CHAPTER-V
REGULATION OF LIFE INSURANCE INDUSTRY

“Why fear death? It is the most beautiful adventure of life.”

Charles Frohman
A. GENERAL

Like all other financial institutions, insurance is an activity that needs to be regulated as health of the insurance sector reflects a country’s economy. This sector not only generates long terms funds for infrastructural development but also increase a country’s risk taking capacity.\(^1\) The basic rationale to regulate this sector is to maintain the confidence of the financial system and to provide appropriate degree of consumer protection. Moreover, the smooth functioning of a business depends on the trust and confidence reposed by the customers in the solvency of the financial institutions. A proper regulatory mechanism is therefore the sine qua non of success and growth of insurance industry as it inspires the confidence of all stakeholders.

The Indian Insurance Sector went through a full circle of phases from being unregulated to completely regulated and then currently being partly regulated. And the law relating to insurance has also gradually developed, undergoing several phases from nationalization of the insurance industry to the recent reforms permitting entry of private players and foreign investment in the insurance industry.\(^2\)

As long as the insurance remained the monopoly of government it was governed by a number of acts and the need for an independent regulatory authority was not felt. The announcement of the new industrial policy in 1991 led to the transition of the insurance sector from a strictly regularized one to a liberalized one. The deregulated regime provided for entry of private players and with the entry of private players, the need for a regulatory authority became paramount.\(^3\) Then in order to prevent misuse by insurers of policyholders’ and shareholders’ funds and to ensure accountability, it was imperative to have in place an effective regulatory regime. And therefore, the regulation of insurance required a paradigm shift from just a

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3. Ibid.
supervisory and monitoring role to a development role so that the insurance business promoted economic growth.

Today, the primary regulator of insurance in India is the Insurance Regulatory and Development Authority (IRDA) which was established in 1999 under the government legislation called the Insurance Regulatory and Development Authority Act, 1999. It oversees the functions of various insurance companies and provides them with valuable guidelines.\(^4\)

The future of Indian Insurance sector looks bright. The section which stood at a strong US $ 72 billion in 2012 has the potential to grow to US $ 280 billion by 2020. This growth is driven by India’s favorable regulatory environment which guarantees stability and fair play. This environment has given rise to an insurance market which encourages foreign investors to tap the sector’s massive potential.\(^5\)

**B. ROLE OF REGULATORY FRAMEWORK**

Regulations define the requirements of an insurer, provide consumer protection through the supervision of insurers to safeguard their solvency and thus shield the customer from buying insurance from an unsuitable company.

The Indian insurance industry has a huge potential and the framework of insurance regulation must enable the industry to tap this vast potential. The regulatory framework in relation to insurance is desired to take care of three major concerns, viz.

(a) Protection of interests of consumers.

(b) Ensure the financial soundness of the insurance industry.

(c) Pave the way to help a healthy growth of the insurance market, where both the government and private parties play simultaneously.

A well developed and well regulated insurance sector is needed for economic development of the country as it provides long term funds for development of a sound

\(^4\) [http://en.m.wikipedia.org/wiki/Insurance_in_India](http://en.m.wikipedia.org/wiki/Insurance_in_India). Accessed on 17/11/13 at 9:00 A.M.

\(^5\) *Supra n.1.*
infrastructural base and at the same time strengthens the risk taking capacity of the insurance companies. But all regulators need to keep in mind that there is a fine distinction between regulation and control as regulations lay down norms while controls have a propensity to micromanage institutions. Thus the regulators must take care to ensure that regulations do not slide into control.

