REPORT OF THE KPN COMMITTEE ON PROVISIONS OF THE INSURANCE ACT, 1938

******JULY, 2005******

MEMBERS OF THE COMMITTEE

Chairman

K.P. Narasimhan

Members

S.V. Mony
N.M. Govardhan
K.N. Bhandari
P.C. Ghosh
Liyaquat Khan
S.P. Subhedar
D.D. Rasgotra
K.C. Mishra
T.S. Vishwanath
D. Varadarajan

Convener

K. Subrahmanyam

K.P.NARASIMHAN

Camp Hyderabad,
26th July 2005.

To

Shri C.S.Rao,
Chariman,
Insurance Regulatory and Development Authority,
Hyderabad.

Dear Shri Rao,

This is further to my letter of 28th April 2005, with which I had enclosed the first report from our Committee, to cover the Sections in the Insurance Act 1938 that we were primarily required to consider. As an interim submission, it had dwelt on the recommendations that we were making, without much of a supporting report on the conclusions that we came to.

The IRDA was kind enough to grant extension of time to the Committee to work on other areas that had formed part of our terms of reference and the opportunity to report thereon has been utilized to come up with a more comprehensive delineation, to fill in too on the recommendations that had formed our earlier interim report as it were. I am pleased to enclose our Committee's final report.

To the acknowledgements of the Committee's indebtedness for all the assistance and cooperation it received and the appreciation by all of us, I would add here our being particularly beholden to two of our own Members. Dr. K.C.Mishra very kindly agreed to host one meeting of our Committee at the National Insurance Academy in Pune and extended all hospitality to us. Shri D.Varadarajan agreed again to our request – and mine particularly – to take upon himself to bring together the outcomes from all our discussions and prepare the draft for what could be our submission to the IRDA and I must add that there was very little left for the rest of us to suggest by way of change or addition.

With regards,

Yours sincerely,

/sd./
(K.P.NARASIMHAN)

INDEX

Chapter	*Contents*	*Page No*
I	**Introduction & Approach of the Committee**	**6**
II	**Provisions relating to Investment** General approach Recommended Amendments as regards Investments – Sections 27, 27A, 27B, 27C and 27D of the Act. Recommended amendments to provisions relating to investments	**10**
III	**Provisions Relating to Shareholders' Funds And Policyholders' Funds** Analysis of statutory matrix Transfer to meet deficit caused by New Business Strain Transfer to meet deficit caused by Expense Overrun Transfer to meet deficit caused by impairment of assets Transfer to meet the cost of New Bonus to the policyholders International practices IRDA initiative to evolve consensus Views that emerged at the 5th Global Conference of Actuaries Recommendations	**18**
IV	**Provisions Relating to Capital, Sufficiency of Assets, Solvency Margin and Prudential Role of Actuaries** Part A: Provisions Relating to Capital, Sufficiency of Assets, Solvency Margin: General Approach IAIS Core Principle Thrust of the various documents and practices "Deposits" under Section 7 of the Act Extant provisions of the Act and recommendations for fine-tuning the provisions Some important issues Recommended amendments Part B : Prudential Role of the Actuary Subject matter Issues	**25**
V	**Insurance Surveyors & Loss Assessors** Overview Recommendations Recommended amendments	**38**
VI	**Tariff Advisory Committee & Insurance Councils**	**45**

	General Approach Examination of statutory matrix Recommendations Recommended amendments	
VII	***Other Provisions & Aspects of the Act*** General Approach Amendments to the Definition Clause Amendment of Section 6A Deletion of Sections 6B & 6C and Amendment of section 11 Amendment of section 21 Amendment of section 38 Amendment of section 39 Amendment of section 42 Amendment of section 48A Amendment of section 50 and deletion of section 64VC Amendment of provisions relating to penalties and suggestion for introduction of adjudicatory mechanism Grievance Redressal Mechanism Amendment of provisions relating to delegation of powers Amendment of section 110G and deletion of section 110H Amendment of section 113 Suggestions regarding other aspects to be dealt with in the Act/Regulations Prudential supervisory provisions Helping consumers select appropriate products Systems control Electronic transactions Pronounced key objectives of IRDA Recognition of 10/10 Rule in contracts of insurance Consumers' pre-grievance help bench Section 20 Custody and Inspection of Documents and supply of copies: Sections 32B and 32C Insurance Business in Rural Sector and Obligations in Respect of Rural or Unorganized Sector and Backward Classes Sections 40, 40A, 40B, 40C and 44 Relating to Agency Commission and Ceilings on Overall Expenses of Management, Section 41 Relating to Prohibition on Rebating and Section 42 Relating to Licensing of Insurance Agents**:** Section 45: Policy not to be called in Question on Ground of Misstatement after two years: Section 118 Exemptions: Comprehensive review of Insurance Rules, 1939	**57**
	Acknowledgements	
	Appendices: **Appendix I: Terms of Reference** **Appendix II: Extension of Time Limit** **Appendix 3: IAIS – Core Principles** **Appendix 4: Acronyms used in the Report** **Appendix 5: List of Names of Persons who sent suggestions**	

CHAPTER I

INTRODUCTION AND APPROACH OF THE COMMITTEE

1.1 The Insurance Act, 1938 (herein after referred to as 'the Act'), notwithstanding many an amendment since its enactment, has retained a basic structure, despite its vintage in the context of contemporary insurance legislation across the globe. The amendments have varied from minor changes to substantial overhaul, dictated by the necessities of various times. To wit, the amendments made in 1950 represented a major legislative review, thereafter in the year 1956, following the nationalization of life insurance business, and again in the year 1972 when general insurance business was also nationalized, the Act had undergone substantial metamorphosis, in the sense that many of the provisions of the Act have not been made applicable to Government owned insurance entities, subject as they are to the specific legislations that created them. In recent times, consequent upon the opening up of the insurance sector again and the enactment of the IRDA Act, 1999, the Act entailed changes, *albeit* not carried out completely and comprehensively, and therefore, anachronisms and redundancies have still remained in the Act.

1.2 The last exercise undertaken in the year 1999 and some modifications in the year 2002 did leave an imminent need to make a thorough review of the Act for removal of perceived incongruities and inconsistencies and come up with a possible integrated set of provisions to take in what had been separately legislated for in the IRDA Act, 1999. The Law Commission was requested to undertake this exercise of reviewing the Act, in the context particularly of the IRDA Act, 1999. This was a major exercise and the Law Commission has since submitted its Report to the Government of India, vide letter D.No.6(3)(75)/2002-LC(LS) addressed by the Chairman of the Commission to the Union Minister for Law & Justice on June 1, 2004.

1.3 Whereas the Law Commission has made specific recommendations in regard to many an area requiring legislative intervention, it, however, has been of the considered view that as regards the following specialized domain areas, a detailed examination by experts in such areas would be necessary for suggesting amendments to the statutory framework of the Act :

Provisions relating to Investments

Shareholders' Funds and Policyholders' Funds
Sufficiency of Assets
Insurance Surveyors
Tariff Advisory Committee

1.4 Accordingly, the Insurance Regulatory and Development Authority (hereinafter referred to as 'the IRDA'), has, vide Office Order No. IRDA/Actl/KS/001/Mar-05, dated 7th March, 2005 (Appendix-1) constituted this Committee (hereinafter called the 'Committee'), *inter alia,* to examine in detail all the aforesaid five areas and recommend changes that are warranted in the statutory framework. Further, the Committee was also called upon to indicate any other sections of the Act, which need to be amended, in the light of the developments that have taken place in the insurance scene, other than those covered by the Law Commission's recommendations. A copy of the IRDA's Office Order as cited above is at Appendix I. Subsequent to the issuance of the Office Order under reference, and pursuant to the clarification sought by the Committee, the Chairman of IRDA had also desired and empowered the Committee to also give its views, suggestions and recommendations on such of the areas examined by the Law Commission, as are considered necessary by the Committee, in the light particularly of submissions made in regard thereto.

1.5 With the aforesaid terms of reference, the Committee has examined the various issues and come out with its recommendations for the consideration of the IRDA, as is stated hereinafter.

1.6 With a view to evolving the approach, methodology and procedure of working of the Committee, so as to consider comprehensively the terms of reference and come out with specific suggestions and recommendations, the Committee, at its First Meeting held on 17th March, 2005 at the Headquarters of the IRDA at Hyderabad, kept in mind the following aspects:

(i) taking due cognizance of the Core Principles evolved by the International Association of Insurance Supervisors (hereinafter referred to as 'the IAIS'), as these principles provide a globally-accepted framework for the regulation and supervision of the insurance sector, and examining as to how in other countries the legislations deal with similar issues;

(ii) fine-tuning the Act, in the context of the mandate to stay with the basic structure of the Act, so as to make the statutory provisions measure up to the demands of contemporary times, but at the same time, recognising the diversity in the regulatory frameworks and supervisory approaches of IAIS Member Countries;

(iii) providing inbuilt flexibility to the working of the Act, by structuring the statutory provisions in such a way as not to warrant frequent legislative intervention, by placing increased reliance on subordinate legislations, with proper checks and balances;

(iv) evaluating the responses received on the Law Commission's Consultation Paper;

(v) inviting views and responses from all concerned by soliciting the same through notice on the website of the IRDA;

(vi) examining the responses from the Insurance Councils, Insurers and other Stakeholders.

1.7 At the First Meeting of the Committee, it was also decided to constitute five Groups from among the Members of the Committee, so that each Group could consider a few specific terms of reference of the Committee and related issues, and come out with its presentation pertaining to the specific areas considered by it. The Committee has reckoned that the Act, when first enacted, had contained very detailed prescriptions with regard to what could or should be done and correspondingly on prohibitions. There have been rules and regulations framed thereafter to lay down prescriptions in more specific detail. In Insurance legislation, as in other economic and corporate legislations, the trend over the years has been to reduce progressively what gets to be enacted in the primary legislation, leaving more and more of details to go into subordinate legislations, so that the Executive and/or the Regulatory Authority could, in a dynamically evolving environment, be enabled and empowered to bring in suitable regulatory changes with promptitude.

1.8 In this background, the Committee in its deliberations did consider to what extent, in the areas it had specifically to look into, to report on changes that it would recommend be left to remain in the Act, and how far the authority could be with the Government or the IRDA to come out with regulatory intervention, as and when warranted to deal with changing times.

1.9 In all, the Committee held six sittings besides meetings of groups of the Committee and had deliberations to arrive at its recommendations. While recommending amendments to the Act, the Committee, as far as possible, has endeavoured to give the draft amendments to the Act for the consideration of the IRDA. The deliberations and recommendations with regard to the specific areas of reference to the Committee, after duly considering the presentations made by the various Groups of the Committee, have been dealt with in the succeeding Chapters.

CHAPTER – II

PROVISIONS RELATING TO INVESTMENTS

General Approach

2.1 The generally accepted approach in respect of insurance legislation in different jurisdictions is that the principal legislation shall lay down the policy to be followed for investments of insurance funds and the regulations shall prescribe the details. The Committee is of the opinion that the same approach be followed while recommending amendments to the provisions of the Act relating to investments. The Committee has examined the extent to which the present provisions in the Act in regard to various aspects of investments could be restrictive, and it is of the considered view that much of the provisions could be left to be decided by way of subordinate legislation, either through Rules framed by the Government or by Regulations framed by IRDA.

2.2 The Committee deliberated upon whole gamut of prudent principles governing investments. In doing so, it took cognizance of the principles relating to investments enunciated by IAIS (Appendix 3 to this Report), existing provisions in the Insurance Act, 1938 and other principles such as corporate governance mechanism and robust independent mechanism for avoiding conflict of interest.

Recommended Amendments as regards Investments - Sections 27, 27A, 27B, 27C and 27D of the Act.

2.3 In the current context, when it is envisaged that the principal legislation would cover only policy matters, it may not be considered necessary to have separate sections for dealing with investments of life and non-life business. Further, the issues relating to micro details of investments, monitoring and control can be left to be determined by the IRDA by way of regulations.

2.4 The following definition may be added in the Act:

- "approved investments" may be defined a follows: **" 'approved investments' means such investments as are defined in the regulations made by the Authority".**

2.5 "Controlled fund" is defined in the Explanation to Section 27A. This was provided in the context of the environment in which investment pattern for all the funds was the same. Further, now that the shareholder funds are also separated from the policyholder funds, the concept of "controlled fund" may be dispensed with, and the concept of 'controlled investible funds' may be introduced. 'Controlled investible funds' may be defined as follows:

" **'Controlled investible funds' means all the funds belonging to the policyholders in the case of an insurer carrying on life insurance business, or attributable to the policies in the case of an insurer carrying on general insurance business (including health and agriculture insurances), as the case may be, and such part of the funds of shareholders as may be required to support the control level solvency as may be determined by the Authority by way of regulations**".

2.6 In the principal provision, it may be stipulated that every insurer shall invest and at all times keep invested his "controlled investible funds" in the manner, viz. twenty five per cent of the said sum in Government securities, a further sum equal to not less than twenty five per cent of the said sum in government securities or other approved securities and the balance in any of the approved investments, or other than approved investments, as may be determined by regulations made by the IRDA.

2.7 In the proviso to clause (4) of section 27A of the Act ceiling on investment in the shares in or debentures of any one company other than a banking company or investment company has been stipulated to the effect: "….nothing in this sub-section shall apply to any investment made with the previous consent of the Authority by an insurer with a view to forming a subsidiary company carrying on insurance business" . This implies that an insurer can set up a subsidiary company for carrying on insurance business. In the current context, where separate entities are required to be set up to transact life insurance and general insurance business, it is not considered desirable to allow an insurer to invest in a subsidiary company for carrying on insurance business in India.

2.8 The Act shall require every insurer to furnish returns in respect of investments of the insurer to the regulatory authority as may be prescribed by the IRDA.

2.9 Insurers shall deal in derivatives only for hedging purposes in the manner as may be prescribed by the IRDA.

2.10 The Committee recommends that sections 27, 27A, 27B, 27C and 27D of the Act may be replaced with a comprehensive section that would cover all the aspects of investments, by laying down the broad parameters in the section and enabling the IRDA to come out with appropriate regulations to govern the various other aspects of investments by insurers, as suggested in the following proposed new section, with consequential amendments to sections 2, 27, 28, 28A, 28B and 30.

Recommended amendments to provisions relating to investments

I. For the existing Section 27, the following may be substituted:

"27. Investment of Funds.-(1) Every insurer shall invest and at all times keep invested his controlled investible funds in the manner, namely, twenty-five per cent of the said sum in Government securities, a further sum equal to not less than twenty-five per cent of the said sum in Government securities or other approved securities and the balance in any of the approved investments or other than approved investments, as may be determined by regulations made by the Authority.

(2) The shareholders' funds not forming part of controlled investible funds shall be invested and kept invested in the manner as may be determined by the Authority by way of regulations.

(3) An insurer may invest or keep invested any part of his funds otherwise than in an approved investment and for this purpose the Authority may determine by regulations, the percentage of such investments, the conditions and modalities of making such investments.

(4) In computing the controlled investible funds,-

(a) any investment made with reference to any currency other than the Indian rupee which is in excess of the amount required to meet the liabilities of the insurer in India with reference to that currency, to the extent of such excess; and

(b) any investment made in the purchase of any immovable property outside India or on the security of any such property,

shall not be taken into account:

Provided that the Authority may, either generally or in any particular case, direct that any investment, whether made before or after the commencement of the Insurance (Amendment) Act, 2005, and whether made in or outside India, shall, subject to such conditions as may be imposed, be taken into account, in such manner as may be specified by the Authority in computing controlled investible funds.

(5) Any funds that are required to be invested and kept invested as stated in this section shall be invested and kept invested by every insurer free of any encumbrance, charge, hypothecation or lien.

(6) An insurer shall not invest or keep invested any part of his controlled investible funds in the shares in or debentures or other securities of any other company, other than a public company.

(7) An insurer shall not out of his controlled investible funds invest or keep invested in the shares in or debentures or other securities of any public company, except in accordance with the regulations made by the Authority.

(8) No insurer shall directly or indirectly invest outside India any part of controlled investible funds, save as prescribed by the Central Government.

(9) No insurer shall out of his controlled investible funds invest or keep invested in the shares of any other insurer:

Provided that shareholders' funds not forming part of controlled investible funds may be invested in the shares of any other insurer up to five per cent of such funds within the limits specified by regulations made by the Authority.

(10) No insurer shall out of his total funds make any investment with a view to forming a subsidiary company carrying on insurance business in India.

