



Ref: IRDA/INSP/CIR/RBSF/166/10/2018

Date: 3rd October, 2018

To:

All the Insurers.

Re: Moving towards 'Risk Based Supervision' of the Insurance Sector

1. The Insurance Regulatory & Development Authority of India (hereinafter referred to as 'the Authority') is in the process of adopting 'Risk Based Supervisory Framework' (hereinafter referred to as RBS or RBSF) for holistic supervision of insurance sector in India. The Authority would be developing an overall plan for moving towards 'RBS' to undertake a review of the current regulatory and supervisory regime and prepare an appropriate framework for holistic supervision, duly incorporating risk assessment mechanism into insurance supervision.
2. At present, the Authority is primarily focusing on compliance based approach for supervision. Over a period of two decades, the number of entities to be supervised have increased manifold. To supervise on compliance approach would need the same yardstick to be applied to all regulated entities regardless of its size, business model and nature of significant activities. Instead, under RBS, each regulated entity will be assessed based on its 'risk profile' and the overall risk it carries. This will enable the Authority to focus more on entities posing higher risk relative to others. To that extent, the Authority will also be in a position to use its resources efficiently and achieve effective supervision.

3. The RBS Framework would consider various risks the insurers pose to themselves and to the financial system at large. The risk profile of each entity would determine the supervisory action plan comprising off-site monitoring, onsite inspections and structured meetings with the entities in conjunction with specific Supervisory Action Plan.
4. Assessment of risks in a typical Risk Based Supervision would include identification of significant activities based on certain criteria, i.e., identifying the inherent risks, examining the control mechanism built around the risks leading to an understanding of the net risk involved in each significant activity. Aggregation of net risks for different significant activities would provide an 'aggregate net risk'. The additional support available for the entities in the form of capital, liquidity and earnings would be suitably adjusted against the aggregate net risk to reflect the overall risk rating for the entity.
5. The benefits of adopting an RBS Framework for insurance supervision could be summarized as under:
 - a. Structured approach to help assess various risks, both internal to the entity and external environment;
 - b. RBS is forward looking and outcome based with due focus on the responsibility of the Board and Senior Management of the entities to ensure financial soundness;
 - c. Facilitates identification of various risks relating to market conduct and prudential aspects at an early stage so that timely regulatory intervention is possible depending upon the overall risk profile of the entity;
6. In the recent Financial Sector Assessment Program report of 2017, the IMF and World Bank recommended that the Authority to move towards a risk based supervisory approach. Insurance Core Principles of IAIS also require Supervisors



to adopt 'risk based approach' to supervision that uses both off-site monitoring and onsite inspections to examine the business of each insurer, evaluate its condition, risk profile, the quality and effectiveness of corporate governance.

7. In the recent times, the international financial spectrum has witnessed trends towards globalization and consolidation. The stability of financial system has become a challenge for the regulators globally. In India too, the insurance sector has also reached a stage of development over the past two decades to require a risk based supervisory approach.
8. In the process of moving towards RBS, certain changes are envisaged in the functioning of the regulated entities. Major changes would include:
 - a. The regulated entities need to have well defined standards of Governance and well documented policies, procedures and practices in place to outline the responsibilities and accountability, more clearly;
 - b. To revisit the organizational structure to align with the requirements of RBS;
 - c. Review of risk management culture;
 - d. Adopting risk based internal audit;
 - e. Improved IT and MIS to capture and report various elements required for risk assessment;
 - f. Building 'Compliance Units' to take prompt corrective actions suggested by the Regulator from time to time as part of Supervisory Action Plans;
 - g. Review of skill sets, extensive training and redeployment of staff, talent retention; etc. as may be necessary to move towards risk assessments in place of mere compliance.
9. It is intended to roll out the RBS process in a phased manner starting with insurers and then intermediaries, after running a pilot project on select entities to test the efficacy and efficiency of the implementation and to identify possible



gaps, if any. In the process, there would be consultation with the industry players, on an ongoing basis, at different stages of development and implementation process.

10. Within IRDAI, an implementation committee has been formed to suggest the implementation approach for RBS and to achieve smooth transition.
11. Given this backdrop, the insurers and intermediaries may initiate steps to lay greater focus on identification of risk of each activity they undertake and to build framework that enables internal assessment of such risks and corresponding control mechanism to mitigate such risks within their organization culture.
12. The Authority would keep the industry updated on an ongoing basis on the phase of development of RBS and suitably involve the industry as and when required.



(J Meenakumari)
Chief General Manager
Chairperson – Implementation Committee