Financial Services Risk

Regulatory updates - Insurance

August to November 2023

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Contents

Summary of key regulatory updates Aug - Nov 2023

22- Aug-23

IRDAI Reinsurance (Amendment) Regulation, 2023 F. No. IRDAI/ Reg/5/193/2023

To create a conducive business environment and attract more reinsurers to operate in India, positioning the country as a global reinsurance hub, IRDAI has recently approved amendments to IRDAI (Reinsurance) Regulations, 2018. The amendments harmonise and streamline regulations for all stakeholders, including Indian insurers, reinsurers, Foreign Reinsurance Branches (FRBs), and International Financial Services Centre Insurance Offices (IIO). Also, to ensure retention within the Indian market, the amendment requires every Indian reinsurer, including the FRBs, to maintain a minimum retention of 50% within India of the Indian reinsurance business underwritten. It also stipulates that any retrocession to an IIO, up to 20% of the Indian reinsurance business underwritten, shall be counted towards this minimum retention requirement of 50%. Further, reducing the minimum capital requirement for FRBs from INR 100 crore to INR 50 crore and simplifying reinsurance programs shall boost market diversity and enrich India's reinsurance landscape. While this is anticipated to foster growth in the insurance sector, reinsurance brokers have a potential downside. Increased market participants may lead to direct engagement between insurance companies and reinsurers, bypassing brokers. The amendments align with the broader goal of positioning India as a global reinsurance hub, collaborating with IFSCA to cultivate a growth-friendly environment for reinsurance activities. The revised Order of Preference for IIOs and simplified regulations are expected to enhance market reach by introducing innovative offerings from reinsurers, contributing to accelerated growth and increased international recognition in the insurance sector.

31-Aug-23

Modifications permitted to withdrawn products of life insurers IRDAI/ACTL/CIR/PRO/166/08/2023

To boost policyholder benefits and flexibility without adverse effects, IRDAI has approved certain additional options/benefits under the withdrawn products of life insurers for the existing policyholders. Permitted options include adding existing open-for-sale riders, premium payment mode options, reduction in interest rates for revivals/policy loans, and introducing additional payment frequencies to income benefits payable to the policyholders. Insurers must adhere to specified conditions, ensuring proper documentation of statements of changes to withdrawn products, effective communication, and informed decision-making by policyholders subject to compliance with the extant norms. The Product Management Committee (PMC) plays a crucial role in reviewing and approving changes. Reporting requirements include submitting a statement of changes along with the Appointed Actuary's Annual Report, emphasising timely documentation submission to IRDAI. The circular, effective immediately, underscores a proactive approach to protect policyholders' interests, emphasising compliance, effective communication, and evolving to meet evolving needs.

Summary of key regulatory updates Aug - Nov 2023

15-Sep-23

Directions from TRAI for curbing the menace of Unsolicited Commercial Communication IRDAI/PP&GR/CI R/MISC/164/8/2023

To curb the menace of spam and pesky messages and prevent fraudsters' misuse such that only genuine communications go to the customers, IRDAI has released TRAI directions for Principal Entities (PE's) to verify headers and message templates. As per the directions, PE's in coordination with telemarketers/service providers, need to whitelist URLs/APKs/OTT links/callback numbers, ensuring only approved ones are allowed in content templates. Messages with unapproved content will be halted. Variables in message templates must be pre-tagged to prevent misuse. Also, TRAI mandates the development and utilisation of a Digital Consent Acquisition (DCA) facility by all access providers, creating a unified platform for registering customer consent digitally across all service providers and principal entities. No other mechanism of consumer consent will be accepted for ease of confirmation and to prevent misuse. Principal entities must acquire digital consent from consumers in collaboration with their service providers. The DCA process, as envisaged, shall have the facility to record the consent of the subscriber and revoke and update the record of the subscriber, thereby ensuring the veracity of the consent as against the prevalent system where consent was obtained and maintained by various PE's.

09-Oct-23

IRDAI Bima Vahak Guidelines, 2023 IRDAI/LIFE/CIR/GDL/174/10/2023

As part of IRDAI's mission towards achieving Insurance for All by 2047, IRDAI has issued guidelines for Bima Vahak, a women-centric distribution channel aimed at enhancing insurance inclusion, creating awareness as well as accessibility & availability of Insurance in all parts of India including the rural areas. Bima Vahak is envisaged to have a key role in taking Bima Vistaar, an affordable, accessible and comprehensive cover especially to the rural segment. Bima Vahak's can be both individual as well as corporates who in addition to creating awareness of insurance in villages shall assist in proposal filling, facilitate KYC process, policy servicing, claims settlement. Further, to ensure coverage of every Gram Panchayat as part of its insurance inclusion objective, Bima Vahaks shall be deployed in each Gram Panchayat before 31st December 2024, with responsibilities distributed among Lead Life, Non-Life, Health Insurers, and others. This initiative targets enhanced coverage and progressive growth of the Bima Vahak network. Insurers must establish internal controls, collaborate with Bima Vahaks, and implement consumer protection measures, including local Complaints Handling Officers for grievance resolution.