(11) An insurer shall not invest more than five per cent in aggregate of his controlled investible funds in companies belonging to the promoters' groups.
Explanation:- **For the purposes of this sub-section, the Authority may determine by way of regulations as to what constitutes promoters' groups.**

(12) Where at any time the Authority considers any one or more investments constituting total funds of an insurer to be unsuitable or undesirable, the Authority may, after giving the insurer an opportunity of being heard, issue to him directions as may be deemed necessary, including treating such investments as inadmissible asset for solvency purpose, if the circumstance so warrants, and the insurer shall comply with such directions within such time as may be specified therein.

(13) Without prejudice to the foregoing provisions of this section, the Authority may, in the interests of the policyholders, specify by the regulations made by him, the time, manner and other conditions of investment of controlled investible funds to be held by an insurer for the purposes of this Act.

(14) Notwithstanding the provisions contained in sub-section (6), the Authority may, give specific directions for the time, manner and other conditions subject to which the controlled investible funds shall be invested in the infrastructure and social sector as may be specified by regulations made by the Authority.

(15) Notwithstanding any thing contained in any other legislation for the time being in force, an insurer shall deal in derivatives only for hedging purposes in such manner as may be specified by the Authority.

(16) Nothing contained in this section shall be deemed to affect in any way the manner in which any moneys relating to the provident fund of any employee or to any security taken from any employee or other moneys of a like nature are required to be held by or under any Central Act, or Act of a State Legislature.

***Explanation*.- In this section and for the purposes of this Act-**

(a) "approved investments" means every investment specified as such by way of regulations made by the Authority.

(b) "approved securities" means.-

(i) government securities and other securities charged on the revenue of the Central Government or of the Government of a State or guaranteed fully as regards principal and interest by the Central Government or the Government of any State;

(ii) debentures or other securities for money issued under the authority of any Central Act or Act of a State Legislature by or on behalf of a port trust or municipal corporation or city improvement trust in any 'A Class' city;

(iii) shares of a corporation established by law and guaranteed fully by the Central Government or the Government of a State as to the repayment of the principal and the payment of dividend;

(iv) such other securities specified as approved securities by the Authority by way of regulations.

(c) "controlled investible funds" means all the funds belonging to the policyholders in the case of an insurer carrying on life insurance business, or attributable to policies in the case of an insurer carrying on general insurance business (including health

and agriculture insurances), as the case may be, and such part of the funds of shareholders as may be required to support the control level of solvency as may be determined by the Authority by way of regulations."

II. Consequential amendment to Section 2(3) regarding "approved securities"

As the definition of "approved securities" as contained in Section 2(3) is sought to be inbuilt in the newly proposed section 27, section 2(3) containing the definition of "approved securities" may be omitted.

III. The existing sections 27A, 27B, 27C and 27D may be omitted.

IV. Section 28:-

(a) Sub-section (2B) may be substituted with the following:

"(2B) In respect of assets forming the controlled investible funds within the meaning of section 27, and which do not form part of the Government securities and approved securities invested and kept invested in accordance with section 27, an insurer shall submit, along with the returns referred to in sub-sections (1) and (2), a statement, where such assets are in the custody of a banking company, from that company, and, in any other case, from the chairman, two directors and a principal officer if the insurer is a company, or from a principal officer of the insurer if the insurer is not a company, specifying the assets, which are subjected to a charge and certifying that the other assets are held free of any encumbrance, charge, hypothecation, or lien, and every such statement after the first shall also specify the charges created in respect of any of those assets since the date of the statement immediately preceding, and, if any such charges have been liquidated, the date on which they were so liquidated."

(b) Sub-section (4) shall be deleted and the existing sub-section (5) may be renumbered as sub-section "(4)".

V. The marginal heading of section 28A and sub-section (1) thereof may be substituted as follows:

"**28A. Return of investments relating to controlled investible fund and changes therein.-(1) Every insurer shall every year within thirty-one days from the beginning of the year submit to the Authority a return in the form specified by the regulations made by the Authority showing as at the 31st day of March of the preceding year, the investments made out of the controlled investible fund referred to in section 27, and every such return shall be certified by a principal officer of the insurer."**

VI. Sub-section (1) of section 28B may be amended as follows:

In sub-section (1) for the word and figure "section 27B", the word and figure "section 27" may be substituted.

VII. Section 30 along with its marginal heading may be substituted as follows:

"30. Liability of directors, etc., for loss due to contravention of sections 27 and 29.- If by reason of a contravention of any of the provisions of section 27 or section 29, any loss is sustained by the insurer or by the policyholders, every director, manager, officer or partner who is knowingly a party to such contravention shall, without prejudice to any other penalty to which he may be liable under this Act, be jointly and severally liable to make good the amount of such loss."

CHAPTER – III

PROVISIONS RELATING TO SHAREHOLDERS' FUNDS AND POLICYHOLDERS' FUNDS

Analysis of statutory matrix

3.1 The provisions of the Act, till it was amended by the IRDA Act 1999, did not require a life insurer to keep separate accounts relating to the funds of shareholders. The IRDA Act, 1999, *inter alia*, added Clause (1B) to Section 11 (dealing with Accounts and balance sheet) of the Act, to require that "every insurer shall keep separate accounts relating to funds of shareholders and policyholders". The regulations framed by the IRDA for preparation of financial statements and auditors report require the balance sheet of a life insurer to show on the liability side two separate compartments – the "Shareholders' funds" and "Policyholders funds". The two accounts thus are completely separate.

3.2 In accounting terms, the "Policyholders' funds" are nothing more than a book-keeping entry and represent the accumulated balance of all previous revenue accounts. It is an up-to-date balance of all premiums received minus all claims and expenses together with investment income of the "Policyholders' funds". The legislation requires that the "Policyholders' funds" are effectively held in trust for the benefit of the policyholders and that those exist to pay out benefits when the policies eventually result into claim or are surrendered.

3.3 In life office operations, when a policy is sold, a negative cash-flow generally arises and an immediate deficiency is created, which may continue as a shortfall in the accumulated policy fund in relation to the policy reserves required to be held. In the case of an established life insurer, this deficiency is met by the retained profits and the surplus emerging on the existing block of business. However, in the case of a new life insurer this deficiency, which is higher on account of expense overrun till the breakeven is achieved, continues until surpluses emerging on the business written in the past have wiped out the accumulated deficits and the then current year's surplus is sufficiently large to cover the deficiency in respect of the year's new business. This period would vary with the type and volume of business written by a life insurer. Due to the inherent conservatism in the statutory reserving basis, it may be some years before the technical deficiency

is eliminated, even when the business is being written on perfectly sound basis. This is particularly the case when the rate of new business growth is high.

3.4 The principal or sub-ordinate legislation in India does not prescribe any line of action for dealing with these deficits. This essentially means that the policyholders' funds can be allowed to continue with the deficit. However, the IRDA circular dated 23rd March 2004 requires that the policyholders' funds shall not be in deficit. The deficit in policyholders' fund does not in any manner impair the security of the policyholders because even if the policyholders' funds are allowed to remain in deficit, the shareholders' funds would always be available to support the policyholders' benefit, if and when needed as the aggregate of shareholders' fund and policyholders' funds would be required to demonstrate the solvency norms prescribed by the IRDA. However, from the policyholders' perspective it can be argued that the policyholders' funds shall have sufficient assets to meet the policy liabilities. If the deficit is allowed to continue, the policyholders in general would have to be educated that even if the policyholders' fund/s are in deficit, the ability of the life insurer to meet its liabilities is not impaired as the life insurer on aggregate basis remains solvent. Some may also argue that if the policyholders' funds are allowed to remain in deficit, it would hamper the asset liability management. Further, in the early stages of opening up of the insurance industry in India, this issue has another dimension as most of the new life insurers in India have chosen the route of providing bonus to the policyholders financed through the shareholders' funds.

3.5 Section 49 of the Act requires that "No insurer, …….who carries on business of life insurance or any other class or sub-class of insurance business…… shall, for the purpose of declaring or paying any dividend to shareholders or any bonus to the policy-holders ……utilize directly or indirectly any portion of life insurance fund or of the fund of such other class or sub-class of insurance business, so as the case may be, except a surplus shown in the valuation…….submitted to the Authority…… as a result of an actuarial valuation of the assets and liabilities of the insurer; nor shall he increase such surplus by contributions out of any reserve fund or otherwise unless such contributions have been brought in as revenue through revenue account applicable to the class or sub-class of insurance business on or before the date of valuation aforesaid,……..". It is therefore necessary for the life insurers which want to provide bonus to

the policyholders financed from the shareholders' fund to transfer such amount from the shareholders' fund to policyholders' fund as would be sufficient to wipe out the deficit in the policyholders' fund as also meet the cost of new bonus to the policyholders.

3.6 In this context, the transfers from the shareholders' fund to the policyholders' fund could take place on the following counts:

- to meet the new business strain;
- to meet the expense overrun;
- to meet the deficit caused by impairment of assets; and
- to meet the cost of new bonus.

As per the provisions of the existing legislation, the transfers from the policyholders' funds to shareholder' fund can be only by way of shareholders' share of valuation surplus.

3.7 Which of the above transfers made from the shareholders' fund to the policyholders' on the above counts can be considered for being given back to the shareholders' fund when surplus emerges in the policyholders' fund? This aspect was duly considered by the Committee.

3.8 This issue is relevant only for the participating fund as the shareholders are entitled to the whole of valuation surplus in respect of non-participating business.

Transfer to meet deficit caused by New Business Strain

3.9 When the first valuation is done immediately following the date of issue of a policy, the valuation will throw up new business strain because of conservative statutory valuation basis causing deficit in the policyholders' fund. If this deficit is to be eliminated, funds have to be transferred from the shareholders' fund to the policyholders' funds. However, if the product pricing is correct, then this deficit is of a temporary nature as the reserves built up because of margins built into valuations basis get released and what the shareholders are doing by such transfer of funds is to simply 'ring fence' the assets in case the pricing does prove to be incorrect and there remains a shortfall. In technical terms it is said that the valuation basis would have Margins for Adverse Deviations (MADs) and these would generate Provisions for Adverse Deviations (PADs) in the reserves set up. As each year passes, a release from risk from adverse deviations will take place and the component of PAD for that year gets released. When these PADs

get released, the support provided by the shareholders' fund by way of transfer of funds to policyholders' fund is not needed. Could this be given back to the shareholder fund?

Transfer to meet deficit caused by Expense Overrun

3.10 In the case of a new life insurer, the actual expenses will exceed those assumed in pricing and valuation because of the low volume of initial business. For a new life insurer, it could take five / six years or thereabout to break even, i.e. actual expenses are at least equal to and then less than those assumed. When this happens, the "expense overrun" ceases. If this does not happen, then the life insurer will have to review the expense assumptions in both pricing and valuation. These expenses do not form a part of the valuation process followed for the business sold. The "expense overrun" is a business development expense and has to be recouped by the shareholders only through their share of surplus, i.e. 90/10 route.

Transfer to meet deficit caused by impairment of assets

3.10 This is a part of business risk which has to be borne by the shareholders. Any transfer effected from the shareholders' fund to meet the deficit caused in the policyholders' funds by impairment of assets has to be recouped only through the shareholders' share of surplus, i.e. 90/10 route.

Transfer to meet the cost of New Bonus to the policyholders

3.11 The shareholders transfer funds from shareholders' fund to meet the cost of new bonus that they would like to give to the policyholders. This essentially is decision taken by the shareholders as a part of their business development strategy and transfers to meet the cost of new bonus has necessarily to be recouped only through their share of surplus.

International practices

3.12 In a few jurisdictions a system of subordinated loan from the shareholders' fund to policyholders' fund is followed for meeting the deficit caused by new business strain and in very special circumstances for meeting the deficit caused by impairment of assets. In this case, the shareholders' fund provides loan to the policyholders' fund to meet the deficits and loan is repaid when adequate surplus is generated in the policyholders' funds. In order to ensure that policyholders' interests are protected at all times, any repayment of principal (or payment of interest, if allowed) on such loan must be authorized by the Board of Directors of the life insurer on the recommendation of the Appointed Actuary. This is also subjected to approval of the regulatory Authority.

3.13 Canada Life Assurance Co., which was a mutual life insurance company, was demutualized in 1999. On demutualization, the company closed the then existing participating fund and started a new participating fund and to support the new participating fund the shareholders provided seed capital of $ 50 million with interest at stipulated rate. This was essentially a subordinated loan with interest thereon. It will be useful here to analyze the implications of the shareholders providing this seed capital. We may ignore here the deficit caused in the policyholders' fund because of impairment of assets; as such deficit is caused by major economic crisis such as the one caused in south East Asia, an event of not frequent occurrence, referred to in the next para. The Canada Life being a well established company did not have the problem of expense overrun. The seed capital being available to meet the new business strain immediately, there was no deficit caused due to new business strain. This being the case, a new policy put on the books of Canada Life would not have caused deficit in the policyholder fund and the surplus would have emerged in the new participating fund in the normal course from year one for providing bonuses to the new policyholders. Thus the seed capital, or subordinated loan, was intended only to meet the deficit caused by new business strain.

3.14 In Malaysia, the insurance law requires that the deficits must be met by transfer of assets from shareholders fund to policyholders' funds. This transfer of assets is then recognized as loss in the shareholders' fund. These transfers can be recouped by the shareholders' fund only through the shareholders' share of valuation surplus. During the Asian Crisis and resultant severe fall in asset values, the regulatory authority allowed deficits in the policyholders' fund to be funded by temporary transfers of assets from the shareholders' fund to policyholders' funds. This provision was made to allow asset values to recover and a three year period was set to be a reasonable time for this to happen. The shareholders were allowed to withdraw their assets within this three year period provided such withdrawal did not leave deficit in the policyholders' funds. Any assets not withdrawn within three years were "lost".

3.15 The UK Insurance Law also does not provide for pay back of transfers from shareholders' fund to the policyholders' funds. The transfers from policyholders' find to the shareholders' fund can only be through the shareholders' share of surplus.

IRDA initiative to evolve consensus

3.16 The Committee has noted that in December 2003, the IRDA, had called an informal meeting of Actuaries, which was attended by M/s J R Joshi, N K Shinkar, K P Narasimhan, J S Salunkhe, (all Retired Chairmen of LIC), Liyaquat Khan, President, Actuarial Society of India, P A Balasubramanian, Member (Actuary), IRDA, and S P Subhedar, Retired Managing Director, LIC, to consider this issue. The aforesaid Group in its Report has concluded: "Shareholders when deciding to transfer Assets to Policyholders' Fund to meet the deficit in Policyholders' fund and also to enable availability of surplus to declare bonus do so at their discretion and cannot expect repayment of the funds transferred to policyholders by way of prior charge on the distributable actuarial surplus determined by the Appointed Actuary as a result of valuation. They are entitled only to their share of actuarial surplus as per provisions of section 49 of the Insurance act and relevant regulations'.

3.17 The IRDA vide its circular dated 23rd March 2004 on the subject of "Preparation of financial statements of life insurers" has issued comprehensive instructions for dealing with the transfers and have specified that "The funds so transferred to the Policyholders' A/c shall be irreversible in nature, i.e. at no point of time can they be recouped to the Shareholders' Fund".

Views that emerged at the 5th Global Conference of Actuaries organised by the Actuarial Society of India, FICCI and the International Actuarial Association (New Delhi, February 2003)

3.18 The Committee also noted that at the 5th Global Conference of Actuaries held in February, 2003, during the Session on "S P Subhedar Committee Report", Mr. Shriram Mulgund, Retd. Valuation Actuary, Canada Life, had suggested the following approach in respect of shareholder transfers made to fund the new business strain:

- When new business is placed on the books, transfer an amount equal to the new business strain from the shareholders fund to the policyholders' fund.
- Each year, transfer from the policyholders fund to the shareholders fund an amount equal to the full release of PADs and a designated portion of the valuation surplus. The net transfer will depend on sizes of these two amounts (to and from the policyholder fund).
- Keep track of the outstanding balance of the amounts transferred from the shareholders fund to meet the new business strain. When it reaches zero, the transfer of PADs will stop and only the designated percentage of the valuation surplus will be transferred. From this point onwards, the policyholders fund will start accumulating retained earnings.

- In order to ensure that the seed money provided by the shareholders is redeemed in a proper manner, IRDA approval can be required.

3.19 The Committee feels that the method adopted by Canada Life of providing seed capital at specified rate of interest, essentially a subordinated loan, is fine for financing new business strain for an established life office as the established life office would not have had the problem of handling expense overrun issue. The process for deciding pay back to the shareholder fund of the amount provided by the shareholder fund to finance the new business strain as suggested at the 5th GCA (mentioned in para 3.8), though looks fine theoretically, is extremely complex to put in practice, raising concerns about the accounting treatment of the transfers from shareholder funds and the charge they would represent on what should be funds held entirely for the benefit of policyholders.

