Ref.No: IRDA/ENF/ORD/ONS/085/05/2016

Final Order in the matter of M/s NATIONAL INSURANCE CO LTD

Based on reply to the Show Cause Notice dated 5th January,2016 and submissions made during Personal Hearing on 15th March, 2016 at 11:30am taken by Member (F&I) at the office of Insurance Regulatory and Development Authority of India, 3rd Floor, Parishrama Bhavanam, Basheerbagh, Hyderabad.

The Insurance Regulatory and Development Authority of India (hereinafter referred to as "the Authority") carried out an onsite inspection of M/s **National Insurance Co Ltd** (hereinafter referred to as "the General Insurer") from 2nd to 6th August, 2010. The Authority forwarded the copy of the Inspection Report to the Insurer seeking comments on the same under the cover letter dated 13th October, 2010. Upon examining the submissions made by the Insurer vide letter dated 18th November, 2010 the Authority issued Show Cause Notice on 5th January, 2016 which was responded to by the Insurer vide letter dated 12th February, 2016. As requested therein, a personal hearing was given to the Insurer on 15th March, 2016. Mr. K.Sanath Kumar, CMD, Mr.M.Vasanth Krishna, General Manager & Director, Mr.P.K.Mahapatra, General Manager and Mr.T.Babu Paul, Chief Compliance Officer were present in the hearing on behalf of the General Insurer. On behalf of the Authority, Mrs.V.R.Iyer, Member (F&I), Mr.Lalit Kumar, FA & HOD (Enforcement), Mr.Suresh Mathur, Sr.JD (Non-life), Mr.Prabhat Kumar Maiti, JD (Enforcement) and Mr. K.Sridhar, Sr.AD (Enforcement) were present during the personal hearing.

The submissions made by the Insurer in their written reply to the inspection observations, Show Cause Notice and also those made during the course of the personal hearing have been taken into account.

The findings on the explanations offered by the General Insurer to the issues raised in the Show Cause Notice and the decisions thereon are detailed below.

1) **Charge – 1**

On examining the available documents, it is noted that insurer is paying additional payouts over and above commission to M/s Maruti Insurance Business Agency Ltd and to M/s Hero Corporate Services Ltd on the motor premium solicited through the two corporate agents. Additional payouts to the licensed entities are referred by insurer as reimbursement towards infrastructure costs.

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Violation of Authority circular Ref.011/IRDA.Brok-Comm/Aug-08 dated August 25, 2008 and clause 21 of Corporate Agents Guidelines ref.no.017/IRDA/Circular/CA guidelines/2005 dated 14-07-2005.

Submission of the insurer:

It may be noted that only commission has been paid to the corporate agents. The company has not entered into any other additional relationship with the licensed entities for obtaining any form of services. The additional payouts mentioned in the observation are the reimbursement of infrastructure expenses to the dealers for the services rendered by them. The MoUs have been entered into with Corporate Agents for solicitation and procurement of business and rendering services incidental to it. Payments are made to the dealers of strategic alliance partners but not to the licensed entities.

Decision:

Payments made towards infrastructure expenses by insurer to the dealers related to the corporate agent/broker are linked to the motor OD premium. The payout to vendors related to licensed entities is exactly equivalent to the commission paid to licensed entities in two cases and more than commission in two other cases. It is also submitted by insurer during the personal hearing that though the agreements were entered with corporate agents, the payments were made only to the dealers who have rendered the services. Insurer has also not submitted the copy of the TDS certificates of FY 2009-10 issued to M/s Tata Motors (SAP) vide its reply dated 31/03/2016. Further, it is also noted that the payout towards infrastructure costs as a percentage on the motor OD premium to few vendors was decided/reviewed on the basis of the incurred claim ratio on the premium emanating from the strategic alliance partners. Insurer in its submissions has also accepted on entering into MoUs with corporate agents.

In view of the violation of the Authority circulars/guidelines on entering into additional relationships with the corporate agents, the Authority in exercise of the powers vested under Section 102 (b) of the Act imposes a penalty of Rs.5 lakhs.