Summary of key regulatory updates Aug - Nov 2023

10-Oct-23

Amendment to master guidelines on Anti-Money Laundering / Counter Financing of Terrorism (AML/CFT) 2022 IRDAI/IID/CIR/MISC/177/10/2023

To close gaps in the master guidelines on Anti-Money Laundering / Counter Financing of Terrorism (AML/CFT), IRDAI has issued amendments that emphasises a unified approach for foreign branches or subsidiaries, requiring the adoption of the more stringent standards between IRDAI and host country insurers. It introduces clauses stressing group-wide programs against Money Laundering/Terrorist Financing (ML/TF) for financial groups, ensuring confidentiality in sharing information for Customer Due Diligence (CDD) and ML/TF risk management. Further, insurers must conduct enhanced due diligence on policyholders, beneficiaries, and others, focusing on high-risk clients to strengthen AML/CFT efforts. The guidelines also highlight the importance of timely Suspicious Transaction Reports (STRs), allowing insurers to file an STR with FIU-IND instead of pursuing CDD if it risks tipping off the customer. Also, the guidelines direct insurers to establish ongoing risk management procedures for Politically Exposed Persons (PEPs), ensuring consistent enhanced due diligence for individuals with elevated risk profiles. It also emphasises risk assessment for new insurance products and technologies, promoting a proactive approach to risk management. The guideline also specifies applying enhanced due diligence to business relationships and transactions with individuals from countries identified as high-risk by FATF, mitigating risks associated with weaker AML/CFT controls.

09-Oct-23

Trade credit insurance guidelines, 2021 - Modification to guideline 5.3A – allowing “reverse factoring” on TReDS platforms IRDAI/ NL/CIR/GDL/176/10/ 2023

The Trade Receivables Discounting System (TReDS), introduced by the RBI in 2018, is an online platform enabling MSME suppliers to discount bills. An essential amendment to the Trade Credit Insurance Guidelines in 2021 now allows financiers on TReDS to secure coverage against buyer defaults, specifically in "reverse factoring" transactions. This makes them the "Fourth Participant" on TReDS. The RBI's 2018 guidelines aimed to ease constraints for MSMEs in converting trade receivables to liquid funds. In June 2023, based on gained experience, the RBI permitted insurance for TReDS transactions, enabling insurance companies as the "fourth participant" in "reverse factoring." IRDAI's 2021 guidelines facilitate trade credit insurance covers for suppliers, banks, and financial institutions, with a recent amendment allowing "reverse factoring" on TReDS. This change, effective immediately, enhances ease of doing business, supports MSMEs, and boosts the economy by making trade receivable conversion more accessible and secure.

Summary of key regulatory updates Aug - Nov 2023

18-Oct-23

Circular on mandating of coverage, payment of premium under IMT-29 compulsory as an inbuilt coverage in a private car policy IRDAI/NL/CIR/MOTOR/178/10/2023-24

On 18 October 2023, IRDAI issued a circular mandating general insurers to include IMT-29 coverage in private car policies for vehicles used to transport employees, addressing concerns raised by the Madras High Court In CMA No. 2166 of 2019 & CMP No. 8871 of 2019 (United India Insurance Co. Ltd., Vs. Ilakkiyamathi & others). Previously, this coverage required an additional premium of INR 50 per employee. The directive makes IMT-29 compulsory, integrated into the standard private car policy as an inbuilt coverage without an extra premium, positioning it under the Compulsory Motor Third Party Liability Section. This directive benefits insurers by potentially impacting premium calculations and risk assessment models. Employers benefit from automatic coverage for employees without an additional premium, fostering trust, and employees and their families gain a safety net in the event of an accident while commuting in the employer's vehicle.

27-Oct-23

Amendment of arbitration clause in general insurance policies IRDAI/NL/CIR/MISC/188/10/2023

The Supreme Court in the matter pertaining to National Insurance Company Ltd vs Nippon Paper Foodpac Pvt Ltd, SLP(C) No. 224-226/2023, had questioned why denial/repudiation of a claim is not arbitrable. In view of the same, IRDAI undertook a comprehensive review of the extant arbitration clause and noted that the policyholders in retail line business have multiple channels to address their grievances, such as consumer courts, civil litigation, and ombudsman. However, commercial line businesses have no option but to avail remedy through civil courts in the absence of arbitration. Therefore, the present circular is an effort to make alternate dispute resolution through arbitration an important tool for commercial lines of business. Accordingly, IRDAI has amended the arbitration clause in general insurance policies to enhance fairness and transparency. The revision, empowered by the IRDA Act 1999, eliminates arbitration clauses in retail insurance policies and introduces a revised clause for commercial insurance policies, allowing parties to agree on a separate arbitration under the Arbitration and Conciliation Act 1996. The changes are effective immediately, with new retail policies issued after the circular lacking an arbitration clause. Existing policies retain their arbitration clause until the policy term concludes, but policyholders can request its replacement with the revised provision. This prompt implementation reflects IRDAI's commitment to consumer protection and transparency in the insurance sector.

