Report of The Advisory Group on Insurance Regulation (Part I)

September 2000

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Executive Summary

The Standing Committee on International Financial Standards and Codes (Chairman: Dr. Y.V.Reddy) constituted the Advisory Group on Insurance Regulation (Chairman: Shri R. Ramakrishnan) "…to chalk out a course of action to achieve the best practices…" in the field of insurance regulation in India. The Group deliberated on the Indian insurance legislation at present in light of standards and codes prescribed by the International Association of Insurance Supervisors (IAIS) and the twenty Insurance Guidelines issued by the OECD for its members.

Insurance regulation can be classified into two, *viz*., a) licencing of new companies and b) supervision of existing companies. Part I of the Report, which was submitted on September 23, 2000, deals with licencing of new companies in India. The major findings of the Group are as follows:

- Regarding the legal form of insurance companies, in India, the joint stock company route is followed, which is not inconsistent with the international practice. However, with a view to spreading insurance business in rural areas, the role of co-operatives may not be ruled out in future (*Para I.a.4*).

- Superannuation business comes under the definition of life insurance business in India. To protect the interests of the members of the superannuation funds, it is, therefore, necessary to bring these funds under some form of clear regulatory arrangements/mechanisms. There are many methods of achieving this. One such method could be through the formation of the Occupational Pension Board, as in the UK (*Para I.a.8*).

- An insurance company can be a domestic or a foreign company. The foreign company can operate either through a branch or on a services basis. This is the practice in most of the countries. Even though foreign companies are not allowed to operate directly, they are permitted through joint venture arrangements with an Indian company with a shareholding not exceeding 26 per cent in the paid-up capital of the company. Hence, this departure from the standard international practice of allowing foreign companies to operate either through a branch or a service basis need not be considered as a material one (*Para I.a.12*).

- Regarding the location of head/corporate office, at present, India's position is consistent with international practice although with globalisation, integration of markets and developments in communication networks, this stipulation may not be effectively implementable in future (*Para I.b.4*)**.**
- With a view to conform to the international practice, a section similar to Section 6(2)(h) of the LIC Act could be considered for incorporation in the IA 1938, which would enable Indian insurance companies to provide similar allied services to their customers (*Para I.c.4*).

- In the field of specialisation, "life" and "non-life" businesses are to be conducted by separate companies. IRDA has also decided not to permit formation of composite companies. However, it would be advisable to place an explicit restriction on the formation of composite companies (*Para I.d.3*).

- It may be desirable to take a fresh look at the developments in other countries and consider introduction of a more elaborate classification of life and non-life insurance business (*Para I.d.6*).

- At present, the minimum capital requirement is more than adequate as compared with best international practices (*Para I.e.5*). The minimum capital levels may be fixed for each class of business on a scientific and on a more transparent basis (*Para I.e.9*).

- The Indian practice in respect of deposit requirements is in conformity with the best international practice (*Para I.f.3*).

- The business plan required to be submitted along with the application for licence is quite comprehensive in India at present and is consistent with the international best practice (*Para I.g.3*).

- With a view to enhancing transparency, the regulator may, as a general rule, ascertain the names of the natural and legal persons holding a direct or indirect qualifying participation in the applicant company and more importantly, make this knowledge public while granting the licence (*Para I.h.3*).

- With regard to suitability of owners, the Group is of the view that the sound reputation of owners may be ensured on a continuous basis (*Para I.h.6*).

- While discussing the suitability of directors and/or senior management, the Group observes that although the present position in India is different from that of the current international practice, necessary steps could be taken, in future, to ensure the fulfillment on a continuing basis. Accordingly, the information system needs to be modified and maintained (*Para I.i.4*).

- Regarding outsourcing, it is the Group's view that it would be desirable to follow the international practice as also other Indian industrial practices, by considering outsourcing of various functions of an insurance company in view of the economies of scale and scope (*Para I.j.7*).

- There is no uniform international practice as regards the design of products. The Group is of the view that the certificate, including the basis of premium, given by the actuary may be treated as a public document and be made available, on demand, to other companies and any practising actuary. Further, the premium rate table and the benefit design may also be treated as "Published Information". A similar procedure could be considered for group business and also for general insurance business (*Paras I.k.3 and 4*).

- The Group considers that with a view to ensuring uniformity in the design of products, terms and conditions and marketability and also to bring about a level playing field between insurance companies and mutual funds, there is a need for co-ordination between regulators of these two segments of the financial sector (*Para I.k.6*).

- It is recommended that the regulator may make available a recommendatory standard format of articles of incorporation (*Para I.l.3*).

- The Group is of the view that a firm of consulting actuaries may be considered for acting as appointed actuaries as per the practice obtaining in most countries. Furthermore, the condition that a "certificate of practice" has to be obtained each year from the professional body is not present in respect of any other profession. The Group feels that this needs a relook (*Para I.m.6*).

- In the field of reinsurance, the Group feels that i) the stipulations regarding reinsurance appear to be adequate for ensuring healthy reinsurance arrangements and are mostly in line with international practices (*Para I.n.6*); ii) the possibility of reinsuring only on risk premium basis may be explored (*Para I.n.7*); iii) the Indian prescription of having compulsory cession of risks to local reinsurers may appear to be against the recommendation of the IAIS. However, this prescription may be continued till a satisfactory solution is found for the problem of international reinsurers converting local insurance companies into brokers (*Para I.n.12*); and iv) since it would take quite some time to develop necessary international contact and build a reliable database on the activities and strengths of various reinsurers, the existing domestic expertise could be nurtured and strengthened for this purpose (*Para I.n.14*).

Introduction

1.1 The Standing Committee on International Financial Standards and Codes was constituted by the Governor, Reserve Bank of India, under the chairmanship of Dr. Y.V. Reddy, Deputy Governor with Dr. E.A.S. Sarma, Secretary, Department of Economic Affairs, Ministry of Finance, Government of India as alternate chairman. The terms of reference of the Committee encompass

"…identifying and monitoring developments in global standards and codes, considering aspects of applicability of these standards and codes to Indian financial system, chalking out a road map for aligning India's standards and practices to international best practices, periodically reviewing the status and progress and making available its reports to all concerned in public or private sectors…".

1.2 The Standing Committee, at its first meeting held in New Delhi on January 13, 2000, identified ten different subject areas in which detailed analyses are to be undertaken to examine the availability of various standards and codes. Accordingly, ten advisory groups were constituted by the Standing Committee, one for each of the areas identified. One of the areas identified was insurance regulation. The terms of reference of the Advisory Group are:

- To study the present status of applicability and relevance and compliance in India of the relevant standards and codes,
- To review the feasibility of compliance and the time frame within which this can be achieved, given the prevailing legal and institutional practices in India,
- To compare the levels of adherence in India *vis-à-vis* in industrialised countries and also emerging economies, particularly to understand India's position and promote actions on some of the more important codes and standards and,
- To chalk out a course of action to achieve the best practices.

The list of members is set out in Annexure I.

1.3 When the broad framework given to the Advisory Group on Insurance Regulation states "**to chalk out a course of action to achieve the best practices**", it is important to recognise that no generally accepted standard practices have so far emerged in the field of insurance at the global level, although continuous efforts are being made to evolve one.

