obnoxious and upheld authority of the Urban Housing Development department to regulate such behaviour of the insurance companies.

(v) **Control over enormous financial resources, basically collected from the ordinary policyholders:** Every insurance company, in course of its business, amasses an enormous amount of finances. These are the contribution of policyholders. These funds need to be used and deployed intelligently and diligently. Otherwise, the insurers will not be in a position to serve the genuine claims of the policyholders. As it is done in case of other segments of financial market, the regulators have to step in to protect the interests of the customers/general public and workout guidelines which ensure liquidity, financial viability as well as profitability of the insurance companies.

To conclude this section, we can say that insurance industry need to be regulated so that:

- future services are provided to the customers, in time, as per agreement;
- the agreements are not designed to cheat the policyholders
- a balance is struck between future costs of services and the pricing of the insurance products;
- public's trust is not violated and the insurance funds are so deployed that the companies remain solvent and profitable while discharging all the contractual obligations towards the policyholders without any delay and hardships to them (the policyholders).

19.3 WHO REGULATES INSURANCE: THE STATE GOVERNMENTS OR THE CENTRAL GOVERNMENT

In USA the legal interpretations have been fluctuating/changing overtime. In 1868, the US Supreme Court had decided in *Paul* vs. *Virginia* case that insurance was not commerce – it was more of a personal contract and thus States could regulate it – rather than the federal government.

However, in 1944 the above decision was overturned by the majority decision (4 to 3) of the court. The new ruling granted status of commerce to insurance, especially where interstate insurance was being done. It was made subject to applicability of the Sherman Act, the Claton Act and the Robinson-Patman Act dealing with business activities in restraint of fair trade, unfair trade, false advertising etc.

Consequent upon the above decision of the court, McCarran-Ferguson Act, known as Public Law 15, was passed. This public law provided that:

1) The Congress was of opinion that States should continue to regulate insurance and only those federal laws, which relate to the insurance specifically, will apply.
2) Applicability of Federal Laws regulating business in general would apply after a gap of three years wherever the states did not regulate insurance.
3) Provisions of Sherman Act relating to boycotts, coercion and intimidation will be fully applicable to insurance.

The National Association of Insurance Commissioners designed a model bill in the spirit of Public Law 15 and most of the states adopted and endorsed suggestions contained in the model bill. Thus, the state level insurance regulatory laws were brought in line with Central Laws such as Sherman, Claton, FTC and Robinson-Patman Acts.

The US Congress has adopted bills in 1986 to remove immunity to insurance from federal Anti-trust laws. In 1993, another attempt was made. It was called Federal Insurance Solvency Act, 1993. But, this was also opposed by the National Association of Insurance Commissioners.

As of date, both State and Central Laws are in the statute books to govern the insurance business. General regulation is done by states, but certain specific aspects/areas are subject to regulation by national government.

Check your Progress 1

1) Why should insurance industry be regulated?

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2) In what ways can an insurer violate the public trust? What can be the consequences of such violation of trust?

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3) Who should regulate the insurance business: States or the Centre? What is the practice in USA?

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19.4 WHAT ASPECTS OF INSURANCE ARE REGULATED?

The regulators for the insurance industry have a six-fold agenda cut out for them:

(a) Licensing

(b) Enforcement of minimum standards of financial solvency

(c) Regulation of Rates

(d) Regulation of expenses

(e) Regulation of Agents' activities.

(f) Regulation of contractual provisions and exceptions enshrined in insurance policy documents to safeguard interests of the customers.

(a) **Licensing**: No company/organization is allowed to enter the insurance business without a licence to be granted by a competent authority. The licences are granted for specific types of insurance business. Separate licences are needed for life and general insurance businesses. Many times, the same company is not allowed to operate in both life and general insurance sectors. In some cases, the insurers are barred from other segments of financial markets such as banking as well. This is done to ensure that funds arising out of one activity are not diverted to finance others.

(b) **Enforcement of minimum standards of financial solvency:** The regulators do specify for insurance company to have different capital (adequacy) standards for different licenses of insurance business. The capital at disposal of an insurer can be in the form of cash accumulation/surplus and/or stock capital. In some US States, 3 million dollars are regarded as adequate. But in some states (Massachusetts) an insurance company can be licensed to work if it has accumulation of 400,000 Dollars only. Financial solvency has another dimension as well: What are the insurance funds invested in? Many limitations are imposed and these funds are placed in bonds, mortgages and other fixed income securities. Idea is to ensure some minimum standards of asset protection and regularity in earnings so that premature liquidation of investments is ordinarily avoided.