2) **Charge – 2**

On examining the agreements with two of the Strategic Alliance Partners (SAPs) i.e of Tata Business Support Services & Honda Seil cars (I) Pvt Ltd and with the corporate agents, it is noticed that services performed by SAPs/CAs were not in compliance with various Regulations/guidelines issued by Authority from time to time.

- Payout is made as a percentage to motor premium and linked to Incurred claim ratio but not based on the level of services rendered by SAPs.
- Allowing SAPs to perform core jobs such as processing of claims, modifying or cancelling policies by passing endorsements, warranties, conditions etc.
- As per the tripartite agreement with M/s TBSS, insurer is supposed to pay service charges on the basis of policies issued, whereas payout is made as a percentage to motor OD premium.
- As per Schedule A of agreement entered with M/s Honda Siel Cars (I) Pvt Ltd, insurer agreed to make commission payout to SAP on motor premium @ 15%.
- As per the insurer agreement with M/s Honda Siel Cars (I) Ltd, insurer has to avail the services of the broker nominated by the SAP.
- In case of Honda customers insured through M/s Honda dealer, insurer agreed not to deduct any salvage from claim.

Violation of Regulation 7(c) of IRDA (Registration of Indian Insurance Companies) Regulations, 2000 and **Clause 6 of corporate governance** guidelines of Annexure II of circular no.IRDA/F&A/Cir/0205/2009-10 dated 5th Aug, 2009 for lack of internal control mechanism by having agreement terms detrimental to the interests of the company/insured.

Submission of the insurer:

TBSS are the service providing units and shall establish and maintain necessary Infrastructure for the purpose of enabling the Insurer to provide various Insurance services from dealerships to customers. As such services cannot be exactly quantified and measured; it was supposed to be scaled against no. of policies issued. However, the company as a part of its prudent business operations and to exercise control over such payments, in order to maintain operational margin, resorted to the practice of linking payouts to premium and ICR. Effectively restricting the expenses to maintain the underwriting margin is a part of cost control mechanism forming part of corporate governance.

Similarly, HSCI shall establish and maintain necessary Infrastructure for the purpose of provision of various Insurance Services at Dealerships to Customers. In consideration of such services utilized, we restricted such service charges as a portion of the revenue generated.

No core activity was ever outsourced to any of our SAPs. The process of settlement is undertaken by in-house claims department and not by the dealerships. Therefore we submit that no core activity has been outsourced to any our SAPs. All that the SAPs do is to operate the system by keying the information needed. Therefore we can say that no core activity is outsourced.

Decision:

On examining the agreements, it is noted that

- Core activities were agreed to be performed by service vendors such as processing of claims, modifying or cancelling policies by endorsements etc.,
- Payout towards services was linked to premium and claims.
- Broker nominated by vendor to be accepted by insurer.
- Payment agreed on policies basis and released on premium collected and
- Agreeing not to deduct salvage from claims of Honda vehicles solicited by Honda channel.

Thus agreements entered into by the insurer provides for services which are required to be either performed by a licensed intermediary or by the insurer and are not permitted to be outsourced, as those were core activities. Further few agreement terms were preventing insurer from performing core activities and allowing disparity in claim settlement practices.

In view of the violation of the Regulation 7(c) of IRDA (Registration of Indian Insurance Companies) Regulations, 2000, **the Authority in exercise of the powers vested under Section 102 (b) of the Act imposes a penalty of Rs.5 lakhs**.

Thus insurer is directed to

1. Comprehensively examine all the existing outsourcing agreements, services outsourced under these agreements and terms of agreements to ensure that they are in compliance with the Outsourcing Guidelines dated 1st February, 2011 and Corporate Agents guidelines dated 14-07-2005.
2. Enter into agreements hereafter with the service providers complying with the norms of the Outsourcing guidelines and also to carry out cost benefit analysis and effective due diligence as specified at Clause 9.3(ii) & 10.1 of Outsourcing guidelines.
3. Re-examine the Honda agreement terms on non recovery of salvage value from the claim amount in order to maintain uniformity in claim payments amongst Honda vehicles solicited through various channels.
4. Exercise enhanced supervision so as to ensure that there are no regulatory violations

3) **Charge – 3**

On examining the insurer agreements with SAPs and insurer's internal audit report of Maruti in the area of underwriting and claims, it is noticed that

- As per the agreement with M/s Honda Siel, insurer has agreed to treat electric parts as other parts for arriving at depreciation in case of partial loss claims.
- Insurer referred motor products issued to customers routed through dealers of M/s Honda Siel as 'Honda Assure' insurance products.
- Insurer internal audit report has also pointed that motor dealers of Maruti were allowing risk factor discounts, NCB discount etc., without collecting the requisite documents and permission from insurer.