Comments on the Development of Insurance Legislation

2.1 Before taking up identification of the best practices, it is necessary to have a brief look at the development of insurance legislation in India. This is given in Annexure II. From what is given in this Annexure it can be seen that the successive legislative measures brought out by the Government during the last century were a demonstration of its concern for the protection of the policy holders and its determination to ensure the healthy development of the insurance industry. These measures cannot be termed as a case of over regulation. Even in the United Kingdom where the Insurance Acts reflected the principle of "freedom with publicity", the authorities increasingly felt, from 1960 onwards, the need for prescribing stricter standards and introduced several new regulations. It appears, however, that these regulative measures failed to check the endless failures of insurance companies and the Government had to finally resort to the extreme measure of nationalisation of the insurance industry. This leads to the questions,

- *Was there really any deficiency in the legislative measures adopted?*
- *Was there any deficiency in the method of supervision? and*
- *What steps should be taken now to rectify the deficiencies, if any?*

2.2 The Insurance Act, 1938 (IA 1938), as amended in 1950, had enough provisions to ensure proper functioning of companies and the 1968 amendment gave the regulator the power to carry out on-site inspections. The deficiency lay not in the Insurance Act but in the method of licensing of new insurers. The Group is of the view that there is scope to improve the effectiveness of this method so as to check proliferation of unhealthy companies. This would also enhance the effectiveness of regulation.

2.3 One of the main reasons for this proliferation of companies might have been the low level of minimum capital requirement. The IA 1938 prescribed Rs.50,000 as the minimum capital required besides requiring deposits for various classes of business. This amount might have been substantial at that time. However, with the rapid fall in the value of money during the post war period, this minimum capital requirement ceased to be an effective instrument in checking the growth of new entrants, principally as there was no provision for enhancing this minimum capital.

2.4 It is now well recognised that in order to enhance the effectiveness of regulation of the insurance industry adequate control at the entry point is essential. As much care has to be exercised while framing regulations governing licensing of new companies as in laying down the standards for the functioning of existing licensed companies.

2.5 Insurance regulation can, therefore, be classified into two broad heads, *viz.*, regulations relating to

- Licensing of new companies, and
- Supervision of existing companies.

The latter one could be sub-divided into six sub-heads as regulations relating to,

- Distribution channels for business,
- Products to be marketed,
- Investment of funds,
- Capital adequacy requirements,
- Accounting practices, and
- On-site inspections.

2.6 Part I of the Report deals with licensing of new companies. While trying to compare the present standards in India, in this regard, through the draft or gazetted regulations, with the desirable level of standards, liberal use has been made of the various reports of the **International Association of Insurance Supervisors (IAIS)** (Annexure III). The Group also has taken into consideration the **Twenty Insurance Guidelines** issued by the Organisation for Economic Cooperation and Development (OECD) (Annexure VI).

2.7 Part II of the Report intends to cover issues pertaining to supervision of existing insurance companies and other related matters. In particular, the

Group proposes to deal with assets, liabilities, solvency margin of insurance and financial statements of insurance companies.

2.8 I would like to place on record my appreciation to each and every member of this group, including Dr. R. Kannan, Convenor and Shri Indranil Sen Gupta, Co-Convenor for their significant contributions.

Part I - Licensing Standards

Introduction

I.1 A Licence refers only to the formal authority to transact business within the meaning of domestic supervision law and does not refer to approvals within the meaning of the general trade or company law. It is to be noted that the IA 1938 uses the term "registration" to indicate a company being authorised to transact insurance business and uses the term "licence" when a person or a legal entity is authorised to act as an insurance intermediary.

I.2 The supervisory standards on licensing have been laid down by the **Technical Committee of the IAIS** in its paper dated September 28, 1998. While discussing the importance of licensing and supervision, the said Technical Committee states, "The role of supervision by or on behalf of the state is to ensure that insurance companies are able at any moment to fulfill their obligations and that the interests of its policyholders are sufficiently safeguarded. The licensing procedure is the first step towards achieving these objectives and is one of the most important elements of the supervisory system. If the licensing system as well as the on-going supervision of licensed insurers meet internationally accepted standards, confidence in the supervisory system will grow on a domestic level as well as on an international level". **Rule No. 2 of OECD guidelines states**, "Sufficiently strict licensing criteria should govern the establishment of insurance companies. Among these criteria, the testing of the nature and adequacy of the financial resources of insurance companies, in particular through analysis of business plan and the requirement for a relevant minimum level of capital (taking account of inflation) deserves particular consideration. Other key requirements are related to the assessment of the ability of the company to meet legal, accounting and technical requirements and, last but not least, requirements for a competent management (fit and proper provision)".

I.3 Before granting licence to a company to transact insurance business, the following items of information have to be obtained, by the regulator, *viz.*,

a) Legal form of the company,

b) Location of the Head/Corporate office,
c) Company's objectives,
d) Specialisation, if any,
e) Minimum capital,
f) Business plan,
g) Suitability of owners,
h) Suitability of Directors and / or Senior Management,
i) Affiliation contract and outsourcing,
j) Product design and premium rates,
k) Articles of incorporation,
l) Actuaries and Auditors, and
m) Reinsurance.

These items are considered in the following sections in the same order. The reproduction from or comments about IAIS and OECD standards are shown in italics.

I (a) Legal Form of the Company

I.a.1 The Technical Committee of the IAIS states, "Each jurisdiction should define the permitted types of legal form. Such legal forms should provide a certain stability to the company and enable the creation of own funds. For example, joint stock company and mutual society".

I.a.2 The two legal forms that are generally permitted are joint stock companies and mutual societies. But, the only permitted legal form in India, at present, is a joint stock company. This is a departure from the practice in other countries where mutual societies could also transact life insurance business.

I.a.3 This departure from best international practices is not material since the mutual societies have gone out of fashion in most countries, even though the concept on which they are based is a sound one.

I.a.4 While the legal form prescribed in India is not inconsistent with the international practice, with a view to spreading insurance business in rural areas, the role of co-operatives may not be ruled out in future.

Superannuation Funds

I.a.5 As per the IA 1938, superannuation business comes under the definition of life insurance business in India. It is, therefore, necessary to consider here the case of superannuation funds. However, there is no standard practice at the international level for regulating these funds.

I.a.6 Section 2C of the IA 1938 prohibits carrying on of insurance business within India by any person not authorised to carry on such business, unless exempted explicitly by the regulator by notification in the official gazette. There are, at present, many approved trust funds in the country providing superannuating / gratuity payments to their members. Some of these funds are quite large in size, covering thousands of employees. There is no requirement, however, for submission of statements of financial information annually, to the regulator or any authority, to ensure that the interests of the members are fully protected.

I.a.7 These funds, approved under Part B and C of the IV Schedule to the Income Tax Act, 1961, are eligible for certain tax concessions, provided they comply with the stipulation regarding the pattern of investment prescribed for the accruing funds. Except for this prescribed pattern of investment, there is no other control.

I.a.8 To protect the interests of the members of the superannuation funds, it is, therefore, necessary to bring these funds under some form of clear regulatory arrangements/mechanisms. There are many methods of achieving this. One such method could be through the formation of the Occupational Pension Board, as in the UK.

Foreign Insurers

I.a.9 An insurance company can be a domestic or a foreign company. The foreign company can operate either through a branch or on a services basis. This is the practice in most of the countries.

I.a.10 The amendment brought in 1999 to Section 2C of the IA 1938, stipulates that "No insurer other than an Indian insurance company, shall begin to carry on any class of insurance business in India under this Act on or after the commencement of the IRDA Act, 1999”. This rules out licensing of direct foreign companies and is a departure from the practice in most of the countries.

I.a.11 Even though foreign companies are not allowed to operate directly, they are permitted to enter into a joint venture arrangement with an Indian company with a share holding not exceeding 26 per cent in the paid up equity capital of the company. Holding of the foreign partners in the Indian promoter companies is considered while deciding on this limitation of 26 per cent.

I.a.12 Hence, this departure from the standard international practice of allowing foreign companies to operate either through a branch or a service basis need not be considered as a material one.

I.(b) Location of the Head / Corporate Office

I.b.1 The Technical Committee recommends that the location of the Head Office as well as the central administration be to be situated within the country.

I.b.2 In India, till recently, insurance was a state monopoly. Necessary opening up of this sector is done only recently. There is no provision in the existing legislation to ensure that the administrative control is not shifted to the corporate office of the joint venture partner, especially when the joint venture partner is a foreign insurance company.