(c) **Regulation of Rates:** The regulator has to see that companies do not charge discriminatory rates from customers. Nor are they allowed to charge excessively high premium. Very low rates on the other hand can threaten the solvency and very survival of the company. In USA, most states insist on prior approval of the regulator for the rates to be charged by insurers. They have to file the rates in advance of the date of implementation. The commissioners are required to communicate their approval/rejection within 10 to 30 days.

Some states follow the policy of 'file and use' for the rates. They believe that competition among the insurers will ensure that they will charge reasonable premia only.

State mandated rates, usually based on political factors can also be found in some states (California, New Jersey; Texas etc.). The state may mandate rates that do not discriminate between men and women policyholders.

(d) **Regulation of expenses:** What is shown by insurers as 'expenditure on servicing a policy' can also become important in many cases. If the insurers are showing very high costs of services, they are perhaps working in an inefficient manner or their staffing patterns are not based on a realistic assessments of needs etc. In such cases the regulator can order rationalization of their expenses to enhance the profitability and liquidity. This can also moderate the rates charged by the insurers.

(e) **Regulation of Agents' activities:** As is well known, agents are the most important link between an insurer and insured. Many a times agents with less than adequate training may make genuine mistakes which land either of the parties in a difficult situation. Yet it has been found that agents are not above deliberate manipulations in many cases. Three types of manipulations practiced by them are twisting, rebating and misrepresentation.

Twisting: It occurs when an agent persuades a policyholder to discontinue "some old and unprofitable" policy and buy a "new and better" policy.

Rebating: This is a common malpractice. The agent shares the commission he receives from the company with the insured. The rebate is negotiable between the agent and the insured. Therefore, it leads to different through similarly placed, customers paying different premia.

Misrepresentation: A common misrepresentation is showing very low "net cost of insurance" by comparing premium paid and sum of dividends plus terminal payments in case of life insurance with endowment. Regulators do frown upon such agents and in many cases their licences can be revoked.

(f) **Regulation of contractual provisions and exceptions enshrined in insurance policy documents to safeguard interests of the customers:** Last, but not least in importance, is regulation of terms and conditions and exceptions their to as enshrined in the policy documents. It is well known that most often insurance companies design the policy documents with the help of legal acumen not usually available to the ordinary policyholder. The latter is, in most cases, ill equipped to understand implications and finer points of those documents. This tends to make the contracts one-sided and loaded against the customers. The regulator has to step in here to safeguard the interests of unsuspecting simple insurance policyholders. The duty of regulator assumes all the more significance in the context of situation where buying an insurance is mandated by some other laws. A case in point is vehicle insurance.

19.5 EFFECTS OF REGULATION ON INSURANCE RATES

When rates are regulated by an independent authority keeping in mind the three principles of adequacy, non-excessiveness and non-discrimination, some tangible benefits accrue to the insurer, the insured and the society in general.

If rates are adequate, they cover all present and future costs of providing the insurance service. This keeps the company solvent. It earns a reasonable profit or surplus, which can be further used to expand the business and reward the shareholders and employees. It also benefits the insured as they receive timely payments or compensation in the event of mishap. Their interests are well protected. For such determination of rates, the regulators make use of actuarial techniques.

The rates must not be excessive. The excessive rates are detrimental for both insurer and insured. The latter is forced to pay too much. This keeps many potential customers away – or simply out of market, as they cannot afford to get insurance cover. The insurer seems to earn more per insurance taken out but the volumes remain low. If volumes or number of policies taken out remains low then costs of servicing each policyholder will remain on the higher side. This shall erode the profits and the company will be ultimate looser.

The rates must be non-discriminatory, as discrimination practiced by a company will soon be discovered by the customers and they will no longer have dealings with it. Any differences in rates charged from different customers must have actuarial basis, that is, it must be justifiable and based on sound principles of business. "My costs of service is high and, therefore, I charge more" cannot be a sufficient ground for discrimination. When discrimination is practiced, the customers feel cheated and the company loses business.