3.20 The Committee did note some very recent changes in the legislation in Singapore but they did not seem appropriate for any adapted consideration.

3.21 The Committee also examined the other provisions of Section 49. The first proviso to Section 49 stipulates "payments made out of any such surplus in service of any debentures shall not exceed fifty per cent of such surplus including any payment by way of interest on debentures, and interest paid on the debentures shall not exceed ten per cent of any such surplus except when the interest paid on the debentures is offset against the interest credited to the fund or funds concerned in deciding the interest basis adopted in valuation disclosing the aforesaid surplus". This proviso, while not currently relevant, could become relevant if the insurance companies were to be allowed to have capital other than equity capital. It was therefore decided to recommend retention of this proviso.

Recommendation

3.22 The Committee, taking an overall view, decided that no change be considered necessary in the provisions of Section 49, except effecting consequential amendments for removal of redundancies.

CHAPTER – IV

PROVISIONS RELATING TO CAPITAL, SUFFICIENY OF ASSETS, SOLVENCY MARGIN AND PRODENTIAL ROLE OF ACTUARIES

PART – A : PROVISIONS RELATING TO CAPITAL, SUFFICIENCY OF ASSETS AND SOLVENCY MARGIN

General Approach

4.1 Issues relating to capital, including minimum capital and solvency margin are interlinked. Besides, section 7 of the Act, which deals with 'Deposit', is proxy to what is now called minimum solvency margin, having been introduced as a requirement, when solvency margin concept was not in vogue. The Committee, therefore, is of the view that issues relating to Sufficiency of Assets and Solvency Margin as embodied in section 64VA of the Act need to be addressed in conjunction with the sections of the Act dealing, which deal with 'Deposit', 'Capital' and 'Minimum Capital'.

4.2 The IAIS and International Actuarial Association (IAA) (Actuarial Society of India is a member of IAA), have dealt with the subject matter of Capital, Minimum Capital and Solvency Margin in the following documents:

IAIS:

1. Guidance on Insurance Regulation and Supervision for Emerging Market Economies, dealing *inter alia* with Capital adequacy.
2. Principles on Capital Adequacy and Solvency
3. Solvency Control level Guidance Paper

IAA:

A Global Framework for Insurer Solvency

IAIS Core Principle

4.3 The IAIS vide Core Principle 23, deals with capital adequacy and solvency. It says that the supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable

the insurer to absorb significant unforeseen losses. The essential criteria for evaluation of attainment of this core principle are:

a. The solvency regime addresses in a consistent manner:

- valuation of liabilities, including technical provisions and the margins contained therein;
- quality, liquidity and valuation of assets;
- matching of assets and liabilities;
- suitable forms of capital;
- capital adequacy requirements

b. Any allowance for risk mitigation or transfer considers both its effectiveness and the security of any counterparty.

c. Suitable forms of capital are defined.

d. Capital adequacy requirements are sensitive to the size, complexity and risks of an insurer's operations, as well as the accounting requirements that apply to the insurer.

e. The minimum capital adequacy requirements should be set at a sufficiently prudent level to give reasonable assurance that policyholder interests will be protected.

f. Capital adequacy requirements are established at a level such that an insurer having assets equal to the total of liabilities and required capital will be able to absorb significant unforeseen losses.

g. Solvency control levels are established. Where the solvency position reaches or falls below one or more control levels, the supervisory authority intervenes and requires corrective action by the insurer or imposes restrictions on the insurer. The control level is set so that corrective action can be taken in a timely manner.

h. Inflation of capital – through double or multiple gearing, intra-group transactions, or other financing techniques available as a result of the insurer's membership in a corporate group – is addressed in the capital adequacy and solvency calculation.

i. The solvency regime addresses the requirements placed upon an insurer operating through a branch.

j. The solvency regime provides for periodic, forward-looking analysis (e.g., dynamic solvency/ stress testing) of an insurer's ability to meet its obligations under various conditions.

k. The supervisory authority assesses the structure of its solvency regime against structures of a

peer group of jurisdictions and works towards achieving consistency.

Thrust of the various documents and practices

4.4 The above documents and the others available and the practices in major jurisdictions lead to the following conclusions:

(i) There should be a *minimum capital requirement* for licensing an insurer, such minimum being reflective of the class of insurance business.

(ii) There should be requirement for *Solvency Margin (SM)*; excess of assets over liabilities including a *minimum solvency margin* requirement which should have relationship with minimum capital.

(iii) Breach of SM should lead to the insurer being required to close down. However, there should be a level spelt out in the law – *the control level* - a breach of which should require the Regulator to trigger actions aimed at restoring the financial health of the insurer before requiring the insurer to close down upon breach of the SM.

"Deposits" under Section 7 of the Act

4.5 The deposit as a fraction of premium with a maximum of rupees ten crorers in respect of a life insurer, as also a general insurer, and to the extent of rupees twenty crores in respect of a re-insurer is required to be maintained with Reserve Bank of India at all times, as per the provisions of section 7. Consequently, section 8 deals with usage of such deposit i. e. to meet policyholder liabilities after all other resources have been exhausted. Section 9 deals with the procedure for refund of the deposit.

4.6 The concept of deposit is a creation of an era, when the concept of solvency did not exist. As of now, the concept of Solvency Margin (SM) required of an insurer at all times is embedded in the Act (sec. 64 V and sec. 64 VA) and is regulated through IRDA regulations. As such, the objective of "Deposit" is met through the SM. The amount of deposit is capped at a very low level, as against what ought to be required to ensure solvency of an insurer. In any case, the continued solvency at a desired regulatory level of confidence has been addressed in the Act and the regulations.

4.7 Therefore, the Committee recommends that section 7 of the Act be deleted with consequential amendments to the other sections, which refer to deposits.

Extant provisions of the Act and recommendations for fine-tuning the provisions

4.8 In respect of Deposit, Capital and SM, currently the Act provides as under. The recommendations in regard to these requirements are also indicated along side in the last column of the following Table:

Sections	Subject matter	Issues	Recommendation
Sec. 6	Requirements as to Capital		Needs to be amended for providing different levels of Capital for certain classes of business, such as, Agriculture Insurance and Health Insurance, as suggested herein by the Committee
Sec. 6A	Requirements as to Capital Structure and voting rights and maintenance of registers of beneficial owners of shares		Needs to be amended as suggested in Chapter-VII.
Sec. 6AA	Manner of divesting excess share capital by promoter in certain cases		Needs to be amended as suggested in Chapter VII
Sec 6B	Provision for securing compliance with requirements relating to capital structure		To be deleted
Sec. 6C	Conversion of Company limited by shares in to Company limited by guarantee		To be deleted
Sec. 7, 8 & 9	Deposits	Not needed any more as the concept of SM is embedded in the Act	To be deleted

Sec 64 V	Assets and Liabilities how to be valued	It provides for exclusion of assets and requirements for valuation of assets in accordance with regulations made by the Authority	To be substituted as suggested herein by the Committee
Sec. 64 VA	Sufficiency of assets	Defines SM, sets its minimum levels, prescribes penalties and course of action.	To be substituted as suggested herein by the Committee

Some important issues

4.9 Currently there is lack of legal harmony between some provisions of the Act and the Regulations made by the Authority.

4.10 The matters currently in the Act need to be apportioned between what should remain in the Act, in the Rules prescribed by the Central Government and the Regulations specified by the Authority.

4.11 The level of minimum capital, which, as of now, is the same for both life and non-life insurers, needs to be set at different levels for certain classes of insurance business, such as, health and agriculture.

4.12 There needs to be formula based linkage between minimum capital and minimum SM as against the absolute level prescribed now.

4.13 The control level of solvency, the solvency breach at which the IRDA shall initiate corrective measures is not prescribed.

Recommended amendments to statutory provisions

I. For the existing section 6, the following may be substituted:

"6. Requirement as to Capital.- No insurer carrying on the business of life insurance, general insurance or re-insurance in India on or after the commencement of the Insurance Regulatory and Development authority Act, 1999, shall be registered unless he has,-

(i) **a paid-up equity capital of rupees one hundred crores, in case of a person carrying on the business of life insurance or general insurance; or**

(ii) **a paid-up equity capital of rupees two hundred crores, in case of a person carrying on exclusively the business as a reinsurer :**

Provided that in determining the paid-up equity capital specified under clause (*i*) or clause (*ii*), any preliminary expenses incurred in the formation and registration of the insurer shall be excluded:

Provided further that an insurer carrying on business of health insurance or agriculture insurance exclusivesly shall be required to maintain such minimum paid-up equity capital as may be prescribed by the Central Government.

Provided further that an insurer carrying on the business of life insurance or general insurance or re-insurance in India before the commencement of the Insurance Regulatory and Development Authority Act, 1999 and who is required to be registered under this Act, shall have a paid-up equity capital in accordance with clause (*i*) or clause (*ii*), as the case may be, within such period as may be prescribed by the Central Government in this behalf."

II. For the existing section 64V and 64VA, the following may be substituted:

"64V. Assets and liabilities how to be valued.- (1) For the purpose of ascertaining compliance with determination of solvency margin certain assets shall be excluded as prescribed by the Central Government.

(2) Every insurer shall furnish to the Authority along with the returns required to be filed under this Act, a statement, certified by the auditor, of his assets and liabilities assessed in the manner required by this section as on the 31st day of March of each year within such time as specified by regulations made by the Authority.

(3) Every insurer shall value his assets and liabilities in the manner in accordance with the

regulations made by the Authority in this behalf."

"64VA. Sufficiency of assets.- (1) Every insurer and reinsurer shall at all times maintain an excess of value of assets over the amount of liabilities of, not less than fifty percent of the amount of minimum capital as stated under section 6 of this Act, and arrived at in the manner specified by regulations made by the Authority.

(2) An insurer or reinsurer, as the case may be, who does not comply with sub-section (1) shall be deemed to be insolvent and may be wound up by the court on an application made by the Authority.

(3) The Authority shall, by way of regulation made for the purpose, specify the level of solvency margin, the control level of solvency as required under sub-section (1), on the breach of which the Authority shall act in accordance with the provisions of sub-section (4).

(4) If, at any time, an insurer or reinsurer does not maintain the required control level of solvency margin, he shall, in accordance with the directions issued by the Authority, submit a financial plan to the Authority, indicating a plan of action to correct the deficiency within a specified period not exceeding six months.

(5) An insurer who has submitted a plan, as required under sub-section (4), to the Authority shall propose modifications of the plan, if the Authority considers the same inadequate, and in such an eventuality, the Authority shall give directions, as may be deemed necessary, including direction in regard to transacting any new business, and/or, appointment of an administrator.

(6) An insurer or re-insurer, as the case may be, who does not comply with provisions of sub-section (4) shall be deemed to be insolvent and may be wound up by the court on an application made by the Authority.

(7) The Authority shall be entitled at any time to take such steps as he may consider

necessary for the inspection or verification of the assets and liabilities of any insurer or re-insurer, or for securing the particulars necessary to establish that the requirements of this section have been complied with as on any date, and the insurer or re-insurer, as the case may be, shall comply with any requisition made in this behalf by the Authority, and in the event of any failure to do so within two months from the receipt of the requisition, the insurer or re-insurer, as the case may be, shall be deemed to have made default in complying with the requirements of this section.

(8) The provisions of this section shall not apply to an insurer specified in sub-clause (c) of clause (9) of Section 2 of this Act.

(9) In applying the provisions of sub-section (1) to any insurer or re-insurer, as the case may be, who is a member of a group, the relevant amount for that insurer shall be an amount equal to that proportion of the relevant amount which that group, if considered as a single insurer, would have been required to maintain as the proportion of his share of the risk on each policy issued by the group bears to the total risk on that policy:

Provided that when a group of insurers ceases to be a group, every insurer in that group who continues to carry on any class of insurance business in India shall comply with the requirements of sub-section (1) as if he had not been an insurer in a group at any time.

Provided further that it shall be sufficient compliance of the provisions of the foregoing proviso if the insurer brings up the excess of the value of his assets over the amount of his liabilities to the required amount within a period of six months from the date of cessation of the group.

Provided also that the Central Government may, on sufficient cause being shown, extend the said period of six months by such further periods as it may think fit, so however that the total period may not in any case exceed one year."

III. It is further recommended that the present Sections 6, 6A, 6AA, 6B, 64V and 64 VA may be grouped together under a separate Chapter.

PART – B: PRUDENTIAL ROLE OF THE ACTUARY

Subject matter

4.14 On account of the uniqueness of the insurance business and issues of public interest, such as, customer-benefits protection, soundness of trade and industry through general insurance and stabilization of society through life insurance, social security and pensions and in recent history the stabilization of financial services through capital and ALM management, Governments/Regulators have, across all jurisdictions, relied upon the role, professional inputs and certifications of Actuaries. Such actuarial roles to be undertaken by an "Actuary" have been recognized to be distinct and unique. An Actuary is typically required to be qualified from a recognized professional institute imparting professional qualification in Actuarial Science and regulated by it for continuing updating of knowledge and adherence to edifying professional conduct of high standards. In India, such a professional body of actuaries is the Actuarial Society of India (ASI), a society established in 1944 and structured since 1982 as an Educational and Charitable Society and as a Trust under the Bombay Public Trust Act. Currently, the ASI is recognized as the sole body of actuaries in India under the Act and IRDA Act and regulations.

4.15 The IAIS, of which the IRDA is a part, and the IAA, of which the ASI is part, have dealt with the subject matter of the prudential role of the actuary in two important documents, viz., 'The use of Actuaries as part of a Supervisory Model' – Guidance Paper by the IAIS and 'The Function of Actuary in Prudential Supervision' by the IAA. Both these documents lead to the concept of "Appointed Actuary" (also with different nomenclature in some jurisdiction), which means that the Law/Regulations require the appointment of one single individual in respect of an insurer on a continuing basis, such individual performing specified prudential role in public interest but not being part of the Government or Regulator, the underlying assumption being that in order to perform such functions the Appointed Actuary needs to be in the know of matters which are internal to the functioning of the insurer, which he would not know about if he were to be part of the Government or Regulator.

4.16 Actuarial certifications have been in vogue in Indian Laws right from 1912 when the first law on life insurance came in to being and the institution of Appointed Actuary was introduced for all

classes of insurance business in the year 2000 through the IRDA's Appointed Actuary Regulations.

Issues

4.17 Whereas the IRDA (Appointed Actuary) Regulations, 2000 addressed the need for the Appointed Actuary, the Act not having been amended, currently there exists lack of legal harmony between the substantive law and the IRDA regulations.

4.18 Reproduced herein below is a list showing the provisions of the Act referring to the actuarial function in such contexts as are stated therein, and the recommendation of the Committee against each such provision:

Sections of the Act	**Title and the subject**	**Recommendation**
Section 2(1)	Definition defines Actuary	Should remain as it is.
Section 3(2)f	Registration – certification by an Actuary of prospectus, etc., at the time of registration	To be retained.
Section 3B	Certification of soundness of terms of life insurance business -	To be retained
Section 13	Actuarial Abstract and report	To be retained
Section 15(2)	Submission of returns - signing	To be retained. However, 'Actuary' should be replaced with 'Appointed Actuary', and the term 'Appointed Actuary' be defined in the Act in section 2 thereof, by engrafting the definition, as contained in IRDA (Appointed Actuary) Regulations, 2000.
Section 21(1) (a)	Powers of Authority regarding returns: calling for further information	To be retained. However, the current provision "auditor or actuary" gives

		an impression as if the two roles are substitutable. Therefore, it is suggested that the provision should be "auditor, appointed actuary or both, as the case may be".
Section 22(1)	Powers of Authority to order revaluation	Should remain as it is.
Section 29(1), (6)	Prohibition of loans to actuary and penalty thereof	Should remain as it is. However, 'Actuary' to be replaced with 'Actuary or Appointed Actuary'.
Section 33 (1)	Powers of investigations and inspection by Authority - Authority may employ an actuary for investigation	Should remain as it is.
Section 35 (3) (d)	Report on Amalgamation and transfer of insurance business	The import of the Section should remain as it is but should be made applicable to all classes of insurance business; whether life, general or any other. Clause (d) specifying the role of Independent Actuary should be re-worded as follows: *"A report on the proposed amalgamation or transfer, prepared by an independent actuary who has not been professionally or otherwise connected with any of the parties concerned in the amalgamation or transfer at any time during the five years preceding the date on which he signs his report.* *Provided that such report shall be made in accordance with regulations made by the*

		Authority."
Section 40(B)(1),(3)	Premium basis certificate	To be retained
Section 44A (a)	Power to call for information	To be retained. However, 'Actuary' to be replaced with 'Appointed Actuary'.
Section 49(2)	Reference made to report of actuary	To be retained. However, 'Actuary' to be replaced with 'Appointed Actuary'.
Section 52(2)	Prohibition of business on dividing principle	To be retained. However, 'Actuary' to be replaced with 'Appointed Actuary'.
Section 64K (3) & (5)	Executive Committee of Life Insurance Council - Advise in controlling expenses	To be retained. However, 'Actuary' to be replaced with 'Appointed Actuary'.
Section 81	Provident Society - Actuarial Abstract & report	The Committee agrees with the suggestion of the Law Commission in regard to doing away with the Chapter of the Act dealing with Provident Societies.
Section 82 (2)	Submission of returns to Authority	--- do --
Section 83(1),(3),(4),(5),(6)	Provident Society - Actuarial examination of schemes	--- do --
Section 85(3), (3A), (4)	Provident Society - Prohibition of loan and penalty thereof	--- do --
Section 87 (1), (2) (4)	Provident Society - Inquiry by or on behalf of Authority	--- do --
Section 87A (3(d)	Provident Society - Amalgamation & transfer of insurance business - independent actuary report	--- do --

Section 89(d)	Reduction of insurance contracts	--- do --
Section 91 (1) g	Assistance to liquidator appointed to wind up a society – Powers of liquidator	--- do --
Section 92 (6)	Assistance to liquidator appointed to wind up a society – Procedure at liquidation	--- do --
Section 112	Declaration of interim bonuses	To be retained.