Violation of

a) Para 9 of F&U guidelines dated 28/09/2006.

b) General Regulation 9 on 'depreciation' and General Regulation 27 on 'NCB' of erstwhile of Indian Motor Tariff wordings, Point 1, 2 & 28 of F&U guidelines dated 28/09/2006 & Circular no.IRDA/NL/ Cir/F&U/003/01/2011 dated 6th Jan, 2011, Authority Circular ref. No. IRDA/NL/CIR/F&U/073/11/200 dated 16-11-2009, Authority circular 066/IRDA/F&U/Mar-08 dated 26th March, 2008, Point 8 of Authority circular ref.no.048/IRDA/De-tariff/Dec-07 dated 18th Dec, 2007 and Authority cir.no.19/IRDA /NL/F&U/Oct-08 dated 6th Nov, 2008 for changing the erstwhile tariff wordings on plastic parts.

c) Clause 6 of corporate governance guidelines of Annexure II of circular no.IRDA/F&A/Cir/0205/2009-10 dated 5th Aug, 2009.

Submission of insurer:

1. Kindly note that all our products have only the trade names as approved. Sometimes our SAPs stick / print their name and address on the face of the policy only to indicate the point at which such policies are being generated. Such inscriptions do not alter the approved trade name of the policy nor any of the components of the policy or the product.

2. We have only clarified the coverage and rules under GR 9. Such clarification was further necessitated due to technological advancements in the area of auto parts/ spares where more and more electronics and electrical items are used. The confusion arises when such parts have apparently similar but not exactly similar nomenclature provided in GR 9. Kindly note that no wording as approved has been changed while issuing policy to the Insured. It is only an explanatory statement that was brought out in MoU with SAPs. This is part of knowledge sharing and awareness. We would request you to drop the charge.

3. In the case of Corporate Agents, the system computes the premium. Hence it is not correct to say that Corporate Agents are allowed to rate the risks. However there could be a possibility of system failure or incorrect information being keyed, which might result in wrong computation of premium. Such exceptions are handled by our internal audit team who are the part of our internal control mechanism. Therefore we sincerely submit that there is no violation of rules and guidelines.

Decision:

1. Authority takes note of the insurer submission that the motor product name was properly mentioned in policy document. Taking note of the insurer submission, no charge is pressed. However, mention of vehicle manufacturers logo, name, motor dealer contact details for renewal or any other detail along with the policy document may misguide the insured/prospect in approaching the insurer on any service request, hence insurer is advised to provide only the company details along with the matters as stated at Regulation 7 of IRDA (Protection of Policyholders' Interests) Regulations, 2002 while forwarding the policy document to insured.

2. Clause 14.7 of annexure B of the agreement with HSCI states that 'headlight assembly' will be treated as 'other parts' where depreciation depends upon the age of the vehicle. General Regulation 9 of India Motor Tariff, 2002 clearly states how depreciation is to be arrived in case of partial loss claims on various parts. Insurer allowed depreciation percentage applicable for 'other parts' on 'head light assembly' instead of 'plastic parts', for the business sourced under the agreement. Thus insurer has given differential treatment for the same class of risk sourced through motor dealer tie ups and other channels. Thus insurer has violated GR 9 of erstwhile tariff wordings and other circulars including the 16th November, 2009 circular referred in the charge which provides that terms and conditions of erstwhile motor tariff should not be varied without the Authority's express approval.

   Further on asking insurer to clarify whether depreciation applicable for 'other parts' is charged for headlight assembly too in case of partial loss claims for the customers of all variants of vehicles irrespective of the channel sourcing the business before and after the agreement, insurer chose to remain silent.