The society too benefits when the rates are regulated properly.

Consider case of life insurance. Here companies may not indulge in cooperative rate fixing and regulators need not determine the rates. But use of same life-tables by different companies can ensure that each of them will fix realistic rates to be charged from the customers. The companies can make adjustments depending upon their experiences – but those adjustments and their bases shall also be transparent and justifiable. Very high commissions paid from first premium can push up costs of services provided by companies. Here too, some regulations are generally called for. This practice offers ample scope for agents to entice customers with discounts which ultimately go against both insured and insurer.

19.6 CONCLUSIONS

Insurance industry is a peculiar industry. Its products are unlike those of industries manufacturing tangible goods. It is peculiar in another sense as well: one pays in advance for some service which may be received in future. One pays today to cover possibilities or risks of damages in future. It is also unique to this industry that usually a person does his best to avoid the circumstances/eventualities under which one gets the 'benefits' of insurance. In a sense, it is lottery ticket that you buy and they pray that you do not get the prize!

Each of the insurance firms gets large amounts of money every time period by way of premia paid by different policyholders. This places enormous amounts at their disposal. But they also take upon themselves a huge liability to indemnify/compensate the policyholders (in case they meet with any of the mishaps covered under the terms of the policies issued to them).

There does exist a real possibility of using policyholders' funds to serve own selfish interests. This has, in the past led many insurers to bankruptcy. But the temptation is always there and is very strong. In such cases, the policyholders may face sheer ruin. The public authorities are nearly duty bound to ensure that such a fraud is not inflicted on

the policyholders. The interest of the insurance industry is also best served only when it can continue to work smoothly, without any hiccups, which may erode confidence of general public in this business. The shareholders of insurance companies and their employees too will be much happier when business is transacted as usual.

Thus, the authorities must regulate insurance. The immediate question is which level of government must be empowered to regulate this industry. In a country with unitary form of government this problem will not arise. But in a federation or Union, this can become a ticklish issue. We have examined some experiences of USA where at one stage the Supreme Court held one opinion but reversed it after a few decades. The Federal legislation also, at present recognizes that basic responsibility to regulate insurance rests with the States. Yet it provides for applicability of specific central legislations designed for this sector. The insurance companies are also brought under Federal anti-trust acts.

The second pertinent question is what do the regulators regulate? Now there exists a fair degree of consensus that the agenda for regulators is six folds. They must regulate setting up of an insurance company through license; the license must be granted subject to meeting predefined requirements of financial soundness. The rates of premia must be regulated; so must be the expenses of the insurance business; regulation of activities of the agents is also desirable and so is strict scrutiny of terms and conditions under which a policy is issued.

The rates should be adequate, should not be excessive and they must be non-discriminatory. Any differences in rates must be based on actuarial consideration only.

Check Your Progress 2

1) What aspects of insurance industry need to be regulated?

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2) Why should licensing be needed for insurance business?

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3) Why should an insurance company be expected to possess sufficient/adequate reserves and assets?

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4). Analyse the effects of regulations of rate in insurance industry on:

i) Insurers

ii) Insured.

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19.7 LET US SUM UP

This unit begins with a case for need to regulate insurance industry. Then, a brief round up of judicial pronouncements and legislative measures in USA was provided. Then, we discussed in some detail the aspects of insurance business which need to be regulated. We identified six such aspects. Finally we tried to find out who stands to benefit from these regulations. Our conclusion is that regulation by independent agencies helps put insurance business on sounder footings. It safeguards interests of the insured general public as well as that of stake holders in the insurance business. The regulation also paves the way for proper investment and deployment of funds at the disposal of the insurance industry in such a manner that firms do not face liquidity crunch, policyholders do not face delays in claim settlements, and the industry does prosper while helping rest of the economy to develop along with.

19.8 KEY WORDS

Adequate Rates : Premia rates, which are found to be adequate to cover all the costs of insurance business and to generate surpluses.

Discounting : An agent offers commission on the premium to generate more business for his agency. But this commission, being 'negotiable', leads to discriminatory rates being charged from different customers.

Discriminatory Rates : Different rates for different customers and the difference has no actuarial basis.

Insurance Rates : The premia charged by the insurers from the policyholders.