The basic objectives of the insurance regulations are as under:

1. To protect customers from misleading sellers (by regulating the delivery channel, e.g., through standards for agents/licensing agents and brokers) and unfair claims practices; for example by requiring disclosure and by regulating complaints; or by regulating rate setting/pricing (some jurisdictions have limits for rate or require prior approval); and by regulating policies (forms/contracts and exclusions);

2. To protect the financial viability of insurers, e.g., by requiring standards for qualifications, solvency, performance, risk limitation, disclosure, reserves, reporting (periodicity, accounting and information systems), auditors, investment restrictions;

3. To define general features of insurance, e.g., the provision of insurance, the types of products and the different types of insurance (e.g., short and long term; national or cross border operations; life insurance and general insurance;

4. To define duties and responsibilities, e.g., the persons permitted to engage in insurance activities, ownership (management, domicile, holdings, and foreign investors); the regulatory agency responsibilities for insurance regulations and compliance; sanctions and penalties for non compliance or omission;

5. To define the conditions for the entry and exit of players in the market.

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7. Supra n.2.

C. DEVELOPMENT OF INSURANCE REGULATION IN INDIA

Regulatory supervision has an important impact on the development of market structure as the market grows and strengthens itself with the reforms in regulatory measures. Tracing the development of the Indian insurance sector reveals that it has witnessed a 360 degree turn over a period of two centuries.

1. The Indian Companies Act, 1883

Up to the end of nineteenth century, the insurance business in India was in its inception stage. Therefore, no legislation was required till that time. Usually, the Companies Act, 1883 was applicable to business concerns, banking and insurance companies. Although new Indian insurance companies and provident societies started at the time of national movement; but most of them were financially unsound. It was asserted that the Indian Companies Act, 1883 was inadequate for the purpose.9 So, the regulatory supervision was very weak and the insurance companies did not bother much about the consumer’s interest.

2. The Provident Societies Act, 1912 and the Life Insurance Companies Act, 1912

Insurance finally began in India with the passing of two Acts namely Provident Insurance Societies Act, 1912 and Indian Life Insurance Companies Act, 1912. The later Act was based on the English Act of 1909.10 This Act was passed exclusively for the regulation of life insurance industry and other classes of insurance businesses were left out of the scope of this Act as such kinds of insurance were still in rudimentary form and legislative control over them was not considered necessary.11

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10 Supra n.8.
This Act introduced a measure of control under which the rate tables and periodical valuation were required to be certified by an actuary. And, the insurers were also required to keep certain stated deposits, to prevent any financial weakness.

This Act put the life insurance business on a sounder footing and resulted in creating a healthier atmosphere than before. It was also instrumental in the dissolution of some unsound Indian as well as non-Indian life offices and in merging some of them with the others.

However it suffered from certain defects, like there was no check on irregularities of unhealthy concerns and the investment of their funds, control and enquiry was slight, non-compliance of rules and regulations was not strictly penalized. On top of that anyone could start life insurance business only with the sum of Rs. 25,000 and this led to mushroom growth of companies. Apart from this, the unsound concerns could not be investigated under the Act since the government actuary was not vested with the power to order investigation into the conduct of a company. The foreign companies were exempted from submitting particulars regarding their Indian business.

These defects were compelling the above Acts to be replaced. The public was aware of the fact that the Indian companies in foreign countries or in England were directed to have certain sum in the shape of reserve as contrary to the above regulation. The law in India was not in line with the law in force in other countries.

Therefore persistent demands were made by various important public bodies in the country for statutory provisions which would provide for disclosure and publication of the business carried on by foreign companies in India.\(^\text{12}\)

3. **The Indian Insurance Companies Act, 1928**

After a few years it was realized that there should be another efficient and adequate Act. So, the government placed a bill for essential amendment of the Act, in

1924. The bill contained wide scope for Insurance business and came before the legislative assembly after thorough comments by different bodies. The legislation was to be passed in 1925 but it was postponed because the government of India thought it fit to watch the course of new legislation on Insurance law in England. Great Britain appointed Clauson Committee to report the possible and required changes in the legislation.\textsuperscript{13} The Clauson Committee submitted its report in February 1927, but the Government of England took no action on its recommendations.