Summary of key regulatory updates Aug - Nov 2023

30-Oct-23

Circular on revision of customer information sheet IRDAI/HLT/CIR/MISC/190/2023

To facilitate easy comprehension of terms and conditions associated with the purchased policy, IRDAI has issued a circular on mandate to Insurers to furnish policyholders with essential details in a specified format referred to as Customer Information Sheet (CIS)which encompasses the sum assured coverage inclusions and exclusions, and the claims procedure. Acknowledging information gaps leading to complaints, the revised CIS aims to bridge this and enhance policyholder awareness. The new CIS format (Annexure-A) becomes effective from 1 January 2024, promoting easy comprehension. The circular outlines insurers' compliance requirements, including mandatory CIS provision, acknowledgment, and availability in local languages. It mandates a minimum font size for the CIS and cross-referencing in the policy document forwarding letter. Issued under Regulation 26 of IRDAI (Health Insurance) Regulations, 2016, this circular enhances transparency, reduces disputes, and ensures an informed and satisfied customer base in the insurance sector.

14-Nov-23

Exposure Draft on Insurance regulatory and development authority of India (Expenses of management, including commission, of insurers) regulations, 2023 446.1/8/EoM-PA/F&A-Life/2023-24

To provide insurers flexibility in managing expenses, including commissions, the IRDAI has proposed introducing the IRDAI (Expenses of Management, including Commission, of Insurers) Regulations, 2023. The draft, issued for the EOM Regulations, 2023, proposes to repeal Regulations governing Expenses of Management for General or Health Insurance (2023) and Life Insurance (2023), along with the Payment of Commission Regulations (2023), upon the implementation of the new regulations. Any prior actions or measures under these regulations will be deemed as conducted under the corresponding provisions of the new regulations and consolidated for enhanced clarity. Further, the primary objective is to optimise resources, benefit policyholders, and boost insurance penetration. Emphasising a principles-based regime for efficiency, insurers must develop a board-approved policy for expenses and commission payments and a comprehensive business plan. Specific expense limits are outlined for general, health, and life insurance businesses, and additional allowances are granted for insurtech, insurance awareness, and specific business segments. The IRDAI retains the authority to exercise forbearance in cases of excess expenses. Non-compliance with the proposed regulations may result in various actions, including penalties and restrictions. This regulatory initiative underscores a commitment to providing insurers with the necessary flexibility to manage their expenses effectively, fostering industry efficiency and responsiveness while prioritising the interests of policyholders and promoting greater insurance penetration.

Summary of key regulatory updates Aug - Nov 2023

24- Nov-23

Discontinuation of filing of certain returns by insurers and insurance brokers IRDA/INT/CIR/IB/206/11/2023

Pursuant to the notification of the IRDAI (Payment of Commission) Regulations, 2023, wherein there is no commission, remuneration, or reward cap, the brokers and insurers are no longer obligated to provide specified returns and certificates. This includes returns by insurance brokers under Regulation 39(1)(d) of the Insurance Brokers Regulations, 2018, along with related certifications in Form W Schedule II. The effect of this change is a streamlined process, relieving brokers and insurers from the previously mandated documentation requirements, ultimately reducing administrative burdens in compliance.

Comprehensive overview of unclaimed policy amounts and regulatory measures in India

Overview:

Unclaimed policy amount refers to any amount payable to the policyholder as survivor benefits, death claims, maturity claims, refunds of premiums, premium deposits not adjusted against premiums, indemnity claims, etc., that have not been claimed after six months from the due date for settlement. This may occur due to situations such as the policyholder passing away without naming a beneficiary, lack of communication in the event of address or bank change, or the beneficiary being unaware of the policy in the event of the insured's demise.

According to 'The Sunday Guardian', in 2022, as much as INR 25,000 crore of unclaimed money was lying with various insurance companies nationwide, as per the Insurance Regulatory and Development Authority (IRDAI) report.

The IRDAI has established guidelines for insurers to follow for unclaimed policy funds. Over time, there has been a notable increase in unclaimed amounts, leading the IRDAI to issue several directives to provide improved regulatory oversight. All these directives were consolidated and released as a master circular dated 17 November 2020. According to these directives, insurers holding unclaimed policy amounts for a period exceeding ten years as of 30 September each year must transfer these funds to the Senior Citizens Welfare Fund (SCWF) on or before 1 March of the financial year. The Government of India established the SCWF under the provisions of the Finance Acts of 2015 and 2016. After the funds are transferred to the Senior Citizen's Welfare Fund, policyholders and beneficiaries have up to 25 years to claim the unpaid dues.

Highlighted below are unclaimed amounts of policyholders for some of the insurance companies in India as per their public disclosures of Q1-2023-24

Life insurance companies	Unclaimed amount of policyholder (in lakhs)
Life Insurance Corporation of India (LIC)	15,75,334
ICICI Prudential Life Insurance	91,580
Reliance Nippon Life Insurance	29,940
SBI Life Insurance	25,573
Max Life Insurance	10,574
General insurance companies	**Unclaimed amount of policyholder (in lakhs)**
ICICI Lombard	50,684
United India Insurance	21,715
New India Assurance	17,592
National Insurance	16,664
Oriental Insurance	10,636

Comprehensive overview of unclaimed policy amounts and regulatory measures in India