I.b.3 The first part of the recommendation will be fulfilled automatically since the company has to be registered under the Companies Act, 1956. It may be more difficult, however, to take care of the second part of the recommendation. In a joint venture arrangement, it is likely that the administrative control can be fully with the foreign partner. That is, even though the central administration may be physically situated within the country, all-important decisions of technical nature may be taken at the corporate office of the foreign partner. In other words, the technical administration will be effectively outside the country.

I.b.4 At present, India's position is consistent with international practice although with globalisation, integration of markets and developments in communication networks, this stipulation may not be effectively implementable in future.

I.(c) Objectives of the Company

I.c.1 The Technical Committee recommends that insurance companies should not carry on any activities <u>other than in connection with or for the purposes of their insurance business</u> and the same should be incorporated in the company's articles of incorporation. Rule No.3 of the OECD guidelines states, "The underwriting of insurance risks should be restricted to insurance companies, which may transact insurance (and connected) operations only".

I.c.2 Clause 7A of Section 2 of the IA 1938, inserted by the amendment made in 1999, states that "Indian Insurance Company means any insurer being a company whose sole purpose is to carry on life insurance business or general insurance business or reinsurance business". Let us look at the corresponding provision in the LIC Act, 1956. Section 6(2)(h) of this Act empowers the Corporation "<u>to carry on any other business which may seem to the Corporation to be capable of being conveniently carried on in connection with its business and calculated directly or indirectly to render profitable the business of the Corporation</u>".

I.c.3 That is, while the provision in the LIC Act, 1956, is in conformity with international practice, the amendment made in 1999 (to the IA 1938) is not. Further, Section 30A which was added in 1999 to the LIC Act, 1956, prescribes that, after the commencement of the IRDA Act, LIC shall carry on life insurance business in accordance with the provisions of the IA 1938, thus overriding the provisions of Section 6(2)(h).

I.c.4 With a view to conform to the international practice, a section similar to Section 6(2)(h) of the LIC Act could be considered for incorporation in the IA 1938, which would enable Indian insurance companies to provide similar allied services to their customers.

I.(d) Specialisation

I.d.1 Insurance business can be broadly classified into two classes - "life" and "non-life (i.e., general)". As per the principle of specialisation, recommended by the Technical Committee, a company licensed to operate life insurance should not be licensed to operate non-life insurance, and vice-versa. Rule No.3 of the OECD guidelines states, " …. Life and non-life activities should be separated (in distinct companies), so that one activity cannot be required to support the other".

I.d.2 This restriction has now been imposed both in the European Union and in North America and in amending Acts of many other countries also. However, composite companies that are already transacting both life and non-life business are permitted to continue to do so, but with stricter controls. (It is also interesting to note that Japan, which had imposed this restriction earlier has now relaxed it).

I.d.3 Although international practice restricts composite companies, Section 10(2A) of the IA 1938 places only some limited restrictions on life insurance companies carrying on any other classes of insurance business. It is important to mention here that the IRDA has decided not to permit formation of composite companies. **Hence it would be advisable to place an explicit restriction on the formation of composite companies.**

I.d.4 While on the subject of specialisation, it is necessary to consider one more aspect. In India, a licence is granted for conducting life or non-life business. There is no further classification. In 1938, when the Insurance Act was framed, the classification given in the Act would have been quite adequate to collect returns from the insurers, as the insurance business was not sophisticated.

I.d.5 In the UK and in other parts of Europe, USA and OECD countries, insurance business is classified in more detail for the purposes of authorisation of insurers. The European Directives on Life and Non-Life set out 7 classes for life business and 17 classes for non-life business for independent authorisation. In the UK, an 18th class, titled "Assistance", has been introduced recently. This seems to have been preferred as the risk and claim characteristics, including claim size fluctuations are significantly different from each other. These eighteen classes, however, have been reduced to eight accounting classes for purposes of submitting returns to the supervisory authority. These details are given in Annexure V.

I.d.6 It may be desirable to take a fresh look at the developments in other countries and consider introduction of a more elaborate classification of life and non-life insurance business.

I.(e) Minimum Capital requirement :

I.e.1 The Technical Committee considers the establishment of sufficient free capital as one of the important licensing requirements. It states,

- *The amount of minimum capital should take into account the type of risk that is intended to be covered. If the applicant company proposes to write several classes of business, the minimum capital can be fixed either as the highest of the amounts fixed for individual classes or as the sum of the amounts of the individual classes.*
- *The minimum capital should not be used for covering setting up costs.*

- *It should be uncommitted so as to be available if any unforeseeable losses are to be covered.*
- *Proof of the minimum capital and the elements making it up, should be submitted to the supervisor.*

Rule No. 2 of the guidelines issued by the OECD, dealing with the licensing criteria, mentions "minimum level of capital (taking account of inflation)" as one of the important criteria.

I.e.2 The last three of the four requirements recommended by the Technical Committee have been provided for in the IA 1938. Let us now look at the first of the four requirements.

I.e.3 It has been recognised that insurance companies need capital to provide a cushion under the following situations.

- Unexpected increase in liability,
- Unexpected decrease in the value of assets,
- Premium rates proving to be inadequate,
- Problems associated with cash flow timings and
- Catastrophes.

In recent years, regulators are approaching the problem of minimum capital requirement through statistical methods.

I.e.4 The amendment made in 1999 to Sec.6 of the IA 1938, reads as follows: "No insurer carrying on the business of life insurance or general insurance or reinsurance in India on or after the commencement of the IRDA Act, 1999, shall be registered unless he has :

a) a paid-up equity capital of rupees one hundred crores in case of a person carrying on life insurance or general insurance or
b) a paid-up equity capital of rupees two hundred crore, in case of a person carrying on exclusively the business of reinsurance".

I.e.5 As compared with best international practices, this minimum capital requirement is not only more than adequate but may perhaps be the highest as compared with the insurance legislation of any country.

I.e.6 It is also to be appreciated that the size of the capital will have a bearing on the stability of a company only during its formative years. When the company grows in size the capital becomes an insignificant proportion of technical/mathematical reserves. It is the implicit margins in the valuation basis adopted for estimating the reserves, the margins in the value of assets and the explicit margins in the form of free reserves built up systematically over the years that will then provide real security and stability to the policy holders.

I.e.7 In actuarial parlance, the sum of,

- values of margins, both implicit and explicit,
- reserves, both disclosed and undisclosed, and
- shareholders' capital

is referred to as the "Estate" and this estate has to be built up systematically out of the surplus/profit emerging each year. After the formative years, the shareholders' capital will gradually become a miniscule proportion of the estate and lose all its significance.

I.e.8 The Technical Committee has recommended that "when a company writes several classes of business, the minimum capital can be fixed either as the highest of the amounts fixed for individual classes or as the sum of the amounts of the individual classes". It effectively means that minimum capital required has to be determined separately for each of the classes of business. It was stated earlier that the European Directives on Life and Non-Life have set out 7 classes for life business and 18 classes for non-life business for independent authorisation.

I.e.9 The minimum capital levels may be fixed for each class on a scientific and a more transparent basis. Thus, for example, the total minimum capital could be based on the classes of business that the company proposes to transact and not on the assumption that each company will be transacting all classes of business. This would

encourage formation of specialist companies to develop those classes of business, which are more risky and which have not been tried seriously so far in our country.

I.(f) Deposit :

I.f.1 While on the subject of minimum capital, it is better to consider also the question of deposits. The Technical Committee states, "In order to ensure the guarantee function of the minimum capital, legislation could require a deposit. The company may only dispose of this deposit with the supervisor's approval". There is no mention of deposit requirement in the OECD guidelines

I.f.2 Section 7(1) of the IA 1938, as amended in 1999 specifies the amount to be deposited with the Reserve Bank of India. It is,

a) In the case of life insurance business, a sum equivalent to one percent of its total gross premium written in India in any financial year commencing after the 31st day of March 2000, not exceeding rupees ten crore.
b) In the case of general insurance business, a sum equivalent to three percent of the total gross premium written in India in any financial year commencing after the 31st day of March 2000, not exceeding rupees ten crore.
c) In the case of reinsurance business, a sum of rupees twenty crore.