Misrepresentation : An agent promising services and benefits which are not part of the policies actually being written for the customers.

National Association of Insurance Commissioners : The organization of US State level regulators. Each State has one vote in this Association. The Association

is handicapped by lack of enforcement powers for its decisions.

Regulators : Statutory authority set up by a state or central government to regulate working of a sector.

Twisting : A business tactic under which an insurance agent persuades a policyholder to discontinue an old policy and buy a new one.

19.9 SOME USEFUL BOOKS

Elliott, Curtis M., and Emmett J. Vaughan, *Fundamentals of Risk Management and Insurance*, John Wiley and Sons.

Trieschmann, James S., Gustafson, Sandra G., and Robert E. Hoyt, *Risk Management and Insurance*, Thomson South-Western.

Williams, Arthur C., Jr. and Richard M. Heins, *Risk Management and Insurance,* McGraw Hill.

You can also visit the website: http:/www.NAIC.org/

19.10 ANSWER OR HINTS TO CHECK YOUR PROGRESS

Check Your Progress 1

1) Go through Section 19.2 and 19.3.
2) Go through Section 19.2 and 19.3.
3) Go through Section 19.2 and 19.3.

Check Your Progress 2

1) Go through Section 19.4 and 19.5
2) Go through Section 19.4 and 19.5
3) Go through Section 19.4 and 19.5

UNIT 20 REGULATION OF INSURANCE IN INDIA

Structure

20.0 OBJECTIVES

After going through this unit you will be able to:

- gain an insight into organisation and conduct of insurance industry in India;
- understand some important differences in life insurance business and practices in India and those followed in countries like USA;
- appreciate why the nationalisation of life and general insurance was regarded as necessary ;
- know why nationalisation can be regarded as extreme form of regulation;
- understand the factors which have led to an about-turn in government policy vis-à-vis insurance sector;
- appreciate the insistence of Indian government on steep capital adequacy requirements for private companies seeking to enter insurance industry;
- know main features of IRDA; and

20.1 INTRODUCTION

Insurance in India can be traced back to ancient times. The joint family system was always regarded as a social insurance. But the insurance in modern form came in 1818 from England. The Oriental Life Insurance Company was set up to help the widows from European community in India. Many more insurance companies came up over next 50 years and most striking feature of their working was treating Indian lives as 'inferior'. They all demand additional premium to the tune of 15 to 20 percent to insure natives.

Bombay Mutual Life Assurance Society was first Indian company to be set up in 1870 in this industry which charged normal premia from Indian people. The government enacted Insurance Act in that very year. Many more companies were set up during 1870-1900.

Many important political movements such as Swadeshi Movement, 1905-06, Non-cooperation Movement, 1919 and Civil Disobedience of 1920 led to an increase in numbers of Indian companies. The British Government had come out with a legislation to regulate insurance business in 1912. It was Life Insurance Companies Act 1912. Business expanded in terms of both, number of companies and number of policies taken out.

20.2 REGULATION IN PRE-INDEPENDENCE PERIOD

In 1938, a comprehensive law was passed to establish strict control of the state over both life and general insurance. It was also to looked into investments, expenditure and management of insurance companies in addition to rates charged by them. The office of Controller of Insurance was created and vested with very wide ranging powers.

20.3 REGULATION AFTER INDEPENDENCE

Initially the government of independent India continued with the Insurance Act, 1938, but in 1956 it decided to make a drastic change. It took over life insurance business in India.

20.3.1 Nationalisation of Life Insurance

After independence, in 1956 the Government of India decided to impose what in one sense can be regarded as "ultimate form of regulation" an insurance industry. It set up Life Insurance Corporation of India, took over life insurance business of all the 245 insurance companies/societies active in this field. This move was promoted by increasing number of scams and irregularities. The dubious investment practices of insurance companies provided another set justifications for the government moves. The other motive was also very important in the context of economic changes being visualized in those times. The insurance companies were custodians of enormous financial resources. The Life Insurance Corporation of India has always been focused on assurance plus endowment. In other words, life insurance policies have also been a means of generating a big pool of savings which became available to policyholders on completion of the terms of policy. The Government of India was also tempted to have direct control over this pool of public's savings. It wanted to use this pool to fund development programmes being chalked out under Five Year Plans.