Some of the challenges leading to increase in unclaimed amounts

- Beneficiaries have updated their contact and bank account details without notifying the company.
- Incomplete documentation / lengthy claim process,
- Policyholders and beneficiaries lack awareness of the policies' terms and conditions
- Policyholders pass away without their death being recorded within the company's databases
- Absence of industry-wide database of unclaimed amounts
- The capacity of policyholder to claim their benefits may be affected by economic downturns or natural disasters
- Surge in policy lapse rates

Source: Master Circular Unclaimed Amounts of Policyholders 2020

Comprehensive overview of unclaimed policy amounts and regulatory measures in India

Timeline of treatment of unclaimed amounts over the years in the financial services sector

1977 - 89

RBI advised banks that deposit accounts that have not been operated for over two years should be segregated and maintained in separate ledgers. Branch offices should follow up on accounts that remained inoperative for a year by sending suitable advice to the customer. If the letters are returned undelivered, they may immediately be put on inquiry to find out the whereabouts of customers or their legal heirs in case they are deceased.

2008

Given the increase in the number of unclaimed deposits with banks year after year, in addition to activities stated previously, RBI laid down detailed instructions for banks to play a more proactive role while dealing with inoperative accounts. Banks were advised to regularly credit interest on savings bank accounts, whether the account is operative or not.

2012

Despite the instructions, banks needed to proactively track customers linked with unclaimed deposits/inoperative accounts. Banks were advised to display the list of unclaimed deposits/inoperative funds on their websites that have been inactive/idle for ten years or more. Banks were also advised to put in place an approved policy on the classification of unclaimed deposits;

2014

Pursuant to the amendment of the Banking Regulation Act of 1949, section 26A was inserted, empowering the Reserve Bank to establish The Depositor Education and Awareness Fund (the Fund). Under the provisions of this section, any account in India with any bank that has not been operated upon for a period of ten years or any deposit or any amount remaining unclaimed for more than ten years should be credited to the Fund.

2015

The Central Government established a Fund to be called the **"Senior Citizens' Welfare Fund,"** which mandated that any credit balance in any of the accounts remaining unclaimed for a period of seven years from the date of its declaration as an inoperative account should be transferred by the respective Institutions holding them to the Fund.

2017

Pursuant to the Finance Act 2015, the Insurance Regulatory Development of India (IRDAI) mandated all insurers having unclaimed amounts of policyholders for a period of more than ten years to transfer the same to the Senior Citizens' Welfare.

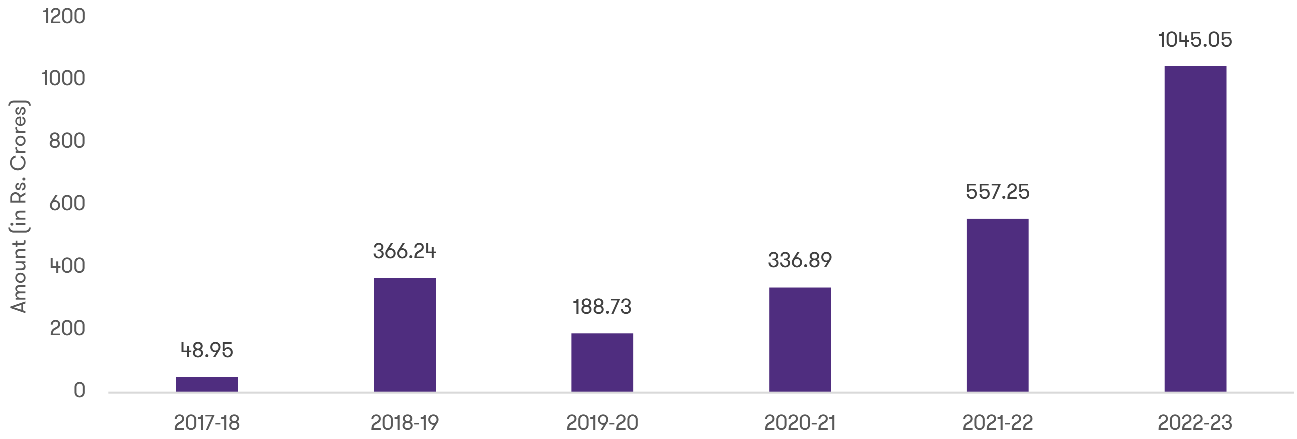
2020

The Insurance Regulatory Development of India (IRDAI) further updated the regulations, particularly with regard to monitoring, reporting, and certification of unclaimed amounts.