4.19 The Committee recommends that the following provision may be inserted in the Act to make it mandatory for every insurer to engage the services of an Appointed Actuary:

"Every insurer shall appoint an actuary, who shall be known as Appointed Actuary, in accordance with regulations made by the Authority and the scope of his duties and responsibilities, and other matters shall be as may be considered expedient by the Authority."

CHAPTER – V

INSURANCE SURVEYORS AND LOSS ASSESSORS

Overview

5.1 Surveyors and loss assessors play an important role in the process of evaluation and settlement of claims pertaining to general insurance policies. Surveyors and loss assessors are independent individuals or firms possessing qualifications as laid down in section 64UM of the Act and the regulations framed there under.

5.2 The requirement of licensing of surveyors was introduced in the year 1968, through an amendment of the Act, read with the Rules/Regulations framed there under. The substantive and procedural legislations deal with the licensing procedure, qualifications, code of conduct, categorization, etc. To wit, section 64UM of the Act provides that no person shall act as a surveyor or loss assessor in respect of general insurance business unless he holds a valid licence issued by the IRDA and that the licence would remain in force for five years, unless cancelled earlier. Earlier, the Controller of Insurance was the competent authority for grant of licence, and as of now, the IRDA is the competent authority.

5.3 It has been observed by the Law Commission that it has received an overwhelming response from various quarters for the abolition of the system of licensing of surveyors. It is to be noted that the system of licensing of surveyors does not exist in major insurance markets. Even in India, there was no licensing requirement prior to 1968.

5.4 The Malhotra Committee, which went into the functioning of surveyors and loss assessors, had highlighted a number of lacunae in the system of licensing, and suggested that the system should be given up, as it did not serve any useful purpose. It further observed that insurance companies should be free to empanel, in their discretion, surveyors possessing the qualification laid down in law, and assign the right surveyor the right job.

5.5 The Committee of Professionals constituted by the Ministry of Finance, Government of India, on 9th December, 2002 had also gone into the issue relating to licensing of surveyors and recommended that licensing of surveyors and loss assessors should be discontinued.

5.6 Thus, it has been observed time and again that the system of licensing is a hindrance to growth of professionalism among surveyors. Mere eligibility to obtain licence as per qualifications prescribed by law does not ensure availability of required expertise in insurance, which is a technically diversified field. It also does not ensure continuing education, learning or up-gradation of their job skills, and there is no effective monitoring of their skills, performance and conduct.

5.7 The responses/suggestions received by the Committee from various individuals and entities veer round to the view that:

(i) surveyors should be technically competent with sound knowledge;
(ii) independent surveyors should assess the loss in a fair and unbiased manner;
(iii) in-house surveys system has many defects and ills, and that the same be reviewed;
(iv) mandatory limit of Rs. 20,000 for survey should be removed and all claims should be surveyed by independent surveyors; and
(v) independent institute of surveyors be established.

Recommendations

5.8 On a detailed examination of the various issues, views, current practices and findings of earlier Committees, the Committee recommends that the system of licensing of surveyors be abolished.

5.9 The Committee opines that the law should only prescribe the minimum qualifications necessary for eligibility to work as a surveyor, and it should be left to the judgment of an insurer to utilize his services, as may be considered necessary.

5.10 The Committee also does not favour dilution of qualifications for in-house surveyors and recommends that they should also have the some qualifications as are required for external surveyors.

5.11 The Committee finds no merit in continuation of mandatory legal requirement for survey by professional surveyors applying only to claims of Rs. 20,000 and above. The limit was fixed in the year 1968, and if inflation, and consequent erosion in the value of rupee is to be reckoned, it would now translate into a very high figure. Instead, the Committee suggests that IRDA may be empowered to notify from time to time limits for different classes of business beyond which only it must be made mandatory on the part of the insurer to utilize the services of professional surveyors.

5.12 The response to the Law Commission's Consultation Paper also yielded an important suggestion of constitution of a self-regulating institute of surveyors on the lines of the Institute of Chartered Accountants of India. Similar such institutes of surveyors exist elsewhere in the world. The Malhotra Committee had also recommended establishment of an institution of surveyors to usher in professionalism by creating and nurturing high levels of skills and evolving a code of conduct. The Committee recommends that the Government, IRDA and Insurance Industry should do every thing possible to promote establishment of an institute of surveyors on self-sustaining basis. Such an institute should undertake the responsibility of developing courses and training programmes, conducting examinations and awarding qualifications.

5.13 In order to ensure that the Institute, as suggested herein above, and its members become fully accountable to the users and consumers for the quality of their services, membership should be restricted to individuals. However, surveyors may form a company or partnership firm, subject to the condition that all the directors or partners, as the case may be, shall possess the certificate of practice.

5.14 The Executive Council of the Institute should have adequate representation from Government/IRDA and general insurance industry. The Council shall have a disciplinary committee, to take cognizance of complaints referred to it by the IRDA, and also to send its report on action taken. An appellate mechanism shall be provided to enable any aggrieved insurer, insured or surveyor to prefer an appeal to the IRDA against an order /decision of the institute.

5.15 If the IRDA, at any time comes to the conclusion that the affairs of the Institute are not being carried on in accordance with the mandate given, or its activities are not conducive to the interests of users and consumers, it may, by an order, supersede the Executive Council of the Institute and appoint an Administrator in its place and such an order by the IRDA should bind all concerned.

5.16 The IRDA should carry out a comprehensive review of functioning of the institute at the end of three years from the date of establishment and if it is satisfied that the affairs are being carried on in accordance with its objectives, it may persuade the Government to confer statutory status on the institute through an Act of Parliament.

5.17 Till such time recognition is granted to an Institute, the IRDA shall continue to discharge the function of granting licence in terms of the present regulations.

5.18 The Committee recommends that the existing provisions of section 64UM(3) and (4) empowering the IRDA to call for a report from an independent surveyor in respect of any claim and issue directions as he may consider necessary with regard to settlement of the claim be dispensed with.

5.19 The Committee also recommends that the newly recast provisions relating to surveyors and loss assessors, as suggested herein below, be included in Part IIA of the Act, as section 64U, consequent upon the recommendation of the Committee in the next Chapter for doing away with Part IIB of the Act.

Recommended amendments to provisions relating to Surveyors and Loss Assessors

I. For the existing Section 64UM, the following may be substituted and the section may be numbered as section 64U, to be included in Part IIA of the Act, as has been suggested in the next Chapter:

"64U. Surveyors and loss assessors. - (1) Save as otherwise provided in this section, no person shall act as a surveyor or loss assessor in respect of general insurance business (including health and agriculture insurance).

(2) No person shall act as surveyor or loss assessor in respect of general insurance business unless he:

(a) possesses one or more educational or technical qualifications as may be specified by the Authority by way of regulations;

(b) does not suffer from any of the disqualifications mentioned in sub-section (4) of section 42;

(c) is a member of a professional body of surveyors and loss assessors, by whatever name called, duly recognized by the Authority for the purpose; and

(d) holds a valid certificate of practice to work as surveyor and loss assessor granted by the professional body as stated in clause (c):

Provided that in the case of a firm or company, all the partners or directors or other persons, who may be called upon to make a survey or assess a loss reported, as the case may be, shall fulfill the requirements of clauses (a) to (d) of sub-section (2).

(3) The Authority may in its sole discretion, upon receipt of application in the form as may be specified by the Authority and on being satisfied that the applicant-institute or association or body by whatever name called has been established as a professional body of surveyors and loss assessors with the objective of promoting educational, technical and professional skills of its members, may grant recognition to the applicant and may also authorize it to issue certificate of practice to such of its members fulfilling the requirements in this behalf as may be specified by the Authority by way of regulations.

Provided that before rejection of an application for grant of recognition, the Authority may give a reasonable opportunity to the applicant to be heard.

Provided further that till such time recognition is granted to an applicant as stated in this sub-section, the Authority shall continue to discharge the function of grant of licence to persons for acting as surveyors and loss assessors, in terms of the regulations made by him before the commencement of Insurance (Amendment) Act, 2005.

(4) Every surveyor and loss assessor shall comply with the code of conduct in respect of his duties, responsibilities and other professional requirements, as may be specified by the regulations made by the Authority.

(5) A surveyor and loss assessor shall investigate, survey, manage, quantify, appraise, adjust and deal with losses on behalf of insurer and/or insured when appointed so to do, arising from any contingency, carry out the assigned task with utmost objectivity and professional integrity by strictly adhering to the code of conduct specified by the Authority and report thereon with in the time specified:
Provided that a surveyor and loss assessor shall act with reasonable dispatch while undertaking any survey and loss assessment work, and shall complete his assigned scope of work within a reasonable time.

(6) The Authority may from time to time notify financial limits and classes of business for which insurers shall appoint a surveyor and loss assessor and obtain his report on the loss before settlement of claim.

Provided that nothing in this sub-section shall be deemed to take away or abridge the right of the insurer to pay or settle any claim at any amount different from the amount assessed by the surveyor and loss assessor, by duly recording the reasons therefor, and communicating the same to the insured.

(7) The Authority shall have power to cause investigation, in the manner laid down in the regulations, of any complaint received against any surveyor or loss assessor alleging professional misconduct, breach of code of conduct and ethics, any act of omission or commission which in his opinion is unbecoming of a professional surveyor and loss assessor or against the interests of policyholders and pass appropriate orders against such surveyor and loss assessor within the disciplinary jurisdiction of the Authority, as may be specified by regulations made by the Authority in this behalf, including imposition of fine and /or disqualification of such a surveyor and loss assessor from acting as a surveyor or loss

assessor permanently or for such period as may be specified in the order, after affording an opportunity of being heard.

(9) Notwithstanding any thing contained in the foregoing provisions, a person acting as a licensed surveyor and loss assessor prior to the commencement of the Insurance (Amendment) Act, 2005 shall continue to act as such for such period as may be specified by the Authority.

Provided that such a person as mentioned in this sub-section shall, within the period as may be notified by the Authority, satisfy all the requirements of sub-section (2), failing which, the person shall be automatically disqualified to act as a surveyor and loss assessor.”

CHAPTER – VI

TARIFF ADVISORY COMMITTEE AND INSURANCE COUNCILS

General Approach

6.1 The provisions of Part IIB of the Act in regard to Tariff Advisory Committee (TAC) and Control of Tariff Rates have become a subject matter of debate for quite sometime now, and the debate got accentuated in the present context, where the insurance sector in India has been opened up for private sector participation. The case for abolition of tariffs and graduation from a controlled regime to a detariffed regime has gained currency as such a regime can be considered to be a basic component of an open market and competitive economy.

6.2 Against this backdrop, the Committee, while considering recommendations to the provisions relating to TAC, thought it apposite to look at some of the other provisions of Part IIB of the Act relating to Insurance Councils, etc.

Examination of statutory matrix

6.3 As had been observed by the Malhotra Committee, the amendment to the Act effected in the year 1968, introducing social control on general insurance, provided for the TAC replacing the Tariff Committee of the General Insurance Council and its Regional Councils. The primary objective was to make rate setting more scientific and base it on statistical analysis of data. TAC became a statutory body with the Controller of Insurance as its Chairman. On nationalization of general insurance business, the Chairman of GIC became the Chairman of TAC. All the members of TAC were nominated by the GIC with prior approval of the Central Government to represent the GIC, its subsidiaries, the State insurance funds, the Ministry of Finance, and the Bureau of Industrial Costs and Prices. The Secretary of TAC was also nominated by the Chairman of GIC from amongst the officers of GIC and subsidiary companies. TAC approves the policy wording of the terms and conditions of all policies relating to tariffed business. Now, with the enactment of the IRDA Act, 1999, Part IIB of the Act has been amended, *inter alia*, in regard to TAC, to give effect to, *albeit*, partially, the recommendations of the Malhotra Committee in regard to the

Composition of TAC. Under the present dispensation, the Chairman of the TAC is the Chairperson of the IRDA.

6.4 The composition, powers and functioning of the TAC has been subject to comments from several quarters, and there were many suggestions, viz., (i) abolition of TAC; (ii) bringing TAC under the control of the Insurance Regulator and expansion of the composition of TAC by including members outside the Industry. The Malhotra Committee also examined the relevant aspects of the functioning of the TAC.

6.5 In the context of the debate in regard to tariffed regime *versus* self-regulated free pricing regime (detariffing), the Committee has taken cognizance of the initiatives taken by the IRDA, in the recent times in the constitution of Justice Rangarajan Committee, to considering the various aspects of detariffing the Own Damage (OD) Portion of Motor Insurance, and S.V. Mony Group, suggesting the roadmap for detariffing the OD Portion of Motor Insurance.

6.6 The Committee fully endorses the main argument against tariff that it greatly reduces the scope for competition, and that tariffs bring about rigidity in the market, and that once the tariff is framed, it becomes very difficult to appropriately revise the same in response to the changes in the market.

6.7 The Committee feels that time is ripe for assigning to the General Insurance Council, the function of self-determination of rates, terms and advantages, with adequate checks and balances. In this context, the Committee endorses the recommendations made earlier to the IRDA, while suggesting the roadmap for detariffing the OD Portion of Motor Insurance, by the S.V. Mony Group, in regard to the role of the General Insurance Council.

6.8 The Committee is of the view that the determination of rates, terms and advantages of insurance be taken away from the TAC and entrusted to the General Insurance Council, as was the case (under the repealed section 64-O of the Act), prior to the insertion of Part IIB of the Act by the Insurance (Amendment) Act, 1968. It will be in the fitness of things to bring TAC under the auspices of the General Insurance Council, as the statistical warehouse and analytical institution to

support the endeavours of the General Insurance Council in the determination of rates, terms and advantage of general insurance products.

Recommendations

6.9 In view of the above, the Committee recommends that :-

(a) the relevant sections of the Act should be amended to provide merely for the establishment of Life Insurance Council, General Insurance Council and the Tariff Advisory Committee (to be renamed as 'Technical Advisory Committee') under Part IIA itself. Details may be provided by the IRDA by empowering it to make the necessary Regulations. Accordingly, Part IIB of the Act may be deleted;

(b) in respect of the provisions relating to the TAC it is felt that ultimately, rate-making should be left to the insurers. This has to be done progressively. As a first step, the function may be transferred to the General Insurance Council as a Self Regulatory Organization within the framework of Regulations to be framed by the IRDA, subject, of course ,to the 'file and use' mechanism. TAC may be brought under the auspices of the General Insurance Council to function as "Technical Advisory Committee" ;

(c) the provisions relating to insurance surveyors (as recommended in the previous Chapter) be brought under Chapter IIA itself;

(d) sufficient safeguards may be inbuilt in the new provisions for protecting the terms and conditions of employment of the officers and employees of the TAC;

(e) rating (pricing) along with terms and conditions of cover, under Section 64 UA onwards now included in the TAC functions may be shifted to Part IIA in the role and functions of the General Insurance Council under 64 L;

(f) the General Insurance Council may have such mechanisms as are necessary to implement the new functions as suggested above;

(g) in the context of progressively converting the Councils into Self Regulatory Organizations, the power of nomination of officials conferred on the IRDA under sections 64F and 64L may be done away with;

(h) nomination of Secretary of the Councils by the IRDA may be replaced with a provision that the Councils will appoint the Secretaries;

(i) with the rating functions being shifted to the General Insurance Council, any omission or failure to submit statistics on the part of insurers may be dealt with seriously by bringing in deterrent provisions.