I.f.3 The Indian practice is in conformity with the best international practice.

I.f.4 It is also to be appreciated that this deposit will have some relevance only in the early years of a company. Once a company grows in size, the deposit will become an insignificant proportion of its technical reserves and will cease to be relevant, as far as the solvency of the insurer is concerned.

I.(g) Business Plan :

I.g.1 The Technical Committee recommends that "the promoters applying for licence have to submit a business plan, for at least three years ahead and that the plan should demonstrate satisfactorily that the company will be able to maintain a sound financial condition and meet its obligations at all times during this period. " Rule No. 2 of the guidelines issued by the OECD, dealing with the licensing criteria, states, "Among these criteria, the testing of the nature and adequacy of the financial resources of the insurance companies, in particular through analysis of business plan and the requirement for a relevant minimum level of capital (taking account of inflation) deserves particular consideration".

I.g.2 There is only indirect mention of the business plan in the IA 1938. However, the IRDA has gazetted in July 2000, detailed regulations for licensing of insurers and the specimen application form requires a five-year business plan. In this business plan, the amount of fund (the life fund, in the case of life insurance business), the valuation liability, the required solvency margin and the available solvency margin as at the end of each of the five years have to be given. This is to ensure that the company will be able to satisfy the solvency requirements throughout the five year period (provided the assumptions made in the calculations are reasonable and borne out) and the capacity of the promoters to bring in additional money, if needed.

I.g.3 The business plan required to be submitted along with the application for licence is quite comprehensive and already is consistent with the international best practice.

I.(h) Suitability of Owners:

I.h.1 The Technical Committee recommends that

a) *The supervisor should know the names of the natural and legal persons holding a direct or indirect qualifying participation in the applicant company, and*
b) *The licence to operate should be refused if facts exist from which it can be deducted that the holders of a qualifying participation,*

- *Are in a difficult economic situation,*

- *Are or ever have been directly or indirectly involved in illegal transactions affecting their suitability, or intend to abuse the insurer for criminal purposes, (for example, money laundering),*
- *Are connected with the applicant company in a way that would obstruct or render effective supervision impossible*

This aspect has not been addressed in the OECD guidelines.

I.h.2 Section 3 of the IA 1938, deals with registration, *i.e.*, granting of licence to companies for transacting insurance business. Subsection 2A of this section states,

"…If on receipt of an application for registration and after making such enquiry as he deems fit, the Authority is satisfied that --

a) the financial condition and the general character of management of the applicant are sound,
b) …
c) The interests of the general public will be served if the certificate of registration is granted to the applicant" …..

That is, even though the suitability of the owners is not spelt out in so many words as recommended by the Technical Committee of IAIS, the intention is quite clear.

I.h.3 With a view to enhancing transparency, the regulator may, as a general rule, ascertain the names of the natural and legal persons holding a direct or indirect qualifying participation in the applicant company and more importantly, make this knowledge public while granting the licence.

I.h.4 The regulator can exercise strict control while granting licence and ensure that persons with not very sound reputation do not enter the insurance sector. But, how to ensure that the control of an insurance company does not pass into undesirable hands after commencement? Three sections of the IA 1938 deal with this issue:

- Section 6A places a ceiling on the share holding of any one person,
- Section 35 (1) places certain restrictions on transfer of shares, and

- Section 3(4) deals with cancellation of registration under certain conditions.

I.h.5 These sections cater for extreme situations. It would appear, however, that not so extreme situations are more difficult to handle. Consider the hypothetical example of a corporate group (say, A) having a controlling interest in a company, say B. Both A and B have sound reputations and B has been granted a licence to start an insurance company. After a few years, let us assume that the corporate group A is taken over by another corporate group, say X, whose professional reputation is not so sound. By this take over, control on B and the insurance company passes on to X. Since neither the transfer/amalgamation of the insurance company is involved in this case, nor the transfer of shares is involved, provisions of none of the above sections will apply. Such situations are not unlikely and may get further complicated since there is no objective way to determine the suitability of owners.

I.h.6 The Group observes that the effectiveness of the spirit of these three sections may be ensured on a continuous basis.

I.(i) Suitability of Directors and/or Senior Management :

I.i.1 IAIS recommends the following two criteria for checking the suitability of directors and / or senior Managers.

a) Directors, and/or Senior Managers must be professionally qualified. Professional qualification means theoretical and practical knowledge of insurance as well as managerial experience.

b) Directors and / or senior Managers must be reliable and of good repute.

The above two criteria are to be satisfied at all times, including at inception and, in particular, whenever any new Director / Senior Manager is appointed or is replaced. The OECD guidelines too mention the need for competent management (fit and proper persons).

I.i.2 Section 3 of the IA 1938 deals with registration of new companies. The application details include the name, address and the occupation of the directors, the proprietors, manager in India *etc*. The regulations gazetted for licensing of applicant insurers also call for detailed information, in prescribed format, on the promoters, directors and key persons. The detailed information required is spread over academic and professional qualifications, working experience over 15 years, reputation and character, and if there is any association with a company either wound up or under receivership during the period of their association *etc*. The key persons are defined as chief executive, chief marketing officer, appointed actuary, chief investment officer, chief internal audit and chief financial officer.

I.i.3 There is, however, no explicit provision in the above-referred section of the Act to ensure that the Directors/ Senior Managers will satisfy the above IAIS conditions at the time of granting the licence.

I.i.4 Although the present position in India is different from that of the current international practice, necessary steps could be taken, in future, to ensure the fulfillment on a continuing basis. Accordingly, the information system needs to be modified and maintained.

I.(j) Affiliation Contracts and Outsourcing :

I.j.1 The Technical Committee recommends that the Supervisor should examine the following types of contracts before granting licence:

- *Affiliation contracts through which a joint stock company subjects itself to management of another company (e.g., a holding company), or commits itself to transfer its profits to that company,*
- *Outsourcing contracts through which certain functions of material importance, (e.g., investment management, distribution accounting etc.) are transferred to another company.*

And it has to be ensured that in the case of affiliation contracts the controlling company does not have any intervention rights that could be an obstacle to effective supervision and, in the case of outsourcing contracts, *the power of the Supervisor to carry out on-site inspections of outsourced functions is not hindered in any way. Rule No.3 of the OECD guidelines states, " …… . The distribution of insurance products by entities from other sectors may be authorised".*

I.j.2 The management of an insurance company can come under that of another company through affiliation contracts. That is, the ownership of an insurance company can undergo substantial change through such contracts. This comes under "suitability of owners" and all aspects of this issue have already been dealt with. Only outsourcing of functions will be dealt with in this section.

I.j.3. Outsourcing, as a part of management strategy, is of recent origin. The managements retain their areas of core competency in an organisation and outsource support functions like software development, security arrangements, staff welfare services *etc*. This strategy is being extensively adopted in the developed countries. In the insurance industry, there is a possibility of outsourcing, in addition to the above functions, the investment activity, premium collection arrangements, business procurement (*i.e.*, distribution), reinsurance placements and IT systems maintenance.

I.j.4 Section 40(1) of the IA 1938 states that, "No person shall pay or contract to pay any remuneration or reward whether by way of commission or otherwise for soliciting or procuring insurance business in India to any person except an insurance agent or chief or special agent". This could mean that the marketing (distribution) functions cannot be outsourced. There does not appear to be any restriction, in the IA 1938, on the outsourcing of other functions.