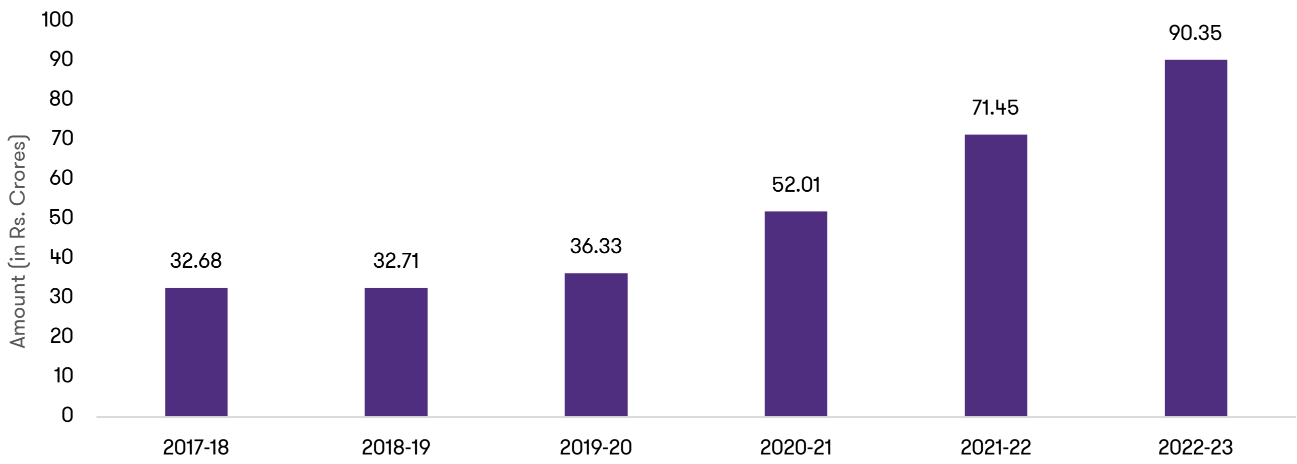
Source: Various regulations and circulars prescribed by the Reserve Bank of India (RBI) and Insurance Regulatory Development of India (IRDAI) ; Finance Act 2015

Comprehensive overview of unclaimed policy amounts and regulatory measures in India

Unclaimed Insurance Amount Transferred to SCWF by Life Insurers
(2017-19 to 2022-23, as on 01st March of the year, in Rs. Crores)



Unclaimed Insurance Amount Transferred to SCWF by General Insurers
(2017-19 to 2022-23, as on 01st March of the year, in Rs. Crores)



As of 1 March 2018, insurance firms transferred INR 81.63 crores to SCWF. After implementing the new regulation, the unclaimed funds were transferred to SCWF for the first time. Life insurers account for INR 48.95 crore, while non-life insurers contribute another INR 32.68 crore. As of March 2023, around 2.85 thousand crores of unclaimed insurance funds have been transferred to SCWF.

Source: Factly is a verified signatory of the International Fact-Checking Network's (IFCN) Code of Principles. Factly filed an RTI application seeking this information from the IRDAI. The dataset based on the response to this RTI can be found on Dataful.

Comprehensive overview of unclaimed policy amounts and regulatory measures in India

What steps can insurers and policyholders take to reduce unclaimed amounts proactively?

Insurers must ensure the money goes to the intended recipients rather than being unclaimed for over ten years. Below listed are some of the practices that insurance companies can follow:

- Publish information regarding unclaimed insurance funds of INR 1000 or more on their official websites per the directives of the Insurance Regulatory and Development Authority of India (IRDAI).
- Establish a system that enables policyholders and beneficiaries to locate any unclaimed funds within the insurance company by entering specific policy details, including (i) policy number, (ii) PAN of the policyholder, (iii) Name of the policyholder, and (iv) Date of Birth of the Policyholder.
- During the proposal stage, insurers must make it mandatory to provide contact details and bank information, collecting necessary bank proofs from policyholders. Additionally, it offers tools for policyholders to update their contact information and preferences easily.
- Introduce penny drop verification to authenticate the policyholder's bank account.
- Keep policyholders and beneficiaries informed about any updates, changes, and maturity details through regular SMS, email, or other approved modes of communication. Regularly review and update policyholder/beneficiary contact and bank details.
- Collaborate with the agent who initially sourced the policy to obtain the latest details from the policyholder.
- Ensure there are no outstanding payouts from previous policies when processing current policy payouts.
- Authorise electronic mode as the exclusive method for remitting proceeds of all claims, maturity payments, or any other sums due to policyholders or beneficiaries.
- Implement advanced analytics and automation tools to identify potential unclaimed policies and engage policyholders proactively.

Whether you are a policyholder yourself or a nominee to an insurance policy, you can take the following steps to avoid letting your money remain unclaimed with the insurance company:

- Maintain a comprehensive record of your policy information by creating a detailed list of all your investments, including calendar entries indicating key payout dates such as maturity and survival benefits.
- Regularly monitor and oversee all your policies using the available facilities provided by your insurance provider.
- Convert all your policies into electronic formats and manage them collectively in a single e-Insurance account accessible online.
- Ensure that all your insurance providers update your latest contact information.
- Update your NEFT payment details with each insurer to ensure you receive all payouts without disruption.
- To facilitate smooth communication, keep your family members and nominees informed about the details
- Assign nominees for all your policies to ensure clarity and ease of processing in case of any eventuality.

Comprehensive overview of unclaimed policy amounts and regulatory measures in India

Initiatives which can be driven by the IRDAI in the insurance sector

In addition to the efforts taken by the Insurance Regulatory and Development Authority of India (IRDAI), the regulator can strongly advocate for automating processing and identification procedures related to unclaimed amounts within the insurance industry. Many insurance companies rely on manual processes for identifying and transferring unclaimed amounts to designated accounts. This manual approach needs to be revised to improve accuracy and timeliness.

Implementation of automated systems:

Encourage insurance companies to invest in and implement automated systems to streamline the identification and processing of unclaimed amounts. These systems can leverage advanced algorithms and data analytics to identify policies with unclaimed benefits efficiently.