   Further decision is at charge 4 of the Order.

3. Since insurer submitted that the company has initiated action on the internal audit observations, no charge is pressed.

4) **Charge – 4**

a) The insurer has issued revised underwriting guidelines on de-Tariff market rates and delegated to Regional Offices, the power to sanction total discount of up to 85% on erstwhile Fire & Engg tariff rate without any scientific basis. It was informed that, this decision was based on Market Competition.

b) The insurer's R.O. II Delhi, has allowed a business procurement discount of 12.50% and de-tariff discount of 75% to M/s. Pragati Power Corporation Limited as against the maximum permissible limit of 51.25 %. This issue was also raised by CAG.

Violation of para 1, 3(ix), 8 & 11 of F&U guidelines dated 28th Sep, 2006

Submission of the insurer:

a. The authority for sanctioning discounts up to 85% on erstwhile Fire and Engg tariff rates had been delegated to the Regional in charges so that they could respond to the market conditions in a shorter span of time. However, this authority is to be used by the Regional in charges based on merit after examining proposals on case to case basis for all risks within their acceptance level.

b. IRDA circular dated 25th June 2007 provided that effective from 1st September 2007, the control on rates with regard to fire, engineering and workmen's compensation insurance classes of business would be totally removed. Subsequently, total decontrol of pricing was postponed by IRDA to January 1, 2008. The market started behaving in a manner as if totally detarified and witnessed huge fall in premium rates. The pricing of the M/s Pragati Power Corporation Ltd was based on the then market conditions. After scrutiny, CAG dropped the draft para vide letter dated 23rd/25th November, 2010.

Decision:

The company has deviated from the discount structure approved by the Authority under F&U guidelines by offering discounts beyond the approved structure, thereby not complying with F&U guidelines.

In view of the violations observed at point 2 of the decision to charge 3 and at charge 4 above on F&U guidelines, the Authority in exercise of powers conferred under Section 102(b) of Insurance Act, imposes a penalty of Rs.5 lakh. The Insurer is also hereby directed to ensure compliance with the F&U guidelines as issued from time to time.

5) **Charge 5:**

The insurer did not put in place any system

- To collect the KYC documents in respect of claims paid/ refunds made to the customers for the amounts in excess of Rs 1 lakh.
- To generate transactions that are mentioned in the indicative list of STRs as stated in the AML policy of the company. As such, the company did not report any STRs to the FIU-IND.
- To train the employees/agents of the company, on an ongoing process on matters relating to AML aspects.
- To verify the compliance of AML guidelines by its various offices, in its internal audits conducted;
- To identify and reject the cases received from the banned persons/entities.

Violation of circular *No. 39/IRDA/AML/CIR/FEB-09, dated 4-3-2009 and para 3 of circular no: 022/IRDA/MasterAML/Nov-08 dated 2nd Dec, 2008.*

Submission of the insurer:

1) Instructions were given to all our operating offices to collect KYC documents manually, in respect of claims paid/ refunds made to the customers, for the amounts in excess of Rs. 1 Lakh. In addition, an IT service provider had developed the application components for AML, KYC. We confirm that a system has been put in place since 07-12-2010, which enabled us to capture the KYC requirements.
2) We did not come across any STRs and hence did not report to the FIU-IND.
3) In house training programmes and meetings related to Accounts department discuss on KYC norms. The company has adopted a system of on-going training programme at the Company's training centre.
4) As a matter of verification of the compliances of AML guidelines by Internal Audit department, a reporting format has been designed specifically on AML and the report is submitted to the Department. Exception reporting will be presented by Internal Audit & Inspection Department to Audit Committee of the Board as part of AML policy.
5) The list of banned persons/entities is sent to all the operating offices through their controlling ROs for their compliance.

Decision:

Taking note of insurers submission on systems in place on compliance to AML/KYC norms, no charge is pressed.

6) **Charge – 6**

It was observed that the Reinsurance Placements were made with few Reinsurers having B+ / B- Rating and Govt. owned and not rated, without seeking prior approval from Authority.