Recommended amendments to provisions relating to Insurance Councils & Tariff Advisory Committee

I. Part IIA of the Act, for the existing section 64F, the following may be substituted:

"64F. Executive Committees of the Life Insurance Council and the General Insurance Council.-(1) The Executive Committee of the Life Insurance Council shall consist of the following persons, namely:

(a) four representatives of members of the Life Insurance Council elected in their individual capacity by the said members in such manner as may be specified by the Authority by way of regulations in this behalf;
(b) a person not connected with any insurance business, nominated by the Authority; and
(c) three persons to represent insurance agents, intermediaries and policyholders respectively as may be nominated by the Authority.

Provided that one of the representatives as mentioned in clause (a) shall be elected as the Chair person of the Executive Committee of the Life Insurance Council.

(2) The Executive Committee of the General Insurance Council shall consist of the following persons, namely:

(a) four representatives of members of the General Insurance Council elected in their individual capacity by the said members in such manner as may be specified by the Authority by way of regulations in this behalf;
(b) a person not connected with any insurance business, nominated by the Authority; and
(c) three persons to represent insurance agents, surveyors and loss assessors and policyholders respectively as may be nominated by the Authority.

Provided that one of the representatives as mentioned in clause (a) shall be elected as the Chair person of the Executive Committee of the General Insurance Council.

(3) If any body of persons specified in sub-sections (1) and (2) fails to elect any of the members of the Executive Committees of the Life Insurance Council or the General Insurance Council, the Authority may nominate any person to fill the vacancy, and any person so nominated shall be deemed to be a member of the Executive Committee of the Life Insurance Council or the General Insurance Council, as the case may be, as if he had been duly elected thereto.

(4) Each of the said Executive Committees may make bye-laws for the transaction of any business at any meeting of the said Committee.

(5) The Life Insurance Council or the General Insurance Council may form such other committees consisting of such persons as it may think fit to discharge such functions as may be delegated thereto.

(6) The Secretary of the Executive Committee of the Life Insurance Council and of the Executive Committee of the General Insurance Council shall in each case be appointed by the Executive Committee concerned.

Provided that each Secretary appointed by the Executive Committee concerned shall exercise all such powers and do all such acts as may be authorized in this behalf by the Executive Committee concerned."

II. Amendment of sub-section (2) of section 64G:

Sub-section (2) of 64G may be substituted as follows:

"(2) Casual vacancies in the Executive Committee of the Life Insurance Council or of the General Insurance Council, whether caused by resignation, death or otherwise, shall be filled in such manner as may be specified by the Authority by way of regulations in this behalf, and

any person so nominated to fill the vacancy shall hold office until the dissolution of the Committee to which he has been nominated."

III. The existing section 64-I may be omitted.

IV. The existing section 64L may be substituted with the following:

"64L. Functions of the Executive Committee of General Insurance Council, - (1) The functions of the Executive Committee of the General Insurance Council shall be -

(a) to aid and advise insurers, carrying on general insurance business, in the matter of setting up standards of conduct and sound practice and in the matter of rendering efficient service to holders of policies of general insurance;

(b) to render advice to the Authority in the matter of controlling the expenses of such insurers carrying on business in India in the matter of commission and other expenses;

(c) to bring to the notice of the Authority the case of any such insurer acting in a manner prejudicial the interests of holders of general insurance policies;

(d) to examine and study pricing methodologies in select markets overseas;

(e) to self-administer rates, terms and conditions of general insurance business as stated in section 64S;

(f) to have regular interface with policy makers, both at the Centre and States, to address motor related issues, such as, initiation of effective measures for tackling the menace of uninsured/underinsured vehicles;

(g) to create robust database on repairs costs that catapult the claims cost;

(h) to undertake activities such as : research to identify strategies and interventions to reduce deaths, injuries and property damage; development of complete, accurate and accessible data; all aspects of vehicle safety including the conditioning of vehicles put on road; education of all stakeholders about road safety; development and promotion of strategies and interventions for increasing road safety; collection of data *inter alia* from the police and enforcement agencies and statutory authorities, hospitals, insurers and the insuring public; conduct of research and studies on various important and

relevant topics like seat belt usage, helmet usage, mobile phone usage, road design, age of drivers and driving skills, pedestrian related, alcohol related, poor/bad road conditions related accidents, etc., in collaboration with the specialized agencies and institutions of repute;

(i) to act in any matter incidental or ancillary to any of the matters specified in Clauses (a) to (c) as with the approval of the Authority may be notified by the General Insurance Council in the Gazette of India.

(2) For the purpose of enabling it effectively to discharge its functions, the Executive Committee of the General Insurance Council may collect such fees as may be decided that Council, from all insurers carrying on general insurance business:

Provided that if the General Insurance Council thinks fit, it may by a resolution passed by it, waive the collection of the prescribed fees for any year and the Executive Committee of the General Insurance Council shall not collect any fees in relation to that year."

V. Section 64R may be amended as follows:

Clause (c) may be modified as: "Keep and maintain up-to-date a copy of list of all insurers who are members of the either Council."

Clause (d) of sub-section (1) of section 64R may be omitted.

VI. The existing Sections 64S and 64T may be omitted and the following new sections may be added:

"64S. Power of General Insurance Council to self-administer rates, terms, etc., of general insurance.-(1) With effect from such date or dates as may be determined by the Central Government, the General Insurance Council shall have the power to self-administer rates, terms and conditions that may be offered by insurers in respect of general insurance business, based on data as may be considered sufficient with respect to each of the risks for which rates, etc., are to be self-administered, by filing the prescribed particulars with the

Authority. Such other powers as are exercised by the Tariff Advisory Committee shall also vest in the General Insurance Council from such date or dates as may be specified.

Provided that the Authority may, in the interests of policyholders and/or orderly growth of insurance industry, give directions from time to time to the General Insurance Council in regard to any aspect of self-administration of rates, terms and conditions that may be offered, and the General Insurance Council shall comply with such directions within such time as stated therein.

Provided further that where the General Insurance Council or any insurer carrying on general insurance business fails to comply with any of the directions as stated in the first proviso, without sufficient cause, the Authority may, after affording a reasonable opportunity, proceed to take such action against the Council or the insurer, or both, as the case may be, including the removal of the elected representatives of the Council or direction to the insurer concerned not to underwrite any business, or both, as the case may be.

Provided further that any person aggrieved by the action of the Authority under the second proviso, may appeal to the Central Government within thirty days and the decision of the Central Government shall be final and binding.

(2) Every insurer carrying on general insurance business shall file with the Authority the rates, terms, etc. that may be offered pursuant to sub-section (1) of this section before implementing the same.

(3) Till such time the self-administration of rates, etc., is allowed by the Central Government as stated in sub-section (1), the Tariff Advisory Committee established under section 64U prior to the commencement of the Insurance (Amendment) Act, 2005 and in existence on such commencement shall continue to function and shall exercise all powers and functions conferred on it, prior to such commencement:
Provided that notwithstanding any thing contained in sub-section (5) of section 64UC of the Insurance Act, 1938, where an insurer is guilty of breach of any rate, advantage, terms or

condition fixed by the Tariff Advisory Committee, he shall be proceeded against by the Tariff Advisory Committee in terms of the regulations made by the Authority.

Provided further that the regulations made by the Authority pursuant to the above proviso may empower the Tariff Advisory Committee to levy and recover a penalty not exceeding rupees twenty five lakhs for each such breach, besides directing the insurer to recover the deficiency in the premium, or where it is not practicable to recover the deficiency in the premium, to modify suitably or cancel the contract of insurance.

Provided further that where an insurer omits or fails to submit the required statistics to the Tariff Advisory Committee, he shall be punishable with a penalty not exceeding rupees ten lakhs for every such omission or failure. The provisions of this proviso shall apply *mutatis mutandis* for every omission or failure to submit the required statistics to the General Insurance Council, from such date as may be notified by the Authority.

Provided also that where an insurer is found guilty of breach of tariff on more than three occasions, the Tariff Advisory Committee shall bring the same to the notice of the Authority and the Authority may take such further action as may be considered expedient against such insurer, including cancellation of his registration.

(4) All rates, terms, etc., fixed by the General Insurance Council may cease to be self-administered by the General Insurance Council with effect from a date or dates as may be determined by regulations to be made by the Authority.

64T. Establishment of Technical Advisory Committee and matters relating thereto.-(1) On and from such date as may be determined by the Central Government and subject to the provisions of section 64S, the General Insurance Council, under its administrative control, shall establish a Technical Advisory Committee to assist and enable the General Insurance Council to carry out the functions as stated in section 64L.

(2) Every whole-time employee of the Tariff Advisory Committee who was employed by that Committee immediately before such date shall become an employee of the Technical Advisory Committee and shall hold his office in it by the same tenure at the same

remuneration, and upon the same terms and conditions and with the same rates and privileges as to pension, gratuity and other matters as he would have held on such commencement if this section had not been enacted, and shall continue to do so until his employment under the technical advisory committee is terminated, or until his remuneration, terms and conditions are duly altered by the Technical Advisory Committee.

(3) Notwithstanding anything contained in the Industrial Disputes Act, 1947 (14 of 1947), or in any other law for the time being in force, the transfer of the services of any employee of the Tariff Advisory Committee to Technical Advisory Committee shall not entitle any such employee to any compensation under that Act or other law, and no such claim shall be entertained by any court, Tribunal or other authority.

(4) On and from the date as may be determined by the Authority, all the assets and liabilities of the Tariff Advisory Committee existing on that date shall be transferred to, and vest in, the General Insurance Council.

(5) Where the Tariff Advisory Committee has established a provident or superannuation fund or any other fund for the benefit of its employees and constituted a trust in respect thereof (hereafter in this section referred to an existing trust), the monies standing to the credit of any such fund, from the date as may be determined by the Authority, shall, subject to the provisions of sub-section (6), stand transferred to, and vest in, the General Insurance Council.

(6) Where any employee of the Tariff Advisory Committee does not become an employee of the Technical Advisory Committee, the monies and other assets appertaining to any fund referred to in subsection (5) shall be apportioned between the trustees of the fund and the General Insurance Council in the manner determined by the Authority, and in case of any dispute regarding such apportionment, the decision of the Central Government thereon shall be final.

(7) The General Insurance Council shall, as soon as may be after the establishment of Technical Advisory Committee, constitute in respect of the monies and other assets which are transferred to, and vested in it, under sub section (5), one or more trusts having, as far as practicable, objects similar to the objects of the existing trusts.

(8) Where all the monies and other assets belonging to an existing trust are transferred to, and vested in, the General Insurance Council under sub-section (5), the trustees of such trust shall be discharged from the trust except as respects things done or committed to be done by them before such transfer.

(9) Unless otherwise expressly provided by or under this Act, all contracts, agreements and other instruments of whatever nature subsisting or having effect immediately before the date of establishment of the technical advisory committee pursuant to sub-section (1), and to which Tariff Advisory Committee is a party or which is in favour of that Committee shall be of as full force and effect against or in favour of the General Insurance Council and may be enforced or acted upon as fully and effectually as if, instead of the Tariff Advisory Committee, the General Insurance Council had been a party thereto or as if they had been entered into or issued in favour of the General Insurance Council.

(10) If, at the date of establishment of the Technical Advisory Committee, any suit, appeal or other legal proceeding of whatever nature is pending by or against the Tariff Advisory Committee, then it shall not abate, be discontinued or in any way be prejudicially affected by reason of the transfer to the General Insurance Council of the assets and liabilities of the Tariff Advisory Committee, or of anything done under this Act, but the suit, appeal or other proceeding may be continued, prosecuted or enforced by or against the General Insurance Council."

VII. For the recommended content of Section 64U, reference may be made to the previous chapter (Chapter-V).

VIII. The following may be added as section 64V:

“64V. Power to remove difficulties.-If any difficulty arises in giving effect to any of the provisions contained in any section under this Part, the Central Government may, by order, make such provisions or give such directions not inconsistent with the provisions of this Act as may appear to it to be necessary or expedient for the removal of difficulty.

Provided that no such power shall be exercised after the expiry of a period of four years from the enforcement of the provisions concerned.”

IX. Part IIB of the Act may be omitted.

CHAPTER – VII

OTHER PROVISIONS AND ASPECTS OF THE ACT

General Approach

7.1 The Committee has also examined the provisions and some important aspects of the Act, which have not been considered by the Law Commission, besides giving its views and suggestions on some of the recommendations of the Law Commission. These are dealt with in the succeeding paragraphs.

Amendments to the Definition Clause

7.2 As the changes that may be warranted in the definition clause as contained in section 2 of the Act, as are not dealt with by the Law Commission, are already examined and provided in the preceding Chapters, an attempt has been made herein regarding some of the other important definitions that require consideration.

7.2.1 The definition of **'General Insurance Business'** as stated in section 2(6B) may be reworded as follows:

> **'General insurance business means fire, marine or miscellaneous insurance business, including health insurance business and agriculture insurance business, as may be defined by way of regulations made by the Authority, whether carried on singly or in combination with one or more of them.**'

Consequently, Clauses (6A), (13A) and (13B) of section 2, which define the terms 'fire insurance business', 'marine insurance business' and miscellaneous insurance business' may be omitted.

The Committee feels that it would be in the fitness of things to define 'general insurance business' in a generic manner by empowering the IRDA to define the various classes of general insurance business by way of Regulations, so that as and when warranted the IRDA can come out with timely amendments to the Regulations for covering the new and emerging classes of general insurance business.

7.2.2 The definition of '**Indian Insurance Company'** as contained in section 2(7A) may be amended as follows:

' **'Indian insurance company' means any insurer, being a company limited by shares-**

(a) which is formed and registered under the Companies Act, 1956 (1 of 1956) as a public company;

(b) in which the aggregate of holding of equity shares by a foreign company either by itself or through its subsidiary companies or its nominees, do not exceed such percent of paid up equity capital of such Indian insurance company, as may be prescribed by the Central Government; and

(c) whose sole purpose is to carry on life insurance business or general insurance business or re-insurance business or health insurance business.

Provided that where at the time of commencement of the Insurance (Amendment) Act, 2005, an insurer, being a company, is not a public company, such insurer shall with in one year from the date of such commencement convert itself into a public company.

Provided further that where an insurer as referred to in the first proviso fails to covert itself into a public company with in one year as stated in that proviso, the insurer shall cease to carry on any insurance business.

***Explanation.*-For the purpose of this clause, the expression 'foreign company' shall have the meaning assigned to it under clause (23A) of section 2 of the Income-tax Act, 1961.'**

The above definition is recommended by the Committee, to make it patently clear that an insurer, being a company, has necessarily to be a public company limited by shares, and not to allow a company other than a public company to carry on any insurance business. Accordingly, by way of proviso, sun-set clause has been suggested for conversion of private insurance companies into public companies with in the stipulated time.

In clause (c) of the definition 'health insurance business' is specifically provided for enabling the formation of 'stand alone' health insurance companies.

The Committee recommends that a separate definition of **'health insurance'** may be incorporated in the definition clause of the Act, by engrafting the existing definition of 'health insurance' as stated in Regulation 2(f) of the IRDA (Registration of Indian Insurance Companies) Regulations, 2000. Likewise a similar definition could be added in respect of agriculture insurance in the IRDA Regulations referred to above, which can similarly again be carried to the Act.

The Committee deliberated at length on the pros and cons of stipulating, in specific terms, the percentage of foreign participation in the paid-up equity, in clause (b) of the definition of 'Indian insurance company', as has been the case now, but refrained from so specifying (such as a percentage not exceeding 49 per cent), leaving it to be addressed by the Central Government in view of the sensitivity of the matter.

The Committee recommends that consequential amendments may be made to section 6AA of the Act, which refers to "twenty-six percent".

7.2.3 The Committee recommends that section 2(8) which defines the term 'insurance company' may be omitted, as the same is rendered redundant.