Integration with database systems:

Advocate for integrating automated systems with comprehensive database solutions that store and manage policyholder information. This integration ensures accurate identification and reduces the likelihood of overlooking eligible beneficiaries.

Centralised unclaimed deposits portal:

IRDAI may institute a centralised hub where individuals can conveniently access information about their unclaimed amounts from multiple insurance companies, streamlining the otherwise intricate process of tracking such funds.

In conclusion, there is a considerable requirement to streamline the procedure for rightful beneficiaries to recover unclaimed funds. The Association of Registered Investment Advisers has recommended making nominations mandatory for all financial assets and other proposals. Presently, the sole recourse is to depend on the government and regulatory bodies to establish unified digital platforms for diverse financial assets and update the process.

01 - Initiatives and actions undertaken by the RBI to reduce unclaimed amounts

- The Reserve Bank of India (RBI) has created a web portal to simplify finding unclaimed deposits from various banks in a centralized location for the public. With the introduction of UDGAM (Unclaimed Deposits: Gateway to Access Information), the RBI has created a platform to assist the general public in conveniently searching for their unclaimed deposits across various banks, streamlining the process and making it more accessible in one centralized location.
- The regulator launched campaigns to trace and settle deposits in every district of the country.
- RBI imposes penalties on banks not complying with norms related to depositor education and awareness fund schemes.
- The regulator releases a press release to members of the public to identify and approach the bank concerned for claiming deposits.

Source: Reserve bank of India

Transition from fixed solvency margin to risk-based capital

Introduction:

The Insurance Regulatory and Development Authority of India (IRDAI) announced in a circular dated 10 August 2023 that it has been taking many steps to bring the Indian insurance industry in line with international standards to facilitate business and ultimately reach the last mile of "Insurance for All by 2047." The circular was related to Technical Guidance regarding the Indian Risk-Based Capital Framework - Quantitative Impact Study-1. One of the key initiatives pertains to developing and implementing a Risk-Based Capital (RBC) Framework for the Indian insurance industry.

Major international insurance markets have already transitioned to the risk-based capital framework. The IND-RBC framework will impact the amount of capital insurance companies must set aside to meet solvency margins.

In this industry, the move to a risk-based capital structure is seen as a more effective use of resources. Under the RBC approach, capital requirements are determined based on the risks an insurance company faces, encompassing factors such as investments, underwriting, operations, market risk, etc. In contrast, the prevailing factor-based method employs a fixed ratio to calculate capital requirements. This article will explain key terms/concepts involved in risk-based capital and its impact on insurance companies.

Why RBC

The financial sector, especially the banking and insurance sectors, has seen setbacks, highlighting the need for a solvency framework capable of enduring financial upheavals. The rationale behind implementing Risk-Based Capital (RBC) is to make the insurance industry adaptable to local and worldwide economic shifts alongside demographic changes. Rather than maintaining a rigid solvency framework with unchanging capital despite fluctuations in economic and demographic conditions, the trend in global markets leans towards a dynamic approach. This approach adjusts solvency capital in response to evolving internal and external risk factors, reflecting a more responsive system.

Let's understand key concepts:

Solvency ratio

The quantity of an insurance company's capital in relation to the risk it has assumed during its operations is known as its solvency ratio. Simply put, the solvency ratio measures how much the insurance company has in assets versus how much it owes. It is one of the fundamental metrics used to evaluate the insurance company's overall capacity to pay claims as well as its financial stability.

Required solvency margin **Current Regime**

All insurers are required by the IRDAI to maintain a Required Solvency Margin (RSM), or a minimum excess of assets over liabilities.
IRDAI mandates a minimum solvency ratio of 150.

Risk-Based Capital (RBC) **Proposed Regime**

RBC requirement is established as a minimum regulatory capital requirement for financial institutions. The purpose is to safeguard financial institutions, investors, customers, and the overall economy. These specifications ensure that every financial institution possesses sufficient capital reserves to withstand operational losses while upholding a secure and well-functioning market.

Transition from fixed solvency margin to risk-based capital

Implementation of risk-based capital regime globally:

- **United States:** The Risk-Based Capital (RBC) framework was developed by the National Association of Insurance Commissioners (NAIC) in the late 1980s, with the formal adoption of RBC requirements in the U.S. occurring in 1993.
- **European Union:** Solvency II, established as the prudential regime for insurance and reinsurance undertakings through quantitative and qualitative measures in the EU, came into force in January 2016. It outlines requirements for insurance and reinsurance companies in the EU to ensure the sufficient protection of policyholders and beneficiaries.
- **Australia:** Australia has implemented risk-based capital requirements for insurance companies, and the regulatory landscape has evolved. In January 2013, the Australian Prudential Regulation Authority (APRA) implemented a comprehensive reform of capital requirements for general and life insurers. This reform included increasing the risk sensitivity of the capital framework and harmonising requirements among banks, life insurers, and public insurers. APRA has also instituted comprehensive group supervision for general insurance groups, known as Level 2 supervision, along with a non-capital prudential framework for conglomerate groups, known as Level 3 Supervision.
- **Singapore:** The Monetary Authority of Singapore (MAS) introduced risk-based capital requirements for insurers, with the RBC framework for insurance companies first introduced in Singapore in 2004. This framework adopts a risk-focused approach to assessing capital adequacy, aiming to reflect the relevant risks insurance companies face.