In the meantime, the government of India in 1928 passed stopgap legislation with the main objective of collecting statistics regarding insurance matters so that the information collected would be of value when the time would come to pass a comprehensive legislation.\textsuperscript{14} The Act was not very comprehensive and could only serve the purpose of collection of statistical data. It required every insurance company which conducted transaction in any class of insurance business in British India to submit annual statements showing details of its business both in and outside India. It allowed the government to collect statistical information from both foreign and India insurance companies operating in India.

The statics to be collected were pertaining to total business in force, new business, amount of claims paid and a summary of classified assets held by all life insurance companies operating in India. The Government of India wanted to wait for the English legislation, which was expected to be passed in 1929 or so and base the law for India on the British model, but the legislation was not passed in Britain. The slow progress of events in England again reviewed the agitation for amendment of the law of insurance in India.

4. The Insurance Act, 1938

Since the Act of 1928 was not comprehensive, demand for another Act was made soon. Moreover, rapid increase in number of insurance companies and growth

\textsuperscript{13} Mr A.C. Clauson was head of the committee appointed to revise the insurance legislation in that country

\textsuperscript{14} Supra n.9, p.307.
in new business prompted several malpractices. So, to stop unhealthy competition of foreign companies, indiscriminate growth - both of insurance companies and provident companies and malpractices and frauds in vogue, some control at highest level became necessary.

The government accepted the demand and decided to proceed with the reforms of insurance law without waiting for the enactment of legislation in England. The government appointed one special officer, Shri Sushil Chandra Sen, a well-known Calcutta Solicitor in 1935 for investigating the special and required reform of legislation.\textsuperscript{15} He was assigned with the special duty to report on the amendments necessary to modernize insurance legislation in India. His report was considered by the Advisory Committee appointed by Government of India. The committee made several changes and the bill was finally introduced in the legislative assembly in 1937. After much debate and several changes, it emerged as the Insurance Act, 1938.\textsuperscript{16}

The Insurance Act of 1938 is the first comprehensive piece of insurance legislation in this country governing both life and non-life branches of insurance. It does not follow the principle of minimum interference with maximum publicity and direct control.

It is a very wide and well balanced Act. On one hand it provided for prevention of mushroom companies; protection of assets; strict control over insurance business; enforcement of sound working principles and prevention of misrepresentation of funds where as on other hand it dealt with licensing of agents, their commission and remuneration. Moreover, it covers several aspects of the insurance business such as deposit mobilization, prohibition of rebates, supervision of insurance companies and appointment of directors. It specifically stresses on the protection of policyholder’s interest and client servicing. Apart from this, it also

\textsuperscript{15} Supra n.12, p.3.

\textsuperscript{16} Supra n.9, p.307.
provided for constitution of Insurance Associations and Insurance Councils and the Tariff Advisory Committee for general insurance.\textsuperscript{17}

This Act was amended from time to time and remained the backbone of Indian insurance industry for a long time. All the subsequent insurance legislations in India are drawn with reference to this Act. Later in 1999 the Insurance Regulatory and Development Authority Act, 1999 replaced this Act.

5. The Insurance (Amendment) Act, 1950

In 1945, it was deemed necessary to protect the interest of Insured. Therefore, in the chairmanship of Shri Cowasji Jehangir, a committee was appointed which was to investigate all the misconduct of insurance business. The committee gave its reports after a thorough inquiry on which recommendations were made for amending many important sections and to introduce new sections. On this basis one amendment bill was made and was sent to different select committees and at last it was enacted on 18th April, 1950 by the parliament. It provided for provisions pertaining to administration.

According to this Amended Act, the total right of control is with the Central Government and the Central government controls the insurance business by appointing Controller of Insurance. The insurance companies must follow the rules and regulations; otherwise they will be penalized under the Act. Certain provisions of this Act also apply to the Life Insurance Corporation of India constituted under the Life Insurance Corporation Act, 1956.