I.j.5 However, the provisions in the IRDA (Registration of Indian Insurance Companies) Regulations - 2000, indicate that NO outsourcing will be permitted. For example, Regulation 7(C), dealing with "Consideration of Requisition for Registration Application", states, "the Authority has to be satisfied that the applicant will carry on all functions of the insurance business including management of investments within its own organisation". Regulation 12(b), dealing with "Consideration of Application for Registration", states that, "the Authority shall take into account the organisational structure of the applicant to met the requirements of Regulation 7(C)".

I.j.6 The above two provisions imply that no function can be outsourced. However, item 7 of the form IRDA/R2 (application for Registration) calls for information regarding investment adviser, if investment function is outsourced.

I.j.7 It is the Group's view that it would be desirable to follow the international practice as also other Indian industrial practices, by considering outsourcing of various functions of an insurance company in view of the economies of scale and scope.

I.(k) Product Design and Premium Rates

I.k.1 The recommendations of the Technical Committee in this regard are,

- *Insurance companies should not be regulated more than strictly necessary regarding the design of their products,*
- *The Supervisor should, however, be empowered to call for full and precise information on the design of the product so that he can assess the risks and ensure that the company's managers have the necessary qualification and its organisational structure is suitable for administering the product,*
- *Information on products may also include the general policy conditions,*
- *It is to be ensured that the cover offered under compulsory insurance (e.g., motor liability) or contracts replacing coverage under the social security system (substitutive system) is adequate,*
- *The appropriateness of the technical bases adopted for determining the premium rates is to be checked.*

Rule No.10 of the OECD guidelines states: "…Initially at least, it may be advisable for economies in transition to request the submission of premium rates and insurance products for prior approval. Supervision of tariffs and products should, however, be adapted to the particular situation of each *country and reassessed at a late stage according the development and progress of the market…".*

I.k.2 There is no uniform international practice in this area. For example, in Germany, a product can be marketed only after getting the approval of the regulator. In the UK, the "File and Proceed" system is adopted. That is, a product can be marketed soon after filing with the regulator provided the design of the product has been duly certified by an actuary. The regulator can call for clarification if the design is found to be inappropriate. The IRDA has proposed to follow the UK model.

I.k.3 However, from the transparency point of view, a limitation of the UK model is to be recognised. **To address this limitation, the Group observes that the certificate, including the basis of premium, given by the actuary, may be treated as a public document and be made available, on demand, to other companies and any practising actuary. Further, the premium rate table and the benefit design may also be treated as "Published Information".**

I.k.4 A similar procedure could be considered for group business and also for general insurance business.

I.k.5 The unit linked assurances / pensions under the life insurance business bear close resemblance to the business transacted by mutual funds.

I.k.6 The Group considers that with a view to ensuring uniformity in the design of products, terms and conditions and marketability and also to bring about a level playing field between insurance companies and mutual funds, there is a need for co-ordination between regulators of these two segments of the financial sector.

I.(l) Articles of Incorporation

I.l.1 The purpose of examining the articles of incorporation is to verify that the provisions of the Insurance Act and the Company Law have been observed.

I.l.2 The articles of incorporation should include a description of the classes of insurance that are to be offered, investment principles and an indication as to whether insurance is to be written directly only or also indirectly.

I.l.3 It is recommended that the regulator may make available a recommendatory standard format of articles of incorporation.

I.(m) Actuaries and Auditors

I.m.1 If companies are required to appoint an actuary with specific responsibilities, the Supervisor should confirm,

- *The qualifications, reliability and good repute of the person to be appointed. Insofar as a legal person is permitted, information should be collected on its experience as well as on the qualification and reliability of the managers of the legal person and*
- *Ensure that that the actuary, irrespective of whether he is employed by the company or free-lance, has sufficient powers and independence to duly fulfill his role.*

If it is required to appoint an auditor before the licence can be granted (e.g., for the purpose of initial audit) the Supervisor should confirm that the requirements given above are met.

I.m.2 The guidelines issued by the OECD are almost silent on this important aspect. The only mention comes in Rule No. 12 where a passing reference is made: "actuarial techniques are a key component of insurance management … the role of the actuarial profession could be encouraged."

I.m.3 The Appointed Actuary Regulation issued by the IRDA prescribes the method of appointment, duties and obligations of the actuary. These regulations are more elaborate than what has been envisaged by the IAIS. As per this regulation,

- a life insurance company should have an appointed actuary,
- a legal person (*i.e.*, a firm of consulting actuaries) cannot be an appointed actuary,
- the appointed actuary has to be an employee of the company,
- a person cannot be the appointed actuary of more than one company,
- no life insurance company can carry on business, until the appointed actuary is in place, and
- a person eligible to act as an appointed actuary has to obtain a certificate of practice, renewable every year from the Actuarial Society of India.

In the case of a general insurance company, the appointed actuary need not be an employee of the company and a legal person can be the appointed actuary.

I.m.4 The condition that the appointed actuary cannot be a legal person in the case of a life insurance company, is a departure from international practice. In other countries, a legal person can perform the functions of appointed actuary for more than one life insurance company. Such a practice will encourage setting up of "actuarial firms", on the same lines as "audit firms" and contribute much towards the development of the profession. It is important to note that the accounting profession has reached the high position it holds today mainly due to the encouragement given to the formation of audit firms.

I.m.5 One of the conditions of eligibility for appointment as appointed actuary is "the person should possess the certificate of practice issued by the Actuarial Society of India". This certificate of practice is renewable each year and is dependent on the actuary attending a minimum number of the Conferences to be held by Actuarial Society of India (ASI) each year (the latter condition has been imposed by the ASI in consultation with IRDA). Such a condition is present only in the UK and in a few other countries where actuaries are available in sufficient numbers.

I.m.6 The Group is of the view that a firm of consulting actuaries may be considered for acting as appointed actuaries as per the practice

obtaining in most countries. Furthermore, the condition that a “certificate of practice” has to be obtained each year from the professional body is not present in respect of any other profession. The Group feels that this needs a relook.

I.(n) Reinsurance:

I.n.1 The Technical Committee recommends that,

- *Reinsurance arrangements proposed to be entered into have to be specified along with the application for licence,*
- *The supervisor must be able to review reinsurance arrangements to assess the degree of reliance placed on these arrangements and to determine the appropriateness of such reliance,*
- *Compulsory cession of risks to local reinsurers, domestic market or discriminatory tax regimes against foreign reinsurance placement should be avoided.*

Rule No.14 of OECD guidelines states, "Regulation should not restrict free access to international reinsurance market. Compulsory cessions of risks to domestic/national reinsurers should therefore be avoided. The collection and monitoring of information relating to reinsurance companies should be established. International cooperation is particularly important to obtain accurate information and should be strengthened...”.

I.n.2 Reinsurance is an important aspect, which the regulator must consider before authorising a company to transact insurance business. In fact, at the time of applying for registration an insurance company has to satisfy the regulator on three important parameters, *viz.*,

- Adequacy of financial resources,
- Availability of fit and proper persons to control and manage the business, and
- Adequacy of reinsurance arrangements.

The last one is quite critical in the case of general insurance business and not so in the case of life insurance.

I.n.3 Even though adequate and effective reinsurance arrangements enable insurance companies to maintain stable underwriting results by spreading risks, develop their business without having to infuse additional capital and gain access to vital technical knowledge, there are also at the same time many points of concern for the regulators. These include the following:

- The major point of concern is the financial stability of the reinsurer. Apart from knowing the financial position of the reinsurer, the regulator has also to take into account, the possibility of the reinsurer becoming insolvent when there is a chain of catastrophes, in case he has too much exposure to catastrophes.
- Unsuitable and unequal reinsurance arrangements entered into by inexperienced insurance companies is the next point of concern.
- In some cases, insurance companies use reinsurance contracts only as a means of cash transfer abroad.