The risk-weighted method of capital allocation is expected to release capital in specific instances, potentially benefiting larger insurers with diversified underwriting portfolios while requiring an infusion of greater capital for insurers dealing with riskier business. Consequently, this movement might elevate the significance of reinsurance to handle fluctuations in earnings and balance sheet volatility effectively.

Transition from fixed solvency margin to risk-based capital

Key challenges for the industry:

01 Volatility of the market and size of companies

The Indian insurance sector is dominated by public insurers, and the business structures of public and private insurers are different. The introduction of RBC significantly impacts the insurance sector and can potentially alter the competitive environment. The RBC will split financially strong players with the weaker ones. To maintain their business strategy, smaller players needed more funding. Instead of trying to be everywhere, players can choose a target market based on how much risk they are willing to take and how stable they are.

02 Interest rate risks

Due to interest rate risk, businesses that offer traditional long-term goods with guarantees must pay a substantial capital charge. The long-term bond market is underdeveloped enough to match long-term assets and liabilities. Companies must manage their assets and liabilities, close the duration gap between them, and hedge their derivative risks to control this risk.

03 Risk management

Capital is based on risk in an RBC regime. There is a direct relationship between better risk management and capital management. Hence, there is a need to ensure a robust risk management framework. The role of CRO becomes very important in balancing the act of helping to identify and assess risks promptly to meet business objectives.

04 Operational impact

Companies must invest considerably in systems and process upgrades. Potential impacts include higher regulatory compliance costs, automation of reporting processes (example, modeling), allowance for additional resources, time and cost of implementation, continuous maintenance, and focus on data quality.

05 Impact on business strategy

Possible effects on business strategy could include adjustments to internal capital triggers and risk appetite, modifications to the level playing field for a few companies, a review of the investment plan, a thorough ERM framework, and improved decision-making, or more effective use of capital.

06 Need for product innovation

By providing flexibility to innovate, RBC will allow insurance companies and support regulators' visions to reach every nook and corner of India. This will give a path to dedicated standalone microinsurance institutions thereby making insurance affordable and available to low-income families, thereby providing a measure of risk mitigation and security.

Transition from fixed solvency margin to risk-based capital

Pros

- Designed with modularity in mind and taking into account all pertinent risks.
- Enhanced sensitivity to risks, aligning more closely with actual financial standings.
- Encourages the adoption of improved risk management methodologies.
- Aligned with global insurance capital standards for consistency.

Cons

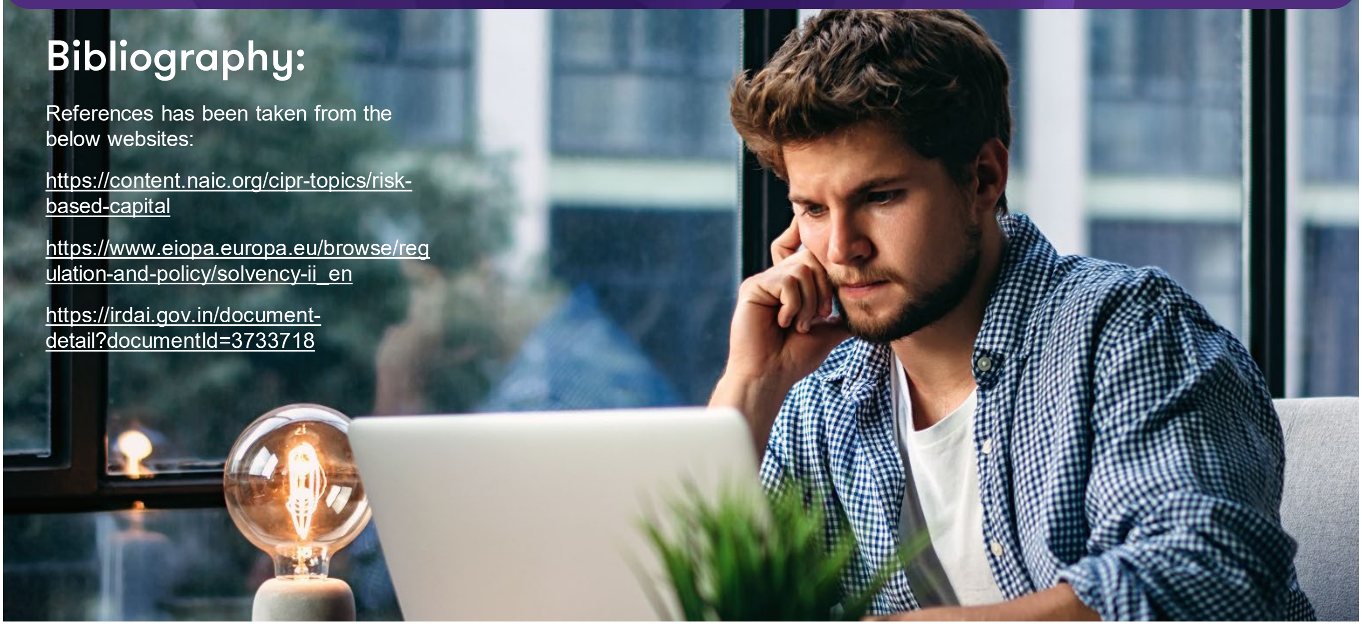
- Requires a more intricate calculation and administration process.
- Limited availability of industry and company data.
- Faces substantial resource constraints during testing and implementation.
- The overall industry and individual companies may experience unknown impacts.