7.2.4 The Committee recommends the following consequential amendment to the definition of 'insurance co-operative society' as contained in section 2(8A), in the substitution of clause (c):

> **"(c) in which no body corporate, whether incorporated or not, formed or registered outside India, either by itself or through its subsidiaries or nominees, at any time, holds more than such per cent of the capital of such co-operative society, as may be prescribed by the Central Government."**

7.2.5 The Committee recommends that the definition of **"**insurer**"** as contained in section 2(9) may be substituted with the following:

" 'insurer' means.-

(a) the Life Insurance Corporation of India, established under the Life Insurance Corporation Act, 196 (31 of 1956); or

(b) an Indian insurance company; or

(c) an insurance co-operative society; or

(d) such other entity, as may be notified by the Central Government."

7.2.6 The Committee recommends that the definition of **"**insurance agent**"** as contained in section 2(10) may be amended as follows:

" 'insurance agent' means every person, appointed to act as such, as stated in section 42, and subject to the regulations made by the Authority, who receives or agrees to receive payment by way of commission or other remuneration in consideration of his soliciting or procuring insurance business, including business relating to continuance, renewal or revival of policies of insurance.

***Explanation.- A* micro-insurance agent, as may be defined by way of regulations made by the Authority, is also an insurance agent and shall be governed by such regulations."**

7.2.7 The Committee recommends that the definition of **"**life insurance business**"** may be amended as stated herein below. The suggested amendment is that sub-clause (c) of clause (11) of section 2 of the Act may be reworded as follows:

"(c) the granting of superannuation allowances and benefits payable out of any fund, including managing of such funds, applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment or of the dependents of such persons;"

Amendment of section 6A

7.3 The Committee recommends that section 6A of the Act requires to be revamped completely, keeping in view the afore-suggested definition of "insurer". The Committee proposes a sleek section, leaving the power to the IRDA to stipulate by way of regulations the other details. Therefore, it is suggested that the existing section 6A may be substituted with the following:

"6A. Requirements as to capital structure and voting rights and maintenance of registers of beneficial owners of shares.- (1) Notwithstanding any thing contrary contained in any other law for the time being in force, no insurer shall, after the commencement of the Insurance (Amendment) Act, 2005 carry on any insurance business, unless he satisfies the conditions and requirements, as regards the capital structure, face value of shares, voting rights and other terms and conditions as may be specified by way of regulations made by the Authority.

(2) Notwithstanding any thing to the contrary contained in any other law for the time being in force or in the memorandum or articles of association or bye-laws, or such other document, but subject to other conditions of this section, as also the regulations that may be made by the Authority, the voting right of every shareholder of an Indian insurance company or an insurance co-operative society shall in all cases be strictly proportionate to the paid up amount of the shares held by him.

(3) An insurer.-

(a) shall maintain, in addition to the register of members to be maintained under any other law for the time being in force, a register of shares containing such details and particulars regarding the beneficial owner of each share and the changes thereof in such manner and within such period as may be determined by regulations made by the Authority;

(b) shall not register any transfer of shares-

(i) unless the transferee furnishes a declaration in such form containing such particulars as may be specified by way of regulations made by the Authority;

(ii) where after the transfer, the total paid up holding of the transferee in the shares of the insurer is likely to exceed five per cent of its paid-up capital or where the transferee is a banking company or an investment company, is likely to exceed two per cent of such paid up capital, unless the previous approval of the Authority has been obtained for the transfer;

(iii) where the nominal value of the shares intended to be transferred by an individual, firm, group, constituents of a group, or a body corporate under the same management, jointly or severally exceeds one per cent of the paid up equity capital of the insurer, unless the previous approval of the Authority has been obtained for the transfer.

Explanation.-For the purposes of this sub-clause, the Authority may by way of regulations determine as to what constitutes "group" and "same management"

(4) For the purpose of giving proper effect to the provisions of this section, the Authority may, in addition to the matters as are required to be provided for in the regulations pursuant to the other sub-sections, provide for such other matters as are considered necessary and expedient."

Deletion of sub-sections 6B and 6C and amendment of section 11

7.4 In the light of the above suggestion for amending section 6A, sections 6B and 6C may be deleted. It is also recommended that in clause (b) of sub-section (1) of section 11, reference to 'receipts and payments account' be deleted.

Amendment of section 21

7.5 The Committee recommends that sub-section (2) of section 21 may be amended in such a way as to confer the powers on the Securities Appellate Tribunal (SAT) constituted under the SEBI Act, instead of Court. Any appeal against the order of SAT may be made to the Supreme Court by an aggrieved party. In addition, the sections as mentioned in clause (d) of sub-section (1) of section 21 require to be finally verified and checked while finalizing the amendments to the Act as a whole.

Amendment of section 38

7.6 The Committee in its deliberations was of the view that this section dealing with assignments has withstood the test of time, and would not seem to call for any amendment, except for the addition one sub-section to empower the Authority to restrict or regulate certain types of assignments. This is called for to nip in the bud the potential for trading in life insurance policies by certain agencies, and to prevent moral hazards associated with such trading in life insurance policies.

7.6.1 Yet, the Law Commission had dealt extensively with the provisions in the Section and had made recommendations on specific amendments that could help to cover partial transfers of interest and conditional assignments. The Law Commission had also considered and provided for

situations of possible conflict with policyholder or public interest when the insurer could decline to act on the endorsement of assignment without further enquiry.

7.6.2 While taking note particularly of the last mentioned recommendation, the Committee, being also of the view on the need for circumspection, makes its own recommendation on what the additional provision to Section 38 could be, possibly as sub-section (9).

It is suggested that the following sub-section may be inserted as sub-section (9) to section 38:

> **"(9) Notwithstanding anything to the contrary contained in any other law for the time being in force, the Authority may, in the interests of policyholders or of the public prohibit, restrict or regulate certain types of assignments as may be specified by regulations made by the Authority."**

Amendment of Section 39

7.7 Like section 38, section 39 governing nominations have also withstood the test of time. There has been considerable jurisprudential development in regard to the rights and obligations of nominees. Therefore, it is suggested that no amendment is called for vis-à-vis section 39.

7.7.1 The Committee has noted again the extensive treatment given by the Law Commission. It is apprehensive though about recommendations providing for beneficial interests to be acquired by nominees who come possibly within kinship relation either blood or by marriage but might not necessarily fall within heir-ship.

Amendment of section 42

7.8 The present system of licensing of agents as embodied in the Act leaves much to be desired. Even the Malhotra Committee had taken cognizance of this aspect, and had recommended that insurers should appoint agents and licensing of agents by the Controller (now the Authority) should be discontinued.

7.9 The Committee has examined again the entire gamut of licensing of insurance agents, and it is of the considered view that the present system of licensing of insurance agents by the IRDA has served no useful purpose, and instead, it would be in the fitness of things to entrust this responsibility on the insurers themselves with checks and balances, by recasting section 42 of the

Act, and enabling the Authority to regulate this aspect by way of detailed regulations. Accordingly, the Committee recommends that section 42 to be recast as follows:

"42. Appointment of insurance agents.—(1) An insurer can appoint any person to act as insurance agent for the purpose of soliciting and procuring insurance business for him:
Provided that such person shall not suffer from any disqualifications mentioned in sub-section (3) of this section.

(2) No person shall act as an insurance agent for more than one life insurer and general insurer.

(3) The disqualifications above referred to shall be the following.-

(a) that the person is a minor;

(b) that he is found to be of unsound mind by a Court of competent jurisdiction;

(c) that he has been found guilty of criminal misappropriation or criminal breach of trust or cheating or forgery or an abetment of or attempt to commit any such offence by a Court of competent jurisdiction:

Provided that where at least five years have elapsed since the completion of the sentence imposed on any person in respect of any such offence, the Authority shall ordinarily declare in respect of such person that his conviction shall cease to operate as a disqualification under this clause;

(d) that in the course of any judicial proceeding relating to any policy of insurance or the winding up of an insurer or in the course of an investigation of the affairs of an insurer it has been found that he has been guilty of or has knowingly participated in or connived at any fraud, dishonesty or misrepresentation against an insurer or insured;

(e) that in the case of an individual, he does not possess the requisite qualifications and practical training for a period not exceeding twelve months, as may be specified by the regulations made by the Authority in this behalf;

(f) that in the case of a company or firm making an application under sub-section (1) or sub-section (3), a director or a partner or one or more of its officers or other employees so designated by it and in the case of any other person the chief executive, by whatever name called, or one or more of his employees designated by him, do not possess the requisite qualifications and practical training and have not passed such an examination as required under clauses (e) and (g);

(g) that he has not passed such examination as may be specified by the regulations made by the Authority in this behalf;

(h) that he has violated the code of conduct specified by regulations made by the Authority.

(4) If any person who acts as an insurance agent for an insurer contravening the provisions of this section, such insurance agent is deemed to have committed fraud for the purposes of section 44 of this Act, and the insurer may be deemed to have contravened the provision of this Section and may be subject to the provisions of Section 105A of this Act

Amendment of section 48A.

7.10 This section prohibits life insurance agents from becoming directors of life insurance companies. However, in the context of the existence of corporate agents, such a stipulation creates difficulties for corporate members holding shares in the life insurance companies, as co-promoters, etc., to field their candidates on the boards of life insurance companies. Further, the general restriction of agents not to become directors should be made applicable to general insurers also. Therefore, the section along with its marginal heading may be substituted with the following:

> **"48A. Insurance agents not to be directors of insures.-No insurance agent, who solicits or procures any insurance business for an insurer, shall be eligible to be or remain a director of that insurer:**
>
> **Provided that the Authority may by way of regulations modify or remove the foregoing restriction, in the case of such of the insurance agents, and subject to such conditions, if any, as may be specified in the regulations."**

Amendment of section 50 and deletion of section 64VC.

7.11 The Committee feels that the proposal of the Law Commission to amend this section in regard to notice of options available to the assured on the lapsing of policies may create practical difficulties to life insurers. The existing provision in regard to options available to the assured on the lapsing of a policy is quite adequate. Hence, it is suggested that no amendment is called for. Once the grace time for payment of premium and consequences of lapsing of policy on account of non-payment of premium are provided in the policy conditions, that should suffice, as per the present provisions of section 50. The Committee recommends that the provisions of section 64VC of the Act in regard to restrictions on the opening of a new place of business may be deleted.

Amendment of provisions relating to penalties and suggestion for introduction of adjudicatory mechanism

7.12 Presently, sections 102 to 105C of the Act deal with penalties. The penal provisions as they stand today are nebulous as regards the power of the Authority to levy penalties even in cases relating to statutory/technical offences in regard to non-compliance of Act, orders, rules, regulations, etc. Therefore, it is suggested for speedy and timely action against defaulting/ delinquent parties, it would be necessary to amend the present penal provisions to enforce market discipline and edifying conduct by empowering the Authority to levy penalties by adapting the SEBI pattern in this behalf, by taking a cue from the SEBI Act. It is also necessary to have in the penal provisions power to award punishments by way of fine and/or imprisonment for serious offences. In such matters, court's intervention becomes imperative. Therefore, it is suggested that the penal provisions may be segregated into two, viz., i) penalties; and ii) fines & imprisonment; whereas in regard to the former, the Authority may be straight away empowered to impose the same with inbuilt checks and balances, and in regard to the latter, the court's jurisdiction is called for.

7.13 For imposition of penalty, it is suggested that the Adjudicatory Mechanism as envisaged in the SEBI Act may be adapted with suitable modifications. The Authority may have a few Adjudicating Officers at a certain level to deal with imposition of penalty, by following the procedure as would be laid down in the new law read with the regulations to be framed by the Authority. Appeal against the order of the Adjudicating Officers would lie to the Securities

Appellate Tribunal (SAT), an independent quasi judicial body constituted under the SEBI Act. An appeal shall lie against the orders of SAT in the Supreme Court.

7.14 It is suggested that in view of the recommendation to confer jurisdiction to SAT, the SEBI Act may be amended to provide for a member of SAT with insurance background who should be on the Bench to hear matters arising out of the appeals under the Insurance Act.

7.15 It is also suggested that the monetary penalties within the proposed domain of Adjudication Officers may also be enhanced from the present level. Accordingly, the present provisions of sections 102 to 105C require to be reworded by taking away fines and imprisonment from their purview.

7.16 In the light of the above proposal, the provisions of the Act in regard to power of court to grant relief, cognizance of offences, etc., as contained in sections 108 and 109 should be reconsidered. Section 107 requiring previous sanction of Advocate General for institution of proceedings should be deleted.

7.17 Section 110, dealing with appeals should be so modified as to confer jurisdiction on SAT instead of Court.

Grievance Redressal Mechanism

7.18 The Law Commission has extensively reviewed the existing grievance redressal mechanism and it has recommended a scheme under which the disputes arising out of insurance contracts presently under the purview of consumer fora and ombudsman are settled by Grievance Redressal Authority (GRA) to be constituted exclusively to deal with insurance disputes. Provision has also been made for an appellate process under which the appeals against the orders of the GRA are heard and disposed of by an Insurance Appellate Tribunal (IAT) with its Headquarters at New Delhi and conducting business in four metros. The recommendations made by the Commission cover broadly the following aspects:

(a) Grievance of policyholders vis-à-vis the insurance companies;

(b) Redressal of grievances of insurers, intermediaries and insurance agents vis-à-vis the IRDA;
(c) Modifications in sections 102 to 105C of Insurance Act to bring them under the purview of the IRDA.

7.19 The recommendations relating to grievances of policyholders against the decisions of the insurance companies flow from the assumption that the existing systems of adjudication of disputes through the consumer fora and the institution of ombudsman have not fully addressed the problem of early resolution of disputes. Hence, the suggestion to create GRA and an Appellate Body to deal with insurance disputes. The proposal of Law Commission to create a parallel judicial hierarchy to address this issue has the following shortcomings:

(i) The Consumer Courts are now located at every District Headquarters and are with in the easy reach of the policyholders. If it is replaced by GRA which is located only in major cities and towns, the consumers would be at a disadvantage. It is not established in statistical terms that the Consumer Courts are so overburdened that they cannot handle the additional burden imposed by the insured approaching them for grievance redressal. The facility of approaching a forum available at District Headquarters would be lost if GRAs are established at major cities only.
(ii) Appeals against the orders of the GRA would lie to ITA with its headquarters at New Delhi and holding court in four metros. As of now, if the insured is not satisfied with the orders of District Consumer Forum, he could approach the State Commission. This facility would be lost in the proposed scheme.
(iii) The existing scheme of Ombudsman has the merit of bringing finality and provides relief to the insured as the insurer is debarred from appealing against the order of Ombudsman. Some of the insured may prefer this route and this facility would be denied to the insured.

7.20 Considering that the need for exclusive courts to deal with insurance claims has not been established statistically and issues relating to access to the dispute redressal mechanism in the proposed scheme, the Committee suggests that it may be desirable to continue and refine the

existing system rather than replace it by a costly parallel mechanism. It is, however, desirable that in those District Fora and State Fora where there is a large number of cases relating to insurance, an additional member who is well versed with insurance matters may be inducted as a measure to hasten the process of disposal and to provide expert Counsel to such fora.

7.21 There is also need to continue with the system of Ombudsman to act as an alternate redressal mechanism. However, this institution, which was established in 1998, is still to make an impact. This is partly due to lack of awareness about the existence of this system and mostly due to the vast jurisdiction covered by the Ombudsman. There may be a case for creating this post in each State Headquarters and give wide publicity about the role of the Ombudsman.

7.22 The second issue raised by the Law Commission relates to the redressal of grievances arising out of the orders passed by the Authority against insurers, intermediaries and insurance agents. The suggestion of the Commission that IRDA should appoint adjudicatory officers to adjudicate the violations of the Act, Regulations and Rules by insurers, insurance agents and intermediaries and levy penalties provided for in the Act needs to be implemented. As regards provision of appeals against the orders of adjudicatory officers, it is suggested that the SAT may be given the authority to deal with this aspect, by inducting a member familiar with the provisions of the Insurance Laws, instead of the IAT as recommended by the Commission. Since we have suggested that the existing grievance redressal should address the disputes between the insured and the insurer, the IAT would not have adequate work if it were to deal with appeals arising out of the orders of the Adjudicating Officers of the IRDA.

7.23 The Committee welcomes the suggestion of the Law Commission to make a statutory provision to ensure that every insurer sets up an in-house grievance redressal mechanism under the overall supervision of the IRDA. It may also be stipulated therein that the claimant should first approach this institution before taking recourse to any legal recourse for redressal of grievances.

