Ref: IRDA/F&A/ORD/116/7/2019 Date: 17/07/2019

Order issued under section 64K(2) of the Insurance Act, 1938 read with

sub-section (1) of Section 14 of the IRDA Act 1999

In the matter of Reliance Nippon Life Insurance Company Ltd.

1. The Insurance Regulatory and Development Authority of India (herein after referred to as "the Authority") issued a certificate of registration bearing No. 121 to Reliance Nippon Life Insurance Co. Ltd (formerly known as Reliance Life Insurance Co. Ltd., herein after referred to as "the insurer"/ "RNLIC") on 3rd January, 2002 to carry on business of Life insurance in India, in terms of Section 3 of the Insurance Act, 1938. In terms thereof, the insurer was subject to the terms and conditions of the certificate of registration and was also required to abide by the provisions of the Insurance Act, 1938 (herein after referred to as 'the Act'), the Insurance Regulatory and Development Authority Act, 1999 (IRDA Act, 1999) and guidelines/ circulars/ other directions issued by the Authority from time to time.

2. As per section 40B of the Insurance Act, 1938 read with Rule 17D of the Insurance Rules, 1939 and IRDA Circular No. IRDA/F&I/CIR/EMT/085/04/2012, every insurer transacting life insurance business in India is required to furnish to the Authority, a statement of Expenses of Management (EoM) along with the Financial statements within 15 days from the date of adoption of accounts by the Board. The Insurer submitted their statement of EoM for the financial year 2015-16, vide their email dated 19th August, 2016.

3. On perusal of the statement, it was observed that the insurer's actual expenses of management were ₹ 1632.24 Crore as against allowable expense limit of ₹ 1069.20 Crore. The percentage of Expenses of Management was 153% of allowable limits under Rule 17D of the Insurance Rules, 1939. The Insurer was found non-compliant with the requirements of Section 40B of the Insurance Act, 1938 read with Rule 17D of Insurance Rules 1939. An explanation for non-compliance was therefore sought vide letter 446/12K/F&A/EML/2015-16/28/2016-17 dated 25th April, 2017.

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4. The Insurer vide letter ref: O/05-17/LCCS/9885 dated 19th May, 2017 submitted their response, stating, *inter-alia,* the following:

a) *The RNLIC has ventured into non-conventional areas catering to customers with wide range of insurance products. …….. In this process, we had to incur huge expenses of management.*

b) *Our company is an agency driven company and has been investing in setting up a long-term agency distribution due to lack of bancassurance, setting up branches in Tier-3 and Tier-4 locations albeit at costs which would pay off in the long term;*

c) *New business premium of the company significantly reduced due to drastic changes in Regulations during the year FY11 and continuing regulatory upheavals till FY 13.*

d) *From 1st April, 2011 to 31st March 2015, more than 2 lakh Advisors have left the company due to unviable commissions….*

e) *Adverse macro-economic factors and global market melt-down led to capital market volatility in India…*

5. The submissions of the insurer were not found tenable for the following reasons:

a. Para 4 (a) & 4 (b): FY 2015-16 is 15th year of operations and the insurer has been non-compliant with EoM limits in 6 out of 8 years from FY 2008-09 to FY 2015-16. From this, it appears that the insurer's business model has not been able to achieve control of expenses of management. This,in turn may have an adverse impact on the policyholders, which is also indicated in the Appointed Actuary's letter dated 3rd July 2017 (refer para 7 below).

b. Para 4 (c) above: Regulatory changes are carried out as per the provisions of insurance legislation particularly Section 14 of IRDA Act 1999 and are applicableto all the insurers in India and are not specific to RNLIC.

c. Para 4 (d) above: Agency attrition is not specific to RNLIC.

d. Para 4 (e) above: Adverse Macro-economic factors and global melt down are also factors which have affected the economy in general and not only RNLIC.

6. Vide email dated 7th June, 2017 a certificate from the appointed actuary of the insurer was sought on the following for FY 2015-16:

a. Policyholders are not impacted by the expense overrun and more particularly PAR Policyholders.
b. The interests of policyholders are not adversely affected at any time.
c. There is compliance with the Product Regulations and File and Use stipulations.