Source: Report of IRDAI Committee on Risk-based Capital (RBC) Approach and Market Consistent Valuation of Liability (MCVL) of Indian Insurance Industry, Part II, July 2017; Oliver Wyman analysis

Conclusion:

RBC requirements aim to identify undercapitalised firms, necessitating regulatory intervention to assure policyholders receive committed benefits without relying on wider capital infusion or public funds. RBC requirements aren't intended as a sole determinant of financial solvency; instead, they serve as one tool that empowers regulators to assume control of an insurance company. These risk-based capital requirements serve as a safeguard, shielding companies from insolvency.

Essentially, the RBC limits shall be critical thresholds that raise triggers for timely regulatory intervention



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Acknowledgements

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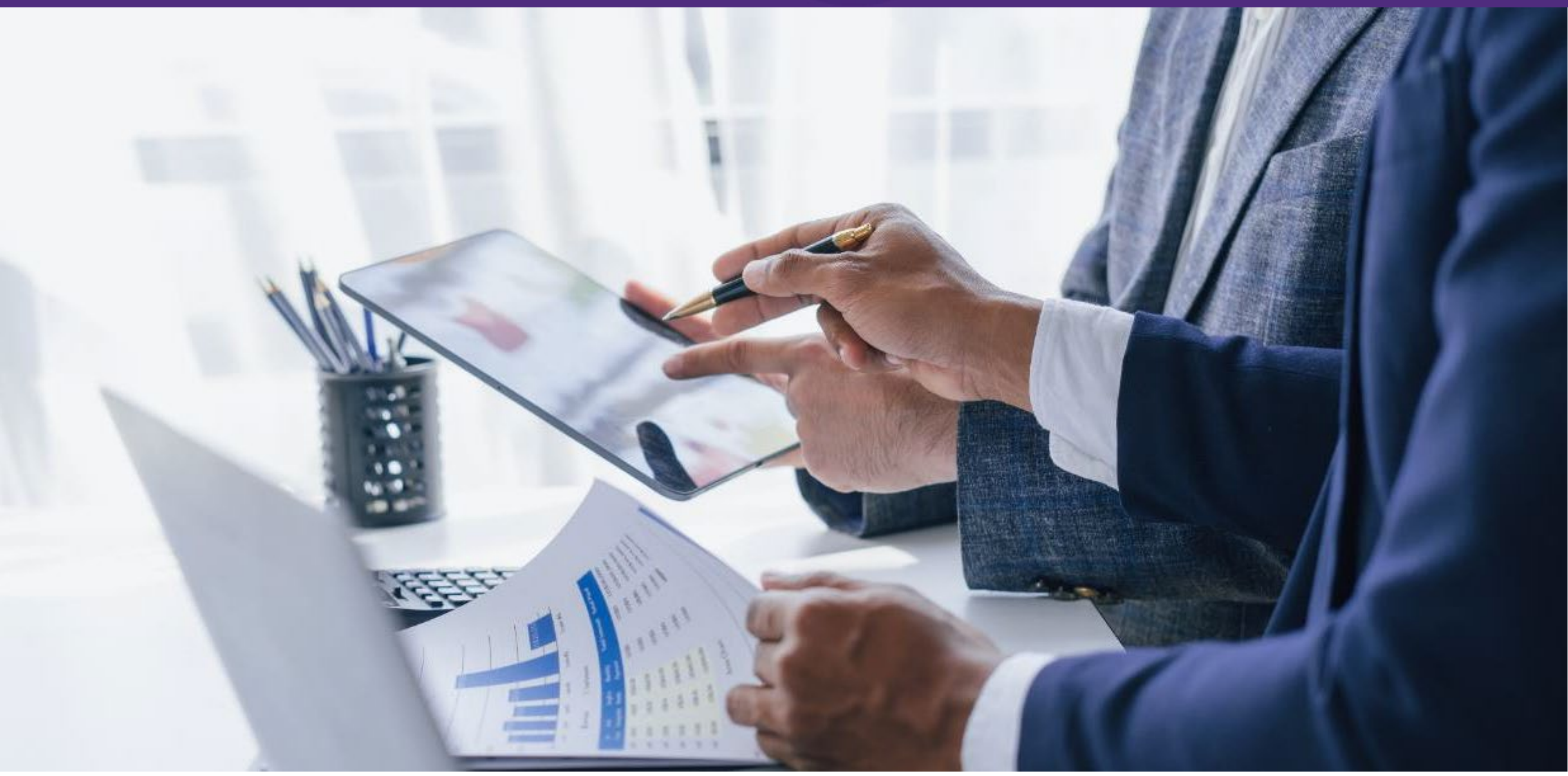

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