20.3.2 Nationalisation of General Insurance

After 16 years, in 1972, even the general insurance was taken over by the Government of India and General Insurance Corporation (GIC) was set up. However, while the Life Insurance Corporation of India (LIC) has remained a monolithic organisation, the GIC was designed as a holding company for its four subsidiaries, namely, National Insurance Company Limited, New India Assurance Company Limited, Oriental Fire & General Insurance Company Limited, and United India Insurance Company Limited. The GIC directly conducts aviation insurance only. The subsidiaries are required to seek re-

insurance of their liabilities from GIC and pay premium thereon. Further 20 percent of their business is also ceded to GIC.

20.3.3 Forms of Regulation and Aspects Regulated

As we have seen in Unit 19, several aspects of insurance business can be regulated to save the helpless policyholders from the manipulative and dishonest practices of 'greedy' insurers. In India, the Insurance Act, 1938 which created the office of Controller of Insurance and vested wide ranging powers in it lays bare the concerns of law makers.

The Controller was given powers which included: directing, cautioning, advising prohibiting, inspecting, investigating, searching, seizing, prosecuting, penalizing, authorizing, registering, amalgamating and liquidating the insurance companies.

But the scenario changed with the decision of nationalization of insurance. As the life insurance was taken over by the Government in 1956, need to have independent regulator/controller 'vanished'. Most of the powers of the Controller were vested into LIC of India. In a way, the government company was entrusted with the task of regulating its own activities.

Similar step was initiated for general insurance in 1972 after taking over such business of all private insurers and creation of GIC and its subsidiaries. The only difference in this case is that powers of controller are vested in GIC, the controlling entity and not the subsidiaries which are actually doing the business.

The powers assigned to the controller in 1938 to give us sufficient clues to what was to be controlled and regulated. It included:

(i) setting up of an insurance company

(ii) registering it and authorizing it to do business

(iii) permitting it to merge into some other company and ordering such amalgamations as may be deemed fit by the controller

(iv) ordering liquidation of insurance companies which mere found to be indulging in improper practices

(v) inspection and investigation into the conduct of business by these companies

(vi) seizing their records, imposing penalties on them and prosecuting them

(vii) directing them to conduct business in a specified manner, containing them wherever deviations from those directions were noted

(viii) advising the companies about proper conduct of business and prohibiting them from indulging in any activity which was regarded as "improper conduct".

Thus, it is absolutely clear that every possible dimension of the insurance business was sought to be controlled by the government. In particular, the following aspects invited continues attention of regulators:

(i) spreading insurance protection to masses at a reasonable cost

(ii) mobilizing people's savings through insurance linked plans

(iii) investing funds to serve the best interests of both, the policyholders and the nation

(iv) minimizing expenses of the insurers as the money under their custody belonged to the policyholders.

In other words the cost of insurance that is, the insurance rates or premia, mobilizing savings and investing them in 'secure' and remunerative venues and keeping expenses of the companies low were the main areas of concern. With nationalization, the other

concerns of the government authorities also came out in the open: investing funds in best national interests – read making use of those savings of the general public to fund government expenditure, expand the insurance net as wide as possible (to collect largest possible slice of public savings through insurance premia) etc.

To serve the above objectives, the LIC in particular has come out with many types of policy instruments to suit 'needs' of different sectors of the society. It offers: term insurance, whole life insurance, endowment plans, annuities, individual and group insurance, pension plans, children's plans and equity linked investment plans. In addition, policies can in 'with benefits' and 'without benefits' former changing higher premia.

The Report of the Committee Reforms in the insurance sector, 1994, has gives some interesting statistics: premium income from individual life insurance business increased from Rs.41 crores in 1950 to Rs.29,270 crores in 2000-01. During the same period, total investments had increased from Rs.227 crores to Rs.1,75,491 crores. The accumulation in life fund increased from Rs.224 crores to Rs.18,602 crores.

No wonder, the government wanted to control the investments by the insurance industry. What is more pertinent is that such a surge in accumulations has taken place while life insurance coverage is still confined to barely 20 percent of Indian public. Rural areas are still, by and far, not enjoining the insurance cover.