7. In place of a certificate as sought, the appointed actuary (AA) vide letter dated 3rd July, 2017 has submitted inter-alia that expenses were higher than the prescribed regulatory limit on an overall basis and expenses incurred/allocated to participating business were well within the prescribed regulatory limit. The Appointed Actuary has indicated the following about PAR-Fund,

> "*.....The higher level of surplus is mainly attributed to lower level of expenses particularly the acquisition expenses which has significantly reduced during the year. However, acquisition expenses are still* ***higher than that used in pricing/benefit illustration****. The higher acquisition expenses (higher than used in the pricing) in the Participating fund may have* ***short-term implications for the par policyholders*** *but in long-run this may not impact the policyholder.....*"

8. After examining Statement of Expenses of Management of the Insurer, the explanation of the insurer and further submissions of the appointed actuary, it was observed that the insurer had not complied with Section 40B of Insurance Act, 1938 read with Rule 17D of Insurance Rules, 1939, in the year FY 2015-16. Further, as sought by the Authority, there is no certification from the appointed actuary. On the contrary the appointed actuary has admitted that the acquisition expenses are still higher than that used in pricing/benefit illustration and further indicated that Par fund may have impacted in short term.

9. In view of the above, a Show Cause Notice (SCN) was issued vide letter reference 446/12K/EML/F&A/2015-16/137/2018-19 dated 30th November, 2018.

10. The Insurer submitted its reply after seeking extension of time, vide letter reference 0/18-19/LCCS/10792 dated 15th January 2019. The Insurer did not respond on the observations at para 6 to 8 of the SCN.

11. As sought by the insurer an opportunity of personal hearing was extended on 1st May 2019. During the hearing, the insurer was asked to submit their response to para 6 to 8 of the SCN and the response of the insurer was received in IRDAI on 22nd May 2019.

12. The insurer in its submission through letter dated 15th January 2019, has stated that

> *.....in considering the new Regulation the gap of expense was significantly reduced by approx.. 30%....*

13. The Insurer has chosen to file EoM return under Section 40B of the Insurance Act, 1938 read with Rule 17D of the Insurance Rules 1939. The option to either follow erstwhile provisions or EoM Regulations in FY 2015-16 was a transition provision facilitating smooth change. Once the insurer has chosen Section 40B, now the insurer cannot selectively apply provisions from either of the two different set of provisions. Therefore this explanation of the insurer does not hold good.

14. The insurer in its submission through letter dated 15th January 2019, has stated

> *....it is pertinent to note that the same business model RNLIC has achieved break even by FY 12 and declared financial profits in FY12, FY13, FY14 and FY15. Under the new regulations, post the hardship faced on account of changes in the Regulations and the consequent adjustments to the business model; RNLIC with the same Agency Model has achieved profits for FY18. Therefore, it will be incorrect to question the viability of the business model....*

15. Insurer's contention is based on incorrect understanding of the issue. It may be noted that the concern raised was on <u>inability of the business model to control expenses</u> and not about viability of the business model.

16. The insurer in its submission through letter dated 15th January 2019, has stated

......due to sudden regulatory changes during FY'11 and market condition the Agency led businesses from FY'12 have been badly affected as compared to Bancassurance businesses...

...... It is pertinent to note that ULIP products were easier to sell (since they were more popular with customers) as compared to traditional products. Therefore, due to sudden change in the regulations, it became difficult for RNLIC to sell ULIP products through agency channel.....

...In addition to adjust to the changes form ULIP sales to traditional sales, RNLIC had to shift gears and incur marketing costs to boost premium income from traditional products.....

...Regulatory changes had also affected RNLIC's new business owing to attrition of the advisors, consequent to reduction of commission ....Due to unviable commissions of the Advisors, more than 1 lakh advisors left RNLIC. Consequently, this resulted into hiring of more number of Advisors and therefore company had to incur more cost in recruitment training and developments....

...Due to down fall in the market... RNLIC had to spend huge amount in marketing to increase the visibility of the product.....

The guidelines for VIP (Universal Life) products (introduced in 2010) led to an overnight ban on the sale of Universal Life products by the Authority. This ban resulted in double-whammy for RNLIC which was already reeling under the adverse impact of new ULIP regulations....

..the negative affect of regulatory changes on the other agency driven business players in the market, who have also incurred over and above expenses in the year 2014 to 2016....

17. The insurer has contested that the regulatory changes and high agency attrition rates have impacted industry as a whole and the impact was more for them. They have further submitted that there are other players in the market who had expense overrun in years 2014-2016. It may be noted that regulatory action is taken on insurers after considering their submissions and their demonstration that policyholders' interests are not affected. In case of RNLIC, required certification as regards protection of policyholders' interest is not provided by the appointed actuary (AA) of the insurer.

18. The insurer in its submission through letter dated 15th January 2019, has stated

...RNLIC has charged PAR under the regulatory limits...RNLIC was diligent in protecting the PAR policyholders as EoM % in PAAR segment is within prescribed limits FY 2016.

Further, as per para 2.5.1 of the IRDAI Master Circular on preparation of Financial Statements dated 11th December 2013, after completing of 12 years in operation, Company cannot contribute any amount to the PAR fund from shareholder fund.....