7.24 The third issue raised by the Law Commission relates to amendments to section 102 to 105C of the Act to enable Adjudicating Officers of the IRDA to deal with and impose penalties for violation of provisions of the Act. This would set at rest any doubt about the jurisdiction of

criminal courts as these provisions deal with imposition of fines. This aspect has already been dealt with by the Committee in para 7.13.

7.25 The Committee feels that the existing grievance redressal mechanism is within easy reach of people and implementation of the recommendations of the Law Commission would not only result in additional expenditure, but also cause inconvenience to the policyholders. Hence, it is recommended that the existing mechanism with suitable strengthening as suggested in the preceding paras may serve the overall interests of the insured.

Amendment of provisions relating to delegation of powers

7.26 The provisions of section 110A of the Act deal with delegation of powers and duties by Chairperson of the Authority, but the section does not talk about delegation of powers and functions of the Authority. It is recommended that this section along with its marginal heading be amended to deal with delegation of powers and functions of both the Authority and Chairperson as follows:

"110A. Delegation of powers.- (1) The Authority may, by general or special order in writing, delegate to the Chairperson or any other member or officer of the Authority subject to such conditions, if any, as may be specified in the order such of its powers and functions under this Act, as it may deem necessary.

(2) The Authority may, by a general or special order in writing, also form committees of the members and delegate to them the powers and functions of the Authority as it may deem necessary.

(3) The Chairperson of the Authority may by general or special order delegate any of his powers or duties under this Act to any person subordinate to him. The exercise or discharge of any of the powers or duties so delegated shall be subject to such restrictions, limitations and conditions, if any, as the Chairperson of the Authority may impose."

Amendment of Section 110G and deletion of section 110H

7.27 Consequent upon the recommendation of the Committee to recast the provisions relating to surveyors and loss assessors, and deletion of section 64VC, it is recommended that in sub-section (3) of section 110G, reference to the provisions of sections 64UM and 64VC may be omitted.

7.28 In view of the suggestion for conferring appellate jurisdiction on the SAT against the orders of the IRDA under the various provisions of the Act, it is recommended that section 110H, which provides appellate jurisdiction on the Central Government against the various order of the IRDA as mentioned therein, may be deleted.

Amendment of section 113

7.29 The Committee recommends that section 113 of the Act dealing with acquisition of surrender value by policies of life insurance be recast as the current provisions of the Section are inadequate to meet the requirements of the product ranges on offer. The suggested text for the Section is as follows:

"113. Acquisition of surrender value by policy.- (1) A policy of life insurance shall acquire surrender value as per the norms specified by the regulations made by the Authority.

(2) Every policy of life insurance shall contain the formula as approved by the Authority for calculation of guaranteed surrender value of the policy.

(3) Notwithstanding any contract to the contrary, a policy of life insurance under a non-linked plan which has acquired a surrender value shall not lapse by reason of non-payment of further premiums but shall be kept in force to the extent of paid-up sum insured, calculated by means of a formula as approved by the Authority, and contained in the policy, and the reversionary bonuses that have already attached to the policy:
Provided that a policy of life insurance under a linked plan shall be kept in force in the manner as may be specified by the regulations made by the Authority.

(**4) The provisions of sub-section (3) shall not apply:**

i) **where the paid-up sum insured by a policy, inclusive of attached bonuses, is less than the amount specified by the Authority or takes the form of annuity of amount less than the amount specified by the Authority; or**

ii) **when the parties after the default has occurred in payment of the premium agree in writing to other arrangement."**

Suggestions regarding other aspects to be dealt with in the Act/Regulations

7.30 The Committee is of the considered view that in the context of revision of the Act, it would be necessary to enhance the provisions in the Act/Regulations to deal with contemporary and emerging areas and developments in the world of insurance. Accordingly, in the succeeding paras suggestions in regard to some of these areas and developments to be dealt with in the Act/Regulations are made.

Prudential supervisory provisions

7.31 Insurance companies expose themselves to business processes, which need prudential supervisory provisions in the following areas:

outsourcing – controls over agreements and management;

risk management – processes to identify, assess, mitigate and report risks;

documentation – of procedures and controls, of computer systems, and reporting the operation of key controls;

responsibilities – documentation and control of limits and authorities delegated to subsidiary companies, sub-committees, management and staff;

business continuity plans; and

stress / scenario testing.

The Committee recommends that there should be an enabling provision/s in the Act to empower the IRDA to come out with regulatory norms for ensuring prudence in the above areas.

Helping consumers select appropriate products

7.32 Retail consumers need access to competitively priced and well-designed products. These should have charges that are fair and reasonable, should be understood both before and after the point of purchase, be appropriately and responsibly sold, and meet consumers' reasonable expectations throughout the term of the product. The IRDA may continue with its regulatory or other interventions, either on its own or through the Insurance Councils, which help consumers with financial planning and select appropriate products; which may include:

web-based decision trees to facilitate financial health check for consumers;

how best to include insurance products in comparative tables given that, for many types of insurance, the premium is heavily influenced by the consumer's individual circumstances; and

a process of 'jargon busting' i.e. how insurers can make their literature easier to understand.

Systems control

7.33 The Committee recommends that the IRDA may consider coming out with guidelines for the insurers on the following important aspects of systems and controls:

(i) high-level controls, including the composition and role of the governing board, apportionment and definition of management responsibilities, and the audit committee;
(ii) responsibilities of the risk assessment function;
(iv) identification and mitigation of legal risk;
(v) internal audit, including its mandate and reporting lines, audit plans and reports, and outsourcing;
(vi) management information needed to identify, measure and control risks in the business;
(vii) outsourcing, including issues to consider, contracts with suppliers and service level agreements; and
(viii) risks arising from a firm's relationship with the rest of the group to which it belongs.

Electronic transactions

7.34 IT effect on insurance business organization, production, operation and compliance requires enabling enactment of provisions in content, authentication and audit trail of documents. There has to be clear cut provision for identification of 'fit and proper person' in IT environment and recognition of IT assets of insurers. In dealing with e-insurance transactions, the following aspects have to be taken care of:

(i) Electronic Services from Insurers - On-line underwriting, issuing electronic policy, on-line claim registration and processing and payment to clients;

(ii) ensuring confidentiality, integrity and availability of electronic transactions – Encryption and Digital Signatures ;

(iii) assurance of insurers' IT services and/or infrastructure quality;

(iv) assuring auditability and maintenance of all and specifically electronic transactions / records for legal and regulatory compliance;

(v) assurance of best practices for developing and implementing information security;

(vi) business continuity plans and management ;

(vii) compatibility of insurer's application with the regulator's application framework;

(viii) electronic interface of insurers with intermediaries;

(ix) providing compliance reports to regulators electronically.

Pronounced key objectives of IRDA

7.35 Under the Act, the IRDA should have the following four key objectives, which may be manifestly stated in the preamble:

market confidence: maintaining confidence in the insurance system

public awareness: promoting public understanding of the insurance system, and thereby enhancing the insurance spread;

consumer protection: securing the appropriate degree of protection for consumers; and reduction of insurance crimes.

Recognition of 10/10 Rule in the contracts of insurance

7.36 There seems to be an increasing tendency to pass off many products as 'insurance products', which do not satisfy the insurance industry's thumb rule, viz., 'the 10/10 rule'.

According to this rule, the insurer should face at a minimum, a 10 per cent chance of losing 10 per cent of the premium for the contract to be considered a 'contract of insurance'. Therefore, it is recommended that the definition of the term "Contract of Insurance" may be incorporated in the Act itself, in the following phraseology:

" 'Contract of insurance' means any contract effected by an insurer by which he assumes a degree of risk of loss or assured benefit, as may be specified by regulations made by the Authority."

Consumers' pre-grievance help bench:

7.37 As a pre-emptive measure, the IRDA either on its own or through the Insurance Councils may consider administration of a mechanism as a pre-grievance help bench. Questions as follows may be answered by AVRU, Kiosk or direct reply:

(How much insurance must I carry? What is the difference between "cancellation" and "non-renewal" of a policy? My policy has been cancelled! Can the company do this? My insurer says it won't renew my policy. What can I do? Is there a period of time during which after I purchase my life insurance policy I can change my mind and have my money refunded? What happens if I forget to pay my premium by its due date? What if I made a mistake in completing my application for a life insurance policy? Can the insurer void my policy? If I forget to pay my premium and the policy lapses is there anything I can do? If I take out a policy loan, what rate of interest can the insurer charge? What happens to a life insurance policy in the event of suicide of the insured? In order to purchase life insurance I am told I must have an "insurable interest" in the person to be insured. What is "insurable interest"? If there is a delay in an insurer paying the death benefit to the beneficiary when a death claim is made, is the beneficiary entitled to any interest on the death benefit? Why am I in the "assigned-risk" plan, why is it so expensive, and how do I get out of it? What discounts can I get on my car insurance? Can my insurance company raise my premium due to an accident or traffic violation? How do I know if I am being charged the right premium? My insurance company is rating me based on something that didn't happen. Where does this information come from and how can I correct any errors? What is a "deductible"? Am I protected by my insurance when I drive a rental car? What happens if an uninsured vehicle injures me? I was involved in an accident or my car was stolen. How much is my automobile worth? What is my "right of recourse"? What is a pre-existing condition and can it be excluded from my health coverage? My insurance company refuses to pay my hospital emergency room bill saying that it was not an emergency. Can they do this? How can I dispute my TPA's decision as to the necessity of my treatment? What is No-Fault coverage and what am I entitled to under it? I have received a No-Fault liability award over a month ago but I have not received payment from the insurer. What should I do? Where can I obtain a copy of the new Medicaid Fee Schedule? What is the correct method of billing for an in-patient hospital stay? What type of coverage is included in my Insurance Policy?)

Section 20 Custody and Inspection of Documents and supply of copies:

7.38 The Section provides for inspection to be allowed of documents filed with the IRDA and for copies being provided at a fee. Similar provisions cover supply by an insurance company, on request, of copies of statutory returns filed by it and of its memorandum and articles of association. The fee specifications need to be revised.

7.39 In respect of a similar provision in Section 51 for supply of copies of proposal forms and related personal statements contained in medical reports, the Law Commission has recommended that the fee structure be left to be provided in Regulations. Similar amendments to Section 20 could have the IRDA lay down on what fee may be charged for any of the copies to be provided to shareholders or policyholders.

Sections 32B and 32C Insurance Business in Rural Sector and Obligations in Respect of Rural or Unorganized Sector and Backward Classes

7.40 The Law Commission has recommended several changes in these Sections. A related suggestion is to replace the requirement in Regulation 3 of IRDA (Obligations of Insurers to Rural or Social Sectors) Regulations, 2002 in so far as it relates to the social sector, spelt out in terms of lives to be covered by insurance, to one specifying policies to be issued. A representation in this connection has been that the social sector is best covered through group insurance, at lower cost, and the obligation on minimum coverage should remain specified in terms of lives to be insured. Another argument, in so far as individual insurances are concerned, has been that a requirement spelt out in terms of policies could lead to a tendency to artificially split insurances to issue additional policies for the same total coverage on an individual life. The Committee agrees and would recommend that in so far as the requirement of minimum coverage in respect of the social sector is concerned, it remains specified in terms of lives to be insured.

Sections 40, 40A, 40B, 40C and 44 Relating to Agency Commission and Ceilings on Overall Expenses of Management, Section 41 Relating to Prohibition on Rebating and Section 42 Relating to Licensing of Insurance Agents:

7.41 While considering the Sections in the Act covering the appointment of agents and the payment of commission to them, the Committee had wide ranging discussions on the need for licensing, on relating payment of renewal commission to continued availability of service from the agents to the policyholders and on the portability of blocks of policies for being kept serviced. The varying practices in other jurisdictions were also considered.

7.42 However, having regard to the milieu in India and the long standing practice there has been under the present Act provisions in regard to payment of commission, the Committee, while proposing an amendment to Section 42 on the appointment of agents– please see supra - felt that the other provisions in the Act covering agents be left with just the changes as had been noted to have been recommended by the Law Commission, including the one relating to Section 40A, on the specification of ceilings on the rates of commission payable to agents being shifted to Regulations.

7.43 The Committee considered representations in this connection relating to ceilings on the overall expenses of management that an insurer could incur, suggesting the need for review of what were to considered expenses of management and, in so far as agency commission was concerned, a consideration of whether under Section 40A – or as to be specified in the Regulations as the Law Commission had recommended – or the overall ceilings on expenses of management (including agency commission) would suffice for the containment of expenses, leaving in the process a degree of freedom to individual insurers what commission they would pay to their agents. Following discussion, the Committee took the view that specific limitations on commission payments would need to remain and the overall ceilings on expenses of management or the interpretation of what constituted such expenses, did not also call for any revision or modification.

7.44 In regard to Section 41, on the prohibition of rebates, the Committee did consider the effectiveness of the provision as it stood, but felt that it should need to stand, along with associated rules relating to reproduction of the prohibition in relevant insurance forms and literature.

Section 45: Policy not to be called in Question on Ground of Misstatement after two years:

7.45 The Committee noted the elaborate consideration given in the Law Commission Report and the recommendations made with regard to amendments to the provisions on the policy of life insurance being called in question on account of any misstatements in the proposal for other papers leading to the issue of the policy. The Law Commission Report has refer to several Court rulings, including those of the Supreme Court, and the Committee considered that there was a quite well settled case law on the subject that insurers did appreciate, making any amendment of the present Act provisions unnecessary for an equitable and adequate protection of the interest of policyholders or of other beneficiary claimants.

7.45.1 A policy of life insurance obtained on false premises constituted a fraud not only on the life insurance company but also on the holders of other policies, in as much as a claim unwarrantedly having to be settled affected the policyholders fund that the insurer carried for its policyholders as a whole and, additionally, could lead to the insurer having to reconsider its underwriting and pricing norms. The requirement of *uberrima fidei* that applied in the placement of a policy for life insurance did not relieve an applicant of that requirement by allowing an extended period of five years for the insurance company, by further due enquiry, to check on the correctness of the information furnished for grant of the insurance. The insurer had to take the proposer on trust beyond whatever information was obtained at the time of the proposal and several practical issues could arise if verifications were left to be undertaken after grant of the insurance, at a cost.

7.45.2 It was represented to the Committee that the amendment proposed by the Law Commission to make a policy of life insurance totally immune from being called in question beyond five years of its issue or of revival following any lapsation, would leave a life insurance company vulnerable to fraudulent insurances being taken and in any case to grant of insurances on inappropriate terms.

7.45.3 A second representation relating to the possible attribution of complicity to an agent who solicited and procured a policy of life insurance, in respect of any misrepresentation or suppression of material fact contained in the proposal papers, carrying as they did a signed declaration by the proposer with regard to the veracity of the statements contained in the proposal papers. The seriousness of any misrepresentation in respect of information provided by the proposal did not become any the less by an effort to ascribe possession of correct information to the soliciting agent – an issue that could come up from the added provision suggested by the Law Commission of deeming such information as then being available to the company – and should not be a mitigation in holding on a breach of warranty by the proposer himself in regard to the correctness of the information that was to be the basis for grant of insurance.

7.45.4 The Committee, while accepting in humility the considerations that had led the Law Commission to recommend amendments to Section 45 of the Act, is of the view, as earlier remarked, that sufficient relief is available, with the section reading as it presently does, supported by case law, against any inequitable efforts by a life insurance company to void a policy on grounds of misstatement or suppression of material facts in the proposal papers leading to the issue of the policy.

Section 118 Exemptions:

7.46 The Committee looked at the provisions in Section 118 of the Act specifying exemptions from the applications of the Act and noted that under sub-para (c) insurance businesses *iner alia*

carried on by the Central Government or a State Government could be exempt from application of the provisions of the Act in entirety or to have them applied to such extent and on such conditions or modifications as the Central Government may by order lay down. The exemption covers the life insurance schemes run by several State Governments for their employees, the Postal Life Insurance Scheme of the Central Government although its extended operations now covered members of the public, and the Army Group Insurance Fund. Having regard to the special arrangements made and the scope of coverage in these cases, the Committee did not consider it necessary or desirable to suggest extending application of that in any selective way as the Central Government would consider.

7.46.1 The Committee noted in this connection that in the recommendation covering amendment to Section 94A(2) of the Act in its application to co-operative societies, which permitted IRDA to selectively apply provisions of the Act to such societies carrying on insurance business, the Law Commission arguing on grounds of making for a level playing field, had recommended that no total exemption should be permitted and selective extension again of provisions of the Act should be a matter for the Central Government to decide. Going on in a sub-note as it were to this recommendation, organizations and associations carrying on insurance business without obtaining a certificate of registration from the IRDA (i.e. Army Welfare Association, Postal Insurance, etc.) are suggested to be brought within the purview of the regulatory regime but requirements of capital and deposits be either relaxed or suspended.