I.n.4 So, the important aspects to be checked in respect of reinsurance arrangements are:

- Reliability of the reinsurer,
- Type of reinsurance,
- Retention limits, and
- Reinsurance premium rates.

I.n.5 The IRDA regulations for licensing require the following details regarding reinsurance arrangements (in the case of general insurance companies):

- Full details, including, copies, of the reinsurance treaty arrangements,
- The manner in which reinsurance limits have been established,
- That any overseas reinsurance is placed only with such a reinsurer who has a minimum BBB rating from Standard's and Poor or any similar agency, and
- That the risk is retained to the maximum in the domestic market, as far as possible, while not prohibiting placement of excess risk abroad.

I.n.6 The stipulations regarding reinsurance appear to be adequate for ensuring healthy reinsurance arrangements and are mostly in line with international practices.

Type of Reinsurance:

I.n.7 Under life insurance, reinsurance can be done purely on risk premium basis. The best international practice is not to pass on the investment risk and expense risk to the reinsurer, while reinsuring the excess risk. Thus, there is a view that there is no need to reinsure on original premium basis or to resort to financial reinsurance. **Accordingly, the possibility of reinsuring only on risk premium basis may be explored.**

Retention Limits :

I.n.8 Having very low reinsurance limits may result in excessive outflow of foreign exchange and has to be guarded against. On the contrary, high retention limits may result in erosion of the stability of a company, in case of large or catastrophic claims. These two aspects are, however, significant only in the case of general insurance companies.

I.n.9 There are instances of general insurance companies in some developing countries ceding hundred per cent of their business to reinsurers (*i.e.,* zero retention limit). This is an extreme case of low retention limit. The difference between the commission received on the premium ceded and the actual operational expenses for procuring the business are the margin of profit. These companies are just "fronts" for the foreign insurance companies.

I.n.10 As a reaction to such tactics of international reinsurance companies, many developing countries have resorted to the system of "National Reinsurers" and stipulated that a certain percentage of the amount reinsured has to be ceded to the National Reinsurer. However, the Technical Committee of IAIS and OECD guidelines has criticised the system of National Reinsurers.

I.n.11 It has been proposed recently that GIC be nominated as the national reinsurer for accepting 20 per cent compulsory reinsurance cessions and arranging for placement of domestic balance risks in a pool of direct writing insurance companies.

I.n.12 This may appear to be against the recommendation of the IAIS regarding compulsory cession of risks to local reinsurers. However, this system may be continued till a satisfactory solution is found for the problem of international reinsurers converting local insurance companies into brokers.

Reliability of the Reinsurer :

I.n.13 To assess the reliability of the reinsurer is not an easy task. A system for collection and monitoring of information relating to reinsurance companies has to be established. As stated in the OECD guidelines, international cooperation is essential for obtaining such information and necessary contacts have to be systematically developed for the same.

I.n.14 Since it would take quite some time to develop necessary international contact and build a reliable database on the activities and strengths of various reinsurers, the existing domestic expertise could be nurtured and strengthened for this purpose.

Annexure I

The Advisory Group on Insurance Regulation

Shri R. Ramakrishnan	Executive Director (Retd.), Life Insurance Corporation of India	Chairman
Shri L.P. Venkatraman	Executive Director (Retd.), Life Insurance Corporation of India	Member
Shri R.C. Rao	Secretary (Retd.), Life Insurance Corporation of India	Member
Shri T.G. Menon	General Manager (Retd.), United India Insurance Company Ltd.	Member
Shri N.C. Gupta	General Manager (Retd.), The Oriental Insurance Company Ltd.	Member
Dr. R. Kannan	Adviser, Department of Economic Analysis and Policy, Reserve Bank of India	Convenor
Shri Indranil Sen Gupta	Assistant Adviser, Department of Economic Analysis and Policy, Reserve Bank of India	Co-Convenor

Annexure II

A Brief History of Insurance Legislation in India

Life insurance in its present form came to India from the United Kingdom with the establishment of a British firm, Oriental Life Insurance Company, in Calcutta in 1818. This was followed by the formation of Bombay Life Insurance Company in 1823, the Madras Equitable Life Insurance Company in 1829 and the Oriental Government Security Life Insurance Company in 1874. The first general insurance company, the Triton Insurance Company Limited, was established in Calcutta in 1850. The shares of this company were held mainly by the British. Till the formation of this company, the general insurance business was being transacted by the British and other foreign companies through their agencies in India. The Indian Mercantile Insurance Company Limited, which was set up in Bombay in 1907, was the first Indian company to transact all classes of general insurance business.

Even though the first life insurance company was established as early as 1818, there was no exclusive legislation to govern the activities of insurance companies during the nineteenth century. The Indian Companies Act passed in 1866 regulated all companies, including insurance companies. Many insurance companies were floated in the latter half of the nineteenth century and early twentieth century, but a good proportion of them could not survive beyond a few years.

In 1912, the Indian Life Insurance Companies Act was enacted to control the operation of life insurance companies. The Act required that Indian insurers make deposits with the Government. The amount of deposit was equal to Rs.25,000 or one third of the income derived from life insurance business whichever was greater, subject to a maximum of Rs.200,000. The interest on the deposit was paid to the company. The foreign insurers were, however, exempted from this provision, thus introducing an element of discrimination, to the disadvantage of Indian insurers. This Act was modeled on Assurance Companies Act, 1909 of U.K.

In 1928, the Indian Insurance Companies Act was passed. This Act amended the 1912 Act and provided for collection of statistics concerning insurance business other than life business. It also covered the foreign companies operating in India.

However, as the Era Sezshian Committee in its Report on the working of LIC observed (in para 2.1, chapter 2), "…the ten year period 1929 to 1938 witnessed the establishment of as many as 172 companies (and) also witnessed liquidation of 61 of them, almost all of them even before a valuation was performed…".

This spate of liquidations resulted in the introduction of a comprehensive bill in 1937 for controlling life and general insurance business, and this bill resulted into the Insurance Act, 1938 (IA 1938). This Act provided for, among other things,

- Constitution of a Department of Insurance,
- Compulsory registration of insurance companies,
- Provision for deposits,
- Control on investment of funds,
- Filing of returns on investments and financial condition,
- Licensing of agents,
- Control on commission,
- Prohibition of rebates,
- Filing of policy conditions and premium rates duly certified by an actuary (in the case of life business),
- Periodical valuation of liabilities and
- Provision for policyholders' Directors.

The introduction of this comprehensive legislation did not, however, prevent proliferation of new companies and failures. In April 1945, a committee under the chairmanship of Sir Cowasji Jehangir, was appointed to enquire into the undesirable developments in the management of insurance companies and recommend suitable remedial measures. On the basis of recommendations of this committee, a Bill was introduced in 1950 and passed in the same year as the Insurance (Amendment) Act, 1950. The salient features of this Act were,

- Minimum capital requirement,
- Stricter control on investments and submission of periodical returns on investments,
- Ceiling on expenses of management and agency commission, and
- Appointment of administrators for mismanaged companies.

Even after the enactment of the amendment Act, the failure of companies did not stop. As Shri R.M. Mehta, a former managing director of LIC of India, in his paper to the 4th All India Conference of Actuaries in 1994 observed, "During the ten year period 1945 (when the Jehangir Committee was constituted) to 1954, 533 valuation reports were submitted to the Controller of Insurance. Of these, 86 valuations showed a deficit, which was not covered by the free paid-up capital. Of these, 25 insurers went into liquidation and an equal number had to transfer their business to other companies".

This persistent problem of insolvency of life insurers led to the nationalisation of life insurance business and the Life Insurance Corporation of India Act was passed in 1956. The Life Insurance Corporation of India came into being on September 1, 1956.