19. The Insurer's interpretation of the master circular is incorrect. The stipulation of the master circular is under section 49 of the Insurance Act, 1938 to fund the deficit in policyholders account in order to declare bonus to the policyholders and reads as under:

Extract from Master Circular on Preparation of Financial Statements of Insurance Companies:

2.5.1 Conditions to be met for declaration of bonus to the policyholders:

An insurer intending to declare bonus, where the Participating Life Fund is in deficit, should strictly satisfy the conditions, as laid down by the Authority, hereunder:
i) The Insurer shall make good the accumulated deficit in the Policyholders" A/c and also transfer adequate assets to cover the cost of bonus, prior to declaration of bonus to the participating policyholders. Such transfer from the Shareholders" A/c can be out of the Profit & Loss A/c balance or reserves in the Shareholders A/c, and/or by drawing upon the paid-up capital of the Insurer. By implication, there shall be no deficit in the Policyholders" A/c in case of the insurer opting for declaration of bonus under these circumstances.

ii) ......
iii) .....

iv) .....

v) .....

vi) .....

The above provisions, for the purposes of meeting the requirement of declaration of bonus are available to the insurers only during the first twelve financial years commencing from the year in which the life insurance business operations were started, thereafter, it is expected that declaration of bonus will be supported by surplus within the life fund without recourse to contribution from the shareholders...

20. The stipulation does not stop shareholders of the insurer from contributing to policyholders account to fund 'expense overrun'.

21. The insurer in its submission through letter dated 15th January 2019, has stated

.....RNLIC has charged PAR under the regulatory limits.... RNLIC has an expense overrun situation on the year 2015-16 at Company level. However, RNLIC was diligent in protecting the PAR policyholders as EOM% in PAR segment is within prescribed limits FY 2016.

The submissions are taken on record.

22. The insurer in its submission through letter dated 15th January 2019, has stated

....bonus has either increased over the years or maintained form last financial year and FFA of the par fund significantly increased...the company has increased bonus rates in FY 2017-18 and FY 2018-19 too. Thus, the policyholders' interests were protected by increasing the bonus rates over the years and significant increase in FFA.

The expenses were higher than the expenses used in the pricing of the products and were related to acquisition expenses which pertains to Par new business. We would like to inform the Authority that all new business written were from products launched post FY 2014-15. ..... The acquisition expense overrun have not impacted the bonus declaration of these products. Thus, the interest of policyholders remained protected for newly launched and sold policies....

....the then Appointed Actuary had given a detailed response towards the queries sought in the response. He had, in his submissions, addressed various parameters on which the Par fund should be analysed, the method adopted for bonus declaration and demonstrated that interest of policyholders are not impacted. He had further stated that higher acquisition expenses may have short term implications. Such short term implication could be for instance, lower FFA which may restrict investment freedom or declaration of higher bonus in short term. However, in case of our book this has not resulted in the reduction of guaranteed benefit or bonus declaration....

23. Despite repeated requirement of 'Certificate' from the appointed actuary of the insurer on protection of policyholders' interest and compliance with product Regulations and F&U guidelines, the insurer claims to have submitted a detailed response to the queries sought. In their submissions till date, insurer has not provided the required certificate but claims that while acquisition expenses were higher than that used in

pricing of the products, they have not impacted bonus declaration of newly launched and sold products. There is no confirmation on protection of existing policyholders.

24. The insurer claims that that there has been no reduction of guaranteed benefit or bonus declaration, but has not ruled out short term implications which is '*lower FFA which may restrict investment freedom or declaration of higher bonus in short term*'.

Decision

25. The insurer has neither furnished the Certificate from the appointed actuary nor demonstrated that the interest of the policyholders was not affected due to the excess of expenses over the prescribed limits. The Insurer is found to have contravened provisions of section 40B of the Insurance Act, 1938 with respect to non-compliance of the limits prescribed for expenses of management. The Insurer is hereby warned u/s 64K (2) of the Insurance Act, 1938, with an advice to comply with the expenses of management limits in future.

26. The insurer is further advised that within a period of seven years, if two warnings have been given u/s 64 (K) (2) and such warnings are disregarded by the insurer, the Authority may cause investigation and valuation pursuant to Section 64K(3) of the Insurance Act, 1938

27. As, the expenses incurred in the PAR segment are within the allowable limits, it is not pressed to debit the excess of expenses over the prescribed limits to the shareholders, as in other segments profits or losses anyway belong to shareholders.

28. If the insurer feels aggrieved by any of the decisions in this Order, an appeal may be preferred to the Securities Appellate Tribunal as per Section 110 of the Insurance Act, 1938.

Place : Hyderabad

Date : 16 July 2019

16/7/19.

CHAIRMAN