Violation of Regulation 3(7) of IRDA (General Insurance – Reinsurance) Regulation, 2000.

Submission of the insurer:

Most of our reinsurers meet with ratings requirement stipulated by IRDA. Few of our Securities/Reinsurers which are unrated are either Regional Pool or Government owned companies with whom we have long business relationship. These reinsurers are also in the placement slip of other PSU companies and GIC. We have never faced any issue as regards recoveries from these Reinsurers and they have been very prompt in payments.

Decision:

Insurer submission is noted and is advised to follow the procedure prescribed at point 6 of the Authority circular 'Guidelines on Cross Border Reinsurers' ref.no. IRDAI/NL/GDL/RIN/017/01/2016 dated 19-01-2016 where in insurers have been guided on the procedure to followed before placing business with Cross Border Reinsurers not compliant with eligibility criteria prescribed in the guidelines

7) **Charge – 7**

On examining the insurers investment operations, it is noticed that

a) Though there is a formal demarcation between Front, Mid and Back Offices, the work flow is not automated and hence there is scope for overlap in the functions carried out. Also, there is no clear segregation in the functions of Chief Investment Officer, Chief Financial Officer.
b) There is no documentation of Standard Operating Procedure.
c) The maximum exposure to an investee/group company is not being monitored through the use of a software system. The system doesn't monitor the compliance of regulatory limits. The procedure adopted being manual, there is a scope for a breach.
d) During random sample examination it is noted that the daily deal register has not been tallied with the Statement of Equity Sale. This highlights the lack of proper system control in the deal room transactions.

e) Shortfall of Rs.4.20 crores in the stock reconciliation of Bonds and Debts has been identified security wise and follow-up action is under process.

Violation of point A (1-e) & B (1,2) C(4,5) D (6b) of Annexure 3 of Investment Risk Mgmt Systems & Processes prescribed under IRDA (Invst) (Fourth Amendment) Regulations, 2008 issued vide circular ref.no.INV/cir/008/2008-09 dated 22nd Aug, 2008.

Submissions of insurer:

a) Standard Operating Procedure (SOP) was approved by our Investment Committee and the roles of CIO & CFO have been clearly stipulated in SOP.Hence there is no overlapping of functions of Front, Mid and Back Office. These changes were incorporated in the system in phases and were fully functional by Aug 2011.
b) Our Exposure to an Investee Company, Group and Industry Sector including all regulatory limits are monitored on real time basis and the system generates appropriate alerts / warning prior to taking exposure in companies/group/sectors in question. There has been no such breach in such limits till now and the system does have key limits preset for ensuring compliances with all regulatory requirements.
c) Since 2012, a new module called e-FOM is incorporated in our Treasury Software and all equity transactions are done through this module. Daily equity purchase/sale register is generated through e-FOM and there is no scope for manual error.
d) Stock Reconciliation is an ongoing exercise; the shortfall of has been brought down to Rs. 2 Cr. as on 31/03/2015. All the companies in question are classified as NPAs in our books and we are following up with respective companies through for reconciliation.

Decision:

Systems being updated and controls in place, insurer submissions noted and no charge is pressed.

In conclusion, as directed under the respective charges, the penalty of Rs.15 lakh (Rupees Fifteen Lakh only) shall be debited to the shareholders' account of the general insurer and the amount shall be remitted to Insurance Regulatory and Development Authority of India within a period of 15 days from the date of receipt of this Order. The penalty shall be remitted through

the NEFT as per details being intimated to the insurer as per a separate e-mail. The transfer shall be made under intimation to Mr.Lalit Kumar, FA & HOD-Enforcement.

Further,

a) The General Insurer shall confirm compliance in respect of all the directions referred to in this Order, within 15 days from the date of issuance of this order. Timelines, if any as applicable shall also be communicated to the Authority.
b) The Order shall be placed before the Audit committee of the insurer and also in the next immediate Board meeting and to provide a copy of the minutes of the discussion.
c) If the general insurer feels aggrieved by any of the decisions in this order, an appeal may be preferred to Securities Appellate Tribunal as per Section.110 of the Insurance Act, 1938.

Place: Hyderabad
Date: 6/05/2016

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