In 1968, the IA 1938 was again amended to provide for social control over general insurance business. The amendment provided for

- Regulation of investments,
- Setting up of the Tariff Advisory Committee (TAC),
- Minimum solvency margin requirements,
- Payment of premium before commencement of risk,
- Licensing of Surveyors, and
- Power to Controller to carry out inspection, investigation, and search & seizure of books, … *etc.*

These amendments came into force on June 1, 1969. In 1971, the Government took over the management of general insurance companies. **The**

General Insurance Business Nationalisation Act was passed in 1972 and general insurance business was nationalised with effect from January 1, 1973.

These successive developments converted the Indian insurance industry into a state monopoly. However, the phased globalisation of the Indian economy that started in the early nineties began having its impact on this monopolistic structure. Further, the liberalisation of Insurance markets was among the objectives of the Uruguay round negotiations being conducted under the auspices of GATT. These negotiations included trade in services and insurance had been included in the context of financial services (Para 59 of UNCTAD Report, January 19, 1993). On April 7, 1993, the Government appointed, as a sequel, a Committee headed by Shri R.N. Malhotra to examine the reforms required in the insurance sector. The Committee, in its report submitted on January 7, 1994 recommended among other things, the opening up of the insurance sector to players other than the state owned ones. These recommendations were accepted by the Government and the Insurance Regulatory and Development Authority Act, 1999, (IRDA, 1999), consequent amendments to the Insurance Act, 1938, Life Insurance Corporation Act, 1956 and the General Insurance Business Act, 1972 were passed in the year 2000, paving the way for opening up of the insurance sector.

Subsequently, the IRDA brought out many Regulations for the conduct of insurance business in India and opened the window for accepting the applications for licensing of insurance companies with effect from August 16, 2000. Several insurance companies have filed the applications for carrying on life and/or general insurance operations.

Annexure III

International Association of Insurance Supervisors (IAIS)

The International Association of Insurance Supervisors was formed in 1994 and at present its membership comprises insurance supervisors from over 100 jurisdictions. The Secretariat of IAIS is hosted at the Bank of International Settlements, Basel, Switzerland. The objectives of the Association are,

- Cooperate to ensure improved supervision of the insurance industry on the domestic as well as international level in order to maintain efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders,
- Develop practical standards for insurance supervision that members may choose to apply,
- Liaise / cooperate with other international entities,
- Provide mutual assistance to safeguard the integrity of markets, and
- Exchange information on each member's experience in order to promote the development of domestic insurance markets

The IAIS is headed by an Executive Committee whose members represent different geographical regions. It is supported by three main committees,

- The Technical Committee
- The Emerging Markets Committee, and
- The Budget Committee

Eleven sub committees report to the main Committees.

The IAIS issues statements on global insurance principles, standards and guidance, provides training and support on issues related to insurance supervision, and organises meetings and seminars for insurance supervisors. It holds an Annual Conference where insurance supervisors, insurance industry representatives and other insurance professionals discuss topics affecting insurance regulation.

Annexure IV

Organisation for Economic Cooperation and Development (OECD)

The original member countries of the Organisation were Austria, Belgium, Canada, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries became Members subsequently through accession at the dates indicated in the brackets: Japan (April 28, 1964), Finland (January 28, 1969), Australia (June 7, 1971), New Zealand (May 29, 1973), Mexico (May 18, 1994), the Czech Republic (December 21, 1995), Hungary (May 7, 1996), Poland (November 22, 1996) and Korea (December 12, 1996). The Commission of the European countries takes part in the work of the OECD (Article 13 of the OECD Convention).

The Convention was signed in Paris on December 14, 1960 and came into force on September 30, 1961. Article 1 of the Convention states that OECD shall promote policies designed :

- To achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy ;
- To contribute to sound economic expansion in Member as well as non - member countries in the process of economic development, and
- To contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

As stated earlier, OECD has issued Twenty Insurance Guidelines for the regulation of the insurance industry. Rule No. 1 of these guidelines states, "Adequate prudential and regulatory provisions should be enforced to ensure the soundness of the insurance markets, the protection of the consumers and the stability of the economy as a whole. Over regulation should be avoided. The insurance regulatory framework must be adapted to the characteristics of individual countries and encourage the stability, while maintaining the necessary flexibility to meet developments in the market.

Annexure V

Insurance Classes for Authorisation in European Countries and for Submission of Returns to the Supervisory Authority

Long-term insurance business

I. Life & annuity: Effecting and carrying out contracts of insurance on human life, or contracts to pay annuities on human life, but excluding (in each case) contracts within class III below.

II. Marriage & birth: Effecting and carrying out contracts of insurance to provide a sum on marriage or on birth of a child, being contracts expressed to be in effect for a period of more than one year.

III. Linked long term: Effecting and carrying out contracts of insurance on human life or contracts to pay annuities on human life, where the benefits are wholly or partly to be determined by reference to the value of, or the income from, property of any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or so specified).

IV. Permanent health: Effecting and carrying out contracts of insurance providing specified benefits against risk of persons becoming incapacitated in consequence of sustaining injury as a result of an accident or of an accident of a specified class or of sickness or infirmity, being contracts that –

a) are expressed to be in effect for a period of not less than five years, or until the normal retirement age for the persons concerned, or without limit of time, and
b) either is not expressed to be terminable by the insurer, or are expressed to be so terminable only in special circumstances mentioned in the contract.

V. Tontines: Effecting and carrying out tontines

VI. Capital redemption: Effecting and carrying out Capital redemption contracts.

VII. Pension Fund management: Effecting and carrying out -

a) contracts to manage the investment of Pension Funds,
b) contracts of the kind mentioned in (a) above that are combined with contracts of insurance covering either conservation of capital or payment of a minimum interest.

Non-life insurance business:

1. Accident: Effecting and carrying out contracts of insurance providing pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of the person insured or, in the case of a contract made by virtue of section 140, 140A or 140B of the Local Government Act 1972, a person for whose benefit the contract is made -

a) sustaining injury as the result of an accident or of an accident of a specified class, or
b) dying as the result of an accident or of an accident of a specified class, or
c) becoming incapacitated in consequence of disease or of disease of a specified class,

inclusive of contracts relating to industrial injury and occupational disease but exclusive of contracts falling within class 2 below or within class IV above (permanent health).

2. Sickness: Effecting and carrying out contracts of insurance providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of the two) against risks of loss to the persons insured attributable to sickness or infirmity, but exclusive of contracts falling within class IV above (permanent health).

3. Land vehicles: Effecting and carrying out contracts of insurance against loss of or damage to vehicles used on land, including motor vehicles but excluding railway rolling stock.

4. Railway rolling stock: Effecting and carrying out contracts of insurance against loss of or damage to railway rolling stock.

5. Aircraft: Effecting and carrying out contracts of insurance upon aircraft or upon the machinery, tackle, furniture or equipment of aircraft.

6. Ships: Effecting and carrying out contracts of insurance upon vessels used on the sea or on inland water, or upon the machinery, tackle, furniture or equipment of such vessels.

7. Goods in transit: Effecting and carrying out contracts of insurance against loss of or damage to merchandise, baggage and all other goods in transit, irrespective of the form of transport.

8. Fire and natural forces: Effecting and carrying out contracts of insurance against loss of or damage to property (other than property to which classes 3 to 7 above relate) due to fire, explosion, storm, natural forces other than storm, nuclear energy or land subsidence.

9. Damage to property: Effecting and carrying out contracts of insurance against loss of or damage to property (other than property to which classes 3 to 7 above relate) due to hail or frost or to any event (such as theft) other than those mentioned in class 8 above.

10. Motor vehicle liability: Effecting and carrying out contracts of insurance against damage arising out of or in connection with the use of motor vehicle on land, including third party risks and carrier's liability.

11. Aircraft liability: Effecting and carrying out contracts of insurance against damage arising out of or in connection with the use of aircraft, including third party risks and carrier's liability.

12. Liability for ships: Effecting and carrying out contracts of insurance against damage arising out of or in connection with the use of vessels on the sea or on inland water, including third party risks and carrier's liability.