The investment pattern of the LIC and GIC is determined by the Government of India. The patterns as per 1995 orders are:

Life Insurance Corporation of India

i)	Central Governments marketable securities	Not less than 20%
ii)	Loans to Housing Bank, including (i) above	Not less than 30%
iii)	State Government securities, including (ii) above	Not less than 50%
iv)	Socially oriented sectors, including cooperatives, house building by policyholders, including (iii) above	Not less than 75%
iv)	Private Corporate Sector, loan to policyholders for construction/ acquisition of immovable property	Not less than 25%

General Insurance Corporation

i)	Central Governments marketable securities	Not less than 20%
ii)	State Government securities and other government guaranteed securities including (ii) above	Not less than 30%
iii)	Loans to HUDCO and States governments for housing, fire fighting equipments	Not less than 15%
iv)	Market sector	Not less than 55%

Check your Progress 1

1) Give an account of powers of the Controller of Insurance as per Insurance Act, 1938.

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2) Why did the government want to control insurance industry?

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3) What were the main objectives of nationalization of insurance companies? What has LIC done to further those objectives?

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4) What are the investment patterns specified by the government for LIC and GIC?

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20.4 ECONOMIC REFORMS AND REOPENING OF THE INSURANCE SECTOR

As is discussed in Section 20.2 above, the nationalization of life insurance in 1956 had created a monopoly in this field. Similarly, in 1972 we created a monopoly in the field of general insurance also. These public sector monopolies did their best to achieve high growth in volumes and expanded the reach of insurance covers as well. Yet, they tried to function as bureaucratically controlled government offices most of the time. The customer service orientation was missing. They were not willing to adopt never

technology and corporate work culture as well. In fact, it is doubtful if the life business would have expanded so much had the investment in savings linked insurance instruments not been tax exempted. Perhaps this same consideration also explains why LIC did not care to reach out to rural sector. The country had high rate of savings at 24 percent of Gross Domestic Product (GDP). With very poor penetration of insurance, just 20 percent Indian market appeared to be a real gold mine to foreign financial giants. In any case, World Trade Organisation (WTO) with its provisions on Trade Related Investment Measures was breathing down the neck of Indian government to open up insurance sector to private companies especially the foreign companies, so, ultimately, in 1993 Government of India appointed a Committee under chairmanship of Shri R.N. Malhotra to examine the issue in full details and make appropriate suggestion. The report of the Committee came in 1994 and made the following recommendations:

i) Government stakes in LIC & GIC be brought down to 50%

ii) Private companies with paid up capital of at least Rs.100 crores be allowed to enter in the industry

iii) No private company to be permitted to enter both life and general insurance

iv) Foreign companies to be permitted only in partnership with Indian business and not on their own

v) Postal Life Insurance be extended to rural areas

vi) LIC investment in Government securities be reduced from a compulsory 75% to 50%

vii) Holdings of GIC and its subsidiaries not to exceed 5 percent

viii) Promoters not have a holding of over 40 percent in newly set up insurance companies. If they had it, they were to bring it down to that level in a specified period of time.

ix) At no time, promoters' holding will fall below 26 percent and no body other than a promoter will hold over 1 percent of equity.

x) Regulatory and prudential norms to be designed and enforced at the earliest.

xi) The public sector insurers to upgrade technology and reorganize to become more efficient to face competition.

xii) Restore the office of Controller of Insurance to its full glory, as an interim measure.

xiii) Exemption to LIC & GIC from several provisions of insurance act be withdrawn.

xiv) Independent and strong regulator on the lines of SEBI be set up for insurance.

xv) State level cooperatives be allowed to transact life insurance business in respective states subject to control by proposed insurance regulator.

xvi) GIC should become a pure re-insurer, it should cease to exist as holding company.

xvii) GIC holding in its subsidiaries be acquired, by government. The paid up capital of these subsidiaries be raised from Rs.40 crores to Rs. 100 crores and the government must have 50 percent shares.

The insurance sector was finally thrown open to private companies in August 2000. But before doing that, Insurance Regulatory and Development Authority (IRDA) was constituted in April, 2000, under IRDA Act, 1999.