7.46.2 The Committee does not consider that the argument of making for a level playing field need apply, in relation to corporate players, to bring these special arrangements under the regulatory regime. Specifically with respect to the Army Group Insurance Fund it has been submitted that it is not insurance business that is being run that a welfare measure covering all Army personnel, in war as in peace, with coverage being a service condition and the needs of the Army for confidentiality continue to remain as valid in regard to experience under the Fund. The Committee does agree and reiterates its view, earlier expressed, that no change need be there in the exemptions currently covering the special insurance arrangements noted as available under Section 118 of the Act.

Review of Insurance Rules, 1939

7.48 A significant number of Insurance Rules, 1939 (‘the Rules’ for short), has become redundant, consequent upon the various amendments to the Act, and more particularly with the enactment of the IRDA Act, 1999, and conferment of powers on the Authority to make regulations in regard to various matters, which were earlier conferred upon the Central Government. Therefore, it is suggested that such of the Rules that have become redundant be weeded out.

ACKNOWLEDGMENTS

The Committee wishes to acknowledge and place on record its appreciation of the valuable assistance and co-operation received from various quarters. At the outset, the Committee conveys its sincere thanks to Mr. C.S. Rao, Chairman, IRDA, for extending all co-operation for the smooth functioning of the Committee and also for graciously extending the deadline for submission of the Committee's Report. The Committee would particularly acknowledge the invaluable part played by Mr. K. Subrahmanyam, who served as the Convener of the Committee with zeal and enthusiasm. The Committee is also beholden to the various individuals and institutions for offering their valuable suggestions to the Committee. The list of such individuals and institutions is at Appendix II. Last but not the least, the Committee acknowledges and appreciates the support received from the staff of IRDA, who made all arrangements for the meetings of the Committee.

(K.P. Narasimhan)

(S.V. Mony)

(N.M. Govardhan)

(K.N. Bhandari)

(P.C. Ghosh)

(Liyaquat Khan)

(S.P. Subhedar)

(D.D. Rasgotra)

(K.C. Mishra)

(T.S. Vishwanath)

(D.Varadarajan)

बीमा विनियामक और विकास प्राधिकरण
INSURANCE REGULATORY AND
DEVELOPMENT AUTHORITY

7th March, 2005

Ref: IRDA/Ord/Act/080/MAR-05

ORDER

Sub: Constitution of Committee to study the Report of the Law Commission and make recommendations – regarding

The Law Commission submitted a Report to the Government of India indicating the amendments to be brought about in the Insurance Act, 1938 keeping in view the developments that have taken place specially the passing of the IRDA Act, 1999. While the Commission has made specific recommendations in areas which relate to legal issues, the Commission opined that in respect of a few areas a detailed examination by experts in its respective fields would be necessary to consider any changes. The following subjects that are covered by this observation are:

(i) Provisions relating to Investments (Sec 27, 27A & 27B)
(ii) Sufficiency of Assets (Sec 64 VA)
(iii) Insurance Surveyors (Sec 64UM)
(iv) Tariff Advisory Committee (Sec 64UA & 64 ULA)
(v) Shareholders' Funds & Policyholders' Funds (Sec 49)

2. In order to examine the issues mentioned in Para 1, the Authority hereby constitutes the following Committee:

1. Mr. K.P. Narasimhan, Chairman
2. Mr. S.V. Mony, Member
3. Mr. N.M. Govardhan, Member
4. Mr. K.N. Bhandari, Member
5. Mr. P.C. Ghosh, Member
6. Mr. Liyaquat Khan, Member
7. Mr. S.P. Subedhar, Member
8. Mr. D.D. Rasgotra, Member
9. Mr. K C Misra, Member
10. Mr. T S Vishwanath, Member
11. Mr Varadarajan, Member

Contd....2

परिश्रम भवन, तीसरा तल, बशीर बाग, हैदराबाद-500 004.
दूरभाष: 91-040-5582 0964, 5578 9768 फैक्स : 91-040-5582 3334
ई-मेल : irauth@vsnl.com वेब : www.irdaindia.org

Parishram Bhavan, 3rd Floor, Basheer Bagh, Hyderabad - 500 004.
Ph: 91-040-5582 0964, 5578 9768, Fax: 91-040-5582 3334
E-mail: irauth@vsnl.com Web: www.irdaindia.org

3. The Committee may also indicate any other sections of the Insurance Act, 1938 which need to be amended in the light of the developments that have taken place in the insurance scene other than those covered by the Law Commission's recommendations.

4. The Chairman and Members be paid a sitting fee of Rs.1000/- per day and conveyance of Rs.400/- per day in addition to reimbursement of expenses towards their stay and conveyance to the venue of the meeting. Chairman/Members will be reimbursed expenses towards their air travel by economy class.

5. The committee is requested to furnish its recommendations by 30th April, 2005.

6. Sri K Subrahmanyam, ED(Actl), will act as convener of the Committee.

This order is issued with the approval of the Chairman of the Authority.

K. Subrahmanyam,
Executive Director.

बीमा विनियामक और विकास प्राधिकरण
INSURANCE REGULATORY AND
DEVELOPMENT AUTHORITY

Ref: 01/IRDA/Actl/Law Comm/2005-06 8th June, 2005

ORDER

Sub: Committee to study the Report of the Law Commission and make Recommendations – regarding

Ref: IRDA/ORD/ACT/080/March05 dated 7th March 2005

In the reference cited above a committee was constituted to examine some of the issues which, according to the Law Commission, required detailed examination by experts before any decision can be taken about the need for changes in the provision of the Act. This committee was also requested to examine any other areas where legal provisions required amendments in the light of the developments that have taken place so far. The committee was requested to furnish its report by 30th April 2005. The committee submitted its first report on 28th April 2005 and sought time till 30th June 2005 for submission of its final report. It has now indicated that time till 31st July 2005 would be required to submit the final report.

The Authority has considered the matter and decided to extend the term of the committee upto 31st July 2005.

C S Rao
8.6.05

(C S Rao)
Chairman

परिश्रम भवन, तीसरा तल, बशीर बाग, हैदराबाद-500 004.
दूरभाष: 91-040-5582 0964, 5578 9768 फैक्स : 91-040-5582 3334
ई-मेल : irauth@vsnl.com वेब : www.irdaindia.org

Parishram Bhavan, 3rd Floor, Basheer Bagh, Hyderabad - 500 004.
Ph: 91-040-5582 0964, 5578 9768, Fax: 91-040-5582 3334
E-mail: irauth@vsnl.com Web: www.irdaindia.org

Particulars of the Meetings convened by KPN Committee on Law Commission Report

Sl No.	Date(S) of Meeting	Venue
1	17.03.2005	Office of the Authority, Hyderabad
2	11.04.2005	Office of the Authority, Hyderabad
3	25.04.2005	Office of the Authority, Jeevan Tara Bldg, New Delhi
	26.04.2005	
4	18.05.2005	Office of the Authority, Hyderabad
	19.05.2005	
5	31.05.2005	NIA, Pune
	01.06.2005	
6	22.07.2005	Office of the Authority, Hyderabad

Appendix - 3

ICP 21 Investments

The supervisory authority requires insurers to comply with standards on investment activities. These standards include requirements on investment policy, asset mix, valuation, diversification, asset-liability matching, and risk management.

Explanatory note

21.1. Insurers must manage their investments in a sound and prudent manner. An investment portfolio carries a range of investment-related risks that might affect the coverage of technical provisions and the solvency margin. Insurers need to identify, measure, report and control the main risks.

21.2. For insurers in many jurisdictions concentration risk arising from the limited availability of suitable domestic investment vehicles is a real problem. By contrast, international insurers' investment strategies are potentially complex because often they need to manage and match assets and liabilities in a number of currencies and different markets. In addition, the need for liquidity resulting from potential large-scale payments may further complicate an insurer's investment strategy.

21.3. The supervisory authority ensures that standards are established for insurers in managing their investment portfolios and inherent risks. The supervisory authority needs to have both the authority and ability to assess these risks and their potential impact on technical provisions and solvency. However, the detailed formulation of an insurer's investment management policy and internal risk control methodology is the responsibility of the board of directors.

Essential criteria

a. Requirements regarding the management of investments are in place, either in the law or in supervisory rules. These requirements address, but may not be limited to, the following:

   - the mixture and diversification by type
   - limits or restrictions on the amount that may be held in particular types of financial instruments, property, and receivables
   - the safekeeping of assets
   - the appropriate matching of assets and liabilities
   - the level of liquidity.

b. Investments are valued according to a method prescribed by or acceptable to the supervisory authority.

c. The supervisory authority requires insurers to have in place an overall strategic investment policy, approved and reviewed annually by the board of directors, that addresses the following main elements:

- the risk profile of the insurer
- the determination of the strategic asset allocation, that is, the long-term asset mix over the main investment categories
- the establishment of limits for the allocation of assets by geographical area, markets, sectors, counterparties and currency
- the extent to which the holding of some types of assets is restricted or disallowed, for example illiquid or volatile assets or derivatives
- the conditions under which the insurer can pledge or lend assets
- an overall policy on the use of financial derivatives and structured products that have the economic effect of derivatives (refer to ICP 22)
- clear accountability for all asset transactions and associated risks.

d. The risk management systems must cover the risks associated with investment activities that might affect the coverage of technical provisions and/or olvency margins (capital). The main risks include:

    - market risk
    - credit risk
    - liquidity risk
    - failure in safe keeping of assets (including the risk of inadequate custodial agreements).

e. The supervisory authority checks that insurers have in place adequate internal controls to ensure that assets are managed in accordance with the overall investment policy, as well as in compliance with legal, accounting, and regulatory requirements. These controls should ensure that investment procedures are documented and properly overseen. Normally the functions responsible for measuring, monitoring, settling and controlling asset transactions are separate from the front office functions (refer to ICP 10).

f. The supervisory authority requires that oversight of, and clear management accountability for, an insurer's investment policies and procedures remain ultimately with the board of directors, regardless of the extent to which associated activities and functions are delegated or outsourced.

g. The supervisory authority requires that key staff involved with investment activities have the appropriate levels of skills, experience and integrity.

h. The supervisory authority requires that insurers have in place rigorous audit procedures that include full coverage of their investment activities to ensure the timely identification of internal control weaknesses and operating system deficiencies. If the audit is performed internally it should be independent of the function being reviewed.

i. The supervisory authority requires that insurers have in place effective procedures for monitoring and managing their asset/liability position to ensure that their investment activities and asset positions are appropriate to their liability and risk profiles.

j. The supervisory authority requires that insurers have in place contingency plans to mitigate the effects of deteriorating conditions.

Advanced criteria

k. The supervisory authority requires that insurers undertake regular stress testing for a range of market scenarios and changing investment and operating conditions in order to assess the appropriateness of asset allocation limits (refer to ICP 20 AC g and ICP 23 AC j).

ICP 23 Capital adequacy and solvency

The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses.

Explanatory note

23.1. A sound solvency regime is essential to the supervision of insurance companies and the protection of policyholders. Capital adequacy requirements are part of a solvency regime. A solvency regime should take into account not only the sufficiency of technical provisions to cover all expected and some unexpected claims and expenses but also the sufficiency of capital to absorb significant unexpected losses - to the extent not covered by the technical provisions - on the risks for which capital is explicitly required. It should also require additional capital to absorb losses from risks not explicitly identified.

23.2. In order to protect policyholders from undue loss, it is necessary that a solvency regime establishes not only minimum capital adequacy requirements, but also a solvency control level, or series of control levels, which act as indicators or triggers for early supervisory action, before problems become serious threats to an insurer's solvency. The form of the solvency control level may be based on capital levels or other financial measures related to the solvency regime of the jurisdiction.

23.3. Any allowance for reinsurance in a capital adequacy and solvency regime should consider the effectiveness of the risk transfer and make allowance for the likely security of the reinsurance counterparty.

Essential criteria

a. The solvency regime addresses in a consistent manner:

   - valuation of liabilities, including technical provisions and the margins contained therein
   - quality, liquidity and valuation of assets
   - matching of assets and liabilities
   - suitable forms of capital
   - capital adequacy requirements.

b. Any allowance for risk mitigation or transfer considers both its effectiveness and the security of any counterparty.

c. Suitable forms of capital are defined.

d. Capital adequacy requirements are sensitive to the size, complexity and risks of an insurer's operations, as well as the accounting requirements that apply to the insurer.

e. The minimum capital adequacy requirements should be set at a sufficiently prudent level to give reasonable assurance that policyholder interests will be protected.

f. Capital adequacy requirements are established at a level such that an insurer having assets equal to the total of liabilities and required capital will be able to absorb significant unforeseen losses.

g. Solvency control levels are established. Where the solvency position reaches or falls below one or more control levels, the supervisory authority intervenes and requires corrective action by the insurer or imposes restrictions on the insurer. The control level is set so that corrective action can be taken in a timely manner (refer to ICP 14).

h. Inflation of capital – through double or multiple gearing, intra-group transactions, or other financing techniques available as a result of the insurer's membership in a corporate group – is addressed in the capital adequacy and solvency calculation (refer to ICP 17).

i. The solvency regime addresses the requirements placed upon an insurer operating through a branch.

Advanced criteria

j. The solvency regime provides for periodic, forward-looking analysis (e.g., dynamic solvency/stress testing) of an insurer's ability to meet its obligations under various conditions (refer to ICP 20 AC g and ICP 21 AC k).

k. The supervisory authority assesses the structure of its solvency regime against structures of a peer group of jurisdictions and works towards achieving consistency.

Appendix 4

ACRONYMS used in the Report:

IRDA: Insurance Regulatory and Development Authority

IAIS: International Association of Insurance Supervisors

MAD: Margin for Adverse Deviations

PAD: Provision for Adverse Deviations

IAA: International Actuarial Association

GRA: Grievance Redressal Authority

Suggestions Received		
Index		
Sl No.	**Subject**	**Received From**
1	Surveyors	Consumer Education and Research Centre
2	Insurance Act, 1938 and IRDA Act, 1999	FICCI
3	Section 40 (C)	Oriental Insurance Co. Ltd
4	Surveyors	The Institute of Loss Adjusters
5	Financial Service and Market Act, 2000	KC Mishra
6	Insurance Core Principles - Insurance	KC Mishra
7	Surveyors	Richard Tully
8	Surveyors	Praveen Kothari
9	Surveyors	Rajan Govind
10	Surveyors	Srimu Sudarshan
11	Surveyors	Chellakannu
12	Surveyors	Association of Loss Assessors & Surveyors, Bihar
13	Surveyors	S Murali
14	Surveyors	S Baskaran
15	Reinsurance	Munish Re
16	Surveyors	Trans Car India
17	Grievance Redressal Mechanism	IRDA
18	Surveyors	Institute of Loss Adjustrers, Chennai
19	Regulation and Supervision	S P Subhedar
20	Surveyors	K Jaya Kumar
21	Raise in Foreign Equity Limit	Sun Life Financial
22	Surveyors	Mehta and Padamsey Pvt. Ltd
23	Insurance Electronic Transactions	K C Mishra
24	Surveyors	Anji KM
25	Surveyors	Nanda Kumar R
26	Surveyors	Laiju G Kodiyan
27	Insurance Law Provisions	P I Majmudar
28	Surveyors	Philip Kuriakose
29	General	American Insruance Association
30	General	American Insruance Association
31	Surveyors	Muhammed Rafeekh

32	Surveyors	Joice John
33	Surveyors	M Kavitha
34	Surveyors	Shaji Suresh Kumar
35	Surveyors	Thadeus Shaju
36	Surveyors	Jaya Roshni
37	Surveyors	Pius J
38	Surveyors	Nanda Kumar R
39	Surveyors	Bijuraj
40	Surveyors	P Sudha
41	Surveyors	T Pannerselvan
42	Insurance Act Amendment	Sreenivasan, Bajaj Allianz Gen. Ins.
43	Sec 40-C & 64-M & 64VB	United India Insurance Officers' Association
44	Sec 64 UM Sub Section 5	Surveyor's Welfare Association, Gurgaon
45	Section - 64UM	Sumant Sud
46	Sections 45,49,2(7A),40(2A),32B,32C, 27C	Max New york Life Insurance Co Ltd
47	Sec 38 & 39	C Ramanathan
48	Sec 64 UM	Sumant Sud
49	Sec 102-109	TAC
50	Rule 17E of Insurance Rules	The Oriental Insurance Company Limited
51	Section 118	Army Group Insurance Fund