13. General liability: Effecting and carrying out contracts of insurance against risks of the persons insured incurring liabilities to third parties, the risks in question not being risks to which class 10, 11 or 12 above relates.

14. Credit: Effecting and carrying out contracts of insurance against risks of loss to the persons insured arising from the insolvency of debtors of theirs or from the failure (otherwise than through insolvency) of debtors of theirs to pay their debts when due.

15. Suretyship: Effecting and carrying out –

a) contracts of insurance against risks of loss to the persons insured arising from their having to perform contracts of guarantee entered into by them,
b) contracts for fidelity bonds, performance bonds, administration bonds, bail bonds or custom bonds or similar contracts of guarantee.

16. Miscellaneous financial loss: Effecting and carrying out contracts of insurance against any of the following risks, *viz*.,

a) risks of loss to persons insured attributable to interruptions of the carrying on of business carried on by them or to reduction in the scope of business so carried on,
b) risks of loss to the persons insured attributable to their incurring unforeseen expense, and
c) risks neither falling within (a) or (b) above nor being of a kind such that the carrying on of the business of effecting and carrying out contracts of insurance against them constitutes the carrying on of insurance business of some other class.

17. Legal expenses: Effecting and carrying out contracts of insurance against risks of loss to the persons insured attributable to their incurring legal expenses (including costs of litigation).

18. Assistance:

The above 17 classes of non-life insurance business have been reduced to eight accounting classes as below for submission of periodical returns to the supervisory authority.

		Accounting classes	Authorisation classes under non-life
	a.	Accident & health	Classes 1 & 2
	b.	Motor vehicles	Classes 3 & 10
	c.	Aircraft	Classes 5 & 11
	d.	Ships	Classes 6 & 12
	e.	Goods in transit	Class 7
	f.	Property damage	Classes 4, 8 & 9
	g.	General liability	Class 13
	h.	Pecuniary loss	Classes 14, 15, 16 & 17

Two more accounting classes relate to proportional treaty reinsurance and non-proportional treaty reinsurance business.

Annexure VI

TWENTY INSURANCE GUIDELINES OF OECD

RULE No.1 Adequate prudential and regulatory provisions should be enforced in order to ensure the soundness of the insurance markets, the protection of the consumers and the stability of the economy as a whole. Over-regulation should be avoided. The insurance regulatory framework must be adapted to the characteristics of individual countries and encourage the stability, whilst maintaining the necessary flexibility to meet developments in the market.

RULE No.2 Sufficiently strict licensing criteria should govern the establishment of insurance companies. Among these criteria, the testing of the nature and adequacy of the financial resources of insurance companies, in particular through analysis of business plan and the requirement for a minimum level of capital (taking account of inflation) deserves particular consideration. Other key requirements are related to the assessment of the ability of the company to meet legal, accounting and technical requirements and last but not least requirements for a competent management (fit and proper provisions).

RULE No.3 The underwriting of insurance risks should be restricted to the insurance companies, which may transact insurance (and connected) operations only. Life and non-life activities should be separated (in distinct companies), so that one activity cannot be required to support the other. The distribution of insurance products by entities from other sectors may be authorised. Tasks associated with the activities and the structure of financial conglomerates should be adequately monitored.

RULE No.4 Establishment of foreign insurance companies should be based on prudential but non-discriminatory rules. Liberalisation of cross-border operations, at least concerning reinsurance and international risks, should be encouraged.

RULE No.5 Adequate insurance contract laws should be established. Rules governing contractual rights and obligations as well as related sanctions, are essential for the protection of both contractual and third parties and indispensable for the development of legal stability. In the absence of contract laws, the approval of policy conditions by the supervisory authority may prove all the more necessary.

RULE No.6 Due to crucial economic and social role of insurance in the development of an economy, consideration should be given to tax facilities in the life insurance and pensions field in the economies in the transaction.

RULE No.7 The establishment of a supervisory body is essential. The supervisors should be professionally independent and properly trained and impartial. The supervisory body should have sufficient personnel and financial resources as well as adequate powers (including sanctions) to carry out its tasks.

RULE No.8 The examination of records and on site inspections of insurance companies are at the core of the work of the supervisor. An adequate reporting system is essential to achieve this task properly. The secrecy of information communication to and between supervisors should be safeguarded.

RULE No.9 Monitoring solvency margins and capital ratios constitute a key element of dynamic supervision. But adequate tariffication and prudent technical provisions backed by reliable and equivalent assets remain the fundamental requirements for maintaining solvency. Adequate business management and reinsurance activities are also indispensable to safeguard the soundness of the companies.

RULE No.10 Initially at least, it may be advisable for economies in transition to request the submission of premium rates and insurance products for prior approval. Supervision of tariffs and products should however be adapted to the particular situation of each country and reassessed at a later stage according to the development and progress of the market.

RULE No.11 Supervisory authorities should take adequate, effective and prompt measures to prevent insurance companies from defaulting, and to arrange an orderly run-off or the transfer of portfolio to a sound company. Appropriate winding up procedures should be enforced. Under certain conditions, and particularly if the national market comprises a sufficient number of potential contributors with a broad spread of risks, the creation of a compensation fund could be considered.

RULE No.12 Standardised accounting rules are essential to ensure the transparency and comparability of the financial situation of insurance companies. Adequate insurance accounting rules and requirements for reporting and disclosure have to be set as a priority action. The compilation of statistical data regarding the frequency and severity of losses is an essential condition for computing tariffs and technical provisions accurately. Tariffs should be based on statistical data. Actuarial techniques area key component of insurance management; the role of the actuarial profession could be encouraged.

RULE No.13 Investment regulation should ensure that both security and profitability requirements are respected. It should promote the diversification, spread and liquidity of investment portfolios as well as the maturity and currency matching of assets and liabilities, although some temporary dispensations to the last principle may be necessary. In any case, account should be taken of the country's current economic environment. Regulations might include a list of admitted assets on which ceilings may be set and requirements on the way in which investments should be valued.

RULE No.14 Regulation should not restrict free access to international reinsurance markets. Compulsory sessions of risks to domestic/national reinsurers should therefore be avoided. The collection and monitoring of information relating to reinsurance companies should b e established. International co-operation is particularly important to obtain accurate information and should be strengthened.

RULE No.15 Insurance intermediaries should be registered in order to ensure their compliance with selected criteria. Insurance intermediaries should possess appropriate qualifications and provide adequate information to policyholders including disclosure of limits to their independence such as significant ties with insurance companies. Insurance brokers should possess either financial guarantees or professional liability insurance.

RULE No.16 Compulsory insurance may be justified in respect of certain forms of social protection and might be considered in other areas where the risks covered are particularly serious, or where premium payments should be divided on an equitable basis among the policyholders group under consideration. Compulsory insurance is particularly recommended for automobile third party liability. Guarantee funds could be created to compensate victims when there is no insurance cover. Tariffs for compulsory insurance should also be based on statistical data. Adequate monitoring systems should be established. Compulsory insurance should not be restricted to former monopolies or state owned companies.

RULE No.17 Regulations should allow for fair competitions within the insurance and reinsurance market. The process of dismantling monopolies and the privatisation of government owned insurance companies should be strongly encouraged.

RULE No.18 The activities of insurance companies in the pensions and health insurance fields should be encouraged within an appropriate regulatory and supervisory framework. Regulations should endeavour to ensure fair treatment between all private companies operating in these areas.

RULE No.19 Governments should strengthen co-operation in order to exchange information on insurance regulation and supervision, facilitate the monitoring of the activities of foreign insurance and reinsurance companies and promote the development of sound, modern and open insurance markets.

RULE No.20 The insurance industry should be encouraged to set up its own business guidelines and to develop adequate training structures. Self-regulatory principles and organisations, including professional bodies, can complement usefully the public supervisory structure.