20.5 INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY

Though the Government of India had set up Insurance Regulatory and Development Authority (IRDA) in 1996, but it was formally constituted as regulator of insurance

industry only on April 19, 2000. The IRDA Act, 1999 amended various provisions of Insurance Act, 1938, LIC Act, 1956 and General Insurance Business (Nationalisation) Act, 1972. This comprehensive legislation was designed to introduce a new wave of change in Indian insurance sector. The industry was finally thrown open to Indian corporates and foreign companies in collaboration with Indian partners.

The IRDA is required to:

(a) frame and issue statutory and regulatory stipulations, guidelines, etc.

(b) perform a developmental and promotional role

To perform its role as promoter of insurance business, the regulator is expected to:

(a) attract a large number of players

(b) integrate insurance market with domestic financial sector

(c) synchronise Indian insurance market with the global market.

Duties, Powers and Functions of IRDA

Given the other laws of the country, IRDA is empowered to:

i) issue, renew, modify, withdraw, suspend or even cancel the certificates of registration issued to insurance companies,

ii) specify qualifications, code of conduct, etc. for the insurance agents, intermediaries, surveyors and loss assessors,

iii) promoting interests of policyholders in assignments of policies, nomination, insurable interest, claim settlement, calculation of surrender value and fixation of other term and conditions of the policies.

iv) promoting professional bodies in insurance and reinsurance business to enhance efficiency

v) levy fees and other charges incidental to this business, regulate rates and terms and conditions offered by insurers,

vi) seeking information, doing inspection, conducting enquiries and audits of insurers and others involved in this business,

vii) specifying form and manner of maintenance of books of accounts by the insurers, regulating their investments and margins of solvency,

viii) adjudication of disputes between insurers and insured, and

ix) supervising Tariff Advisory Committee and also specifying percentage of business to be taken to rural and/or social sectors of the economy.

Working of IRDA – An Appraisal

IRDA is the sole authority to issue licences for insurance industry. It can issue licenses to any number of companies. However, separate licences are needed for Life and General Insurance companies. All the licences have nation-wide validity. New players must commence business with 15-18 months of getting the licence.

New applicants are required to pay a fee of Rs.50,000/-. But for renewal of licences, they are required to pay 0.20 percent of 1 percent of gross premium income or Rs.50,000/- whichever is higher.

The insurers are given a 'file and use' procedure in respect of rates and products etc. They have to file copies of standard terms and conditions and other related documents along with rates.

In case of tariff products, Tariff Advisory Committee has to file product and pricing details with IRDA, like any other insurance company.

All the insurance intermediaries like agents have to undergo compulsory training. They must have prescribed educational qualifications to join that training programme. At the end of training, they appear in an IRDA conducted examinations and get a licence to function as an agent only on success in that test. The training is spread over 100 hours and at the time of renewal of licence, the agents have to undergo further training for 25 hours.

To ensure ethical behaviour of insurers and to set standards the IRDA has revived the Insurance Association and Life Insurance and General Insurance Councils.

IRDA has recognized the Actuarial society of India and Insurance Institute of India as the designated apex institution for setting standards for insurance education and training. It has also tied up with IIM, Bangalore to promote research and higher education in insurance.

The IRDA has come out with details of specified percentage of business to be transacted by an insurer in rural sector. It has also prescribed standards for maintenance of books of accounts.

Protection of Policyholders' Interests

The Insurance Council is administrative body for protection of policyholders. It has appointed 12 ombudsmen across the country. Each of them is empowered to receive and consider complains of individuals where insured amount is less than Rs.20 lakhs.

The Ombudsman Act as conciliators and are empowered to issue awards which the insurers are required to honour within three months. Two separate policyholder protection funds for life and general insurance are being set up and each insurer is required to contribute 1 percent of its profits to this fund.

The IRDA has also specified norms of exposure for the insurance firms. As per these norms, an insurer is required that his investment:

a. in equity/convertible debentures and preference shares does not exceed 20 percent of capital employed of investee company, and

b. the limit for short-medium terms loans and financial assistance does not exceed 20 percent of annual accretion of funds.

The norms for exposure to a group of companies are set at 15 percent for (a) and 10 percent for (b) above.

A further stipulation is that an insurer will not contribute more than 15 percent of capital employed in my industry.

These stipulations are designed to save the insurer from possible capital loss when a company fails, a group of companies' lands in financial problems or an entire industry faces unprecedented problems.

In addition to above norms, a separate set of exposure norms is laid down for investment in public sector financial institutions.

The IRDA has laid down some Prudential Norms for investment in fully and partially convertible debenture. Here adequate attention is required to be paid to rates of interest, appreciation, dividend income etc.

The insurers can place funds in terms deposits and loans with Non-Banking Companies also. Here the stipulations are:

- when net worth of borrower is Rs.15 crores, an insurer will not give insured loans exceeding 25 percent of such net worth.
- The recipient company must have paid dividends in 10 out or previous 15 financial years and 3 out of immediate 5 financial years.
- Borrower must be listed on a stock exchange and its share prices must have been quoted continuously over 12 months before sanction of the loan.
- Advance cheques for principal and interest are taken along with personal guarantee of promoters and security of shares.

In addition, every insurer has to keep IRDA informed of status of its investments through quarterly returns.

Check Your Progress 2

1) What internal factors have been instrumental in reforms in the insurance sector in India?

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2) Enumerate external factors which prompted the Indian government to shed its monopoly over the insurance business.

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3) What were the salient features of Malhotra Committee report on insurance reforms?

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4) Give an account of working of IRDA.

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5) Analyse IRDA specified norms of exposure for the insurance industry. Why Are such norms prescribed?

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20.6 LET US SUM UP

Regulation of insurance industry in India began in 1938. The Insurance Act, 1938 created office of the Controller of Insurance and assigned wide-ranging powers to it. However, frauds and scams continued and insurance companies continued to go bankrupt. In 1956, the Government of India nationalized Life Insurance business of all the companies operating in India. A public sector company, Life Insurance Corporation of India was created. All the powers of the controller of insurance in connection with the life insurance were delegated to the LIC which was made a self-regulating entity.

The General Insurance Corporation (GIC) was creating after take over of general insurance companies in 1972. The very next year it was reorganized as holding company and the actual business was divided among its four subsidiaries. The powers of the controller in respect of general insurance stood delegated to GIC.

This way, the first chapter in regulation of insurance ended with "extreme regulation".

However, financial sector in general and insurance industry in particular could not remain immune to changes taking place in the economic policies under auspicious of World Trade Organisation and reforms process initiated in 1991. The government was facing pulls and pressures to open up the insurance to private enterprises and also to foreign companies. Hence, the need to rework and revive the mechanism for control was being felt. An expert committee (Malhotra Committee) gave wide ranging recommendations and in 2000, the government set up IRDA and allowed private companies to enter insurance industry. The foreign companies too were permitted to commence business in India, but only as partners of some Indian companies.

Since its setting up, the IRDA has been working overtime to set norms, lay down procedures etc. for different aspects of insurance business. How successful it has been will be determined by course of future events as they unfold.

20.7 KEY WORDS

Exposure Norms : These specify what proportion of a company's capital resources can be contributed by an insurance company. Such norms are specified for a group of companies and an in industry separately.

GIC : The public sector monopoly created under General Insurance business(nationalization) Act, 1972. Later it

was reorganized in four subsidiaries, the parent body was re-designated as a holding company.

IRDA : Insurance Regulatory and Development Authority, set up under IRDA Act, 1999. Though an organization had been set in up as early as 1996,but it acquired its full glory in April 2000 only when all the powers, responsibilities etc. as under 1999 Act were notified.

LIC of India : Monopoly created by Indian government in 1956 by taking over life insurance business of 245 companies working in India.

The Controller of Insurance: The office set up under Insurance Act, 1938to regulate and control insurance industry.

20.8 SOME USEFUL BOOKS

Govt. of India, *Economic Survey, 1996-97*

Govt. of India, *Report of the Committee on Reforms in the Insurance Sector, 1994*

IDBI, *Report on Development Banking in India,* various issues

L. M. Bhole, *Financial Institutions and Markets,* 4th ed, Tata McGraw Hill

LIC and GIC, *Annual Reports*

20.9 ANSWER OR HINTS TO CHECK YOUR PROGRESS

Check Your Progress 1

1) Read 20.3 and answer
2) Read 20.3 and answer
3) Read 20.3 and answer
4) Read 20.3 and answer

Check Your Progress 2

1) Read 20.4 and answer
2) Read 20.4 and answer
3) Read 20.4 and answer
4) Read 20.5 and answer
5) Read 20.5 and answer

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