6. The Life Insurance Corporation Act, 1956

The Life Insurance Corporation Act, 1956 nationalized the business of Life Insurance in India and provided for the establishment of life Insurance Corporation (LIC) as a body corporate consisting not more than 16 members appointed by the

Central Government, one of them being chairman. LIC has the exclusive privilege to transact the business of life insurance in India to the best advantage of the community.

LIC is one organization that has played a great role in national reconstruction and economic planning. It emerged as an important supplier of resources for the planning process and contributed its lot in the creation of today’s India. Although, it was a state monopoly but it worked for the people and the country and has been able to create trust even among ordinary and illiterate people. Apart from this it has also been able to fulfill the expectations of the policy makers, with its outstanding achievements in almost every aspect- expanding the life insurance market, spreading insurance in rural areas, promoting saving habit among the people, contributing to national development particularly through socially oriented investment and creating employment opportunities for millions of people in the country.

During 1956-2000, Indian Life Insurance Market was completely dominated by LIC of India and the objectives of nationalization were achieved to a great extent.

7. The General Insurance Corporation Act, 1972

In 60’s and 70’s, the law relating to other forms of insurance also underwent reforms. The Indian Marine Insurance Act, 1963 was enacted to regulate marine insurance in India. This Act is a replica of the English Marine Insurance Act, 1909. The general insurance business was also nationalized in 1972 by setting a government corporation called the General Insurance Corporation with four subsidiary companies for carrying on the general insurance business. The nationalized companies were expected not to confine themselves to the present activities but to cover new fields in due course of time.

8. **The Insurance Regulatory and Development Authority, 1999**

1990’s saw the emergence of liberalization. It meant lifting the government control and allowing the private enterprises including the MNC’s to operate in the area of insurance, which was hitherto monopolized by the government. To offer a red carpet to the private players the Government brought the Insurance Regulatory and Development Authority Act, 1999. This Act provided for the establishment of an Authority that protects the interests of policyholders, regulate, promote and insure the orderly growth of the insurance sector and takes care of matters connected therewith or incidental thereto.

With the birth of IRDA, the government amended the Insurance Act, 1938, the Life Insurance Corporation Act, 1956 and the General Insurance Business Act, 1972 for the sake of proper control at the Apex Level.21 The IRDA Act opened the Indian Insurance market for private insurance companies and put an end to the monopoly position of LIC.

9. **The Insurance Law (Amendment) Bill, 2008**

In India, insurance companies are not permitted to have foreign holdings of more than 26%. But now the private sector insurance companies are demanding a hike in the sectoral FDI cap as they need capital from their foreign partners to expand their business. This bill seeks to raise the limit to 49% and allow the entry of foreign reinsurers. It also provides for permanent registration of insurance companies. As per the Bill, an insurer cannot challenge a life insurance policy after a period of 5 years. Apart from this it provides for appeals against the decisions of IRDA to lie with the Securities Appellate Tribunal set up under SEBI Act, 1992.22 The Bill introduced in Rajya Sabha in 2008 is still pending, however, to pursue reforms; the cabinet had already approved the proposal to raise FDI cap to 49%.23

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21 *Supra n.9, p.356.*
10. The Life Insurance Corporation (Amendment) Bill, 2009

The IRDA recommended certain amendments in the 53 year old Life Insurance Corporation Act, 1956 to bring this Act in consonance with the Insurance Act, 1938 and to gear the state giant to deal with the competition from private players. The Bill seeks to raise the capital base of LIC from 5 crore to 100 crore besides capping the sovereign guarantee provided by government and reducing the amount of surplus from any investment made by LIC to be available for policyholders. The Act will bring LIC at par with private insurers-both in life and non-life segment. The bill has already been passed by Lok Sabha.

A brief review of reports of such committees / commissions / groups and the important changes in the history of insurance regulation are as under:

**D. A BRIEF REVIEW OF INSURANCE REGULATIONS IN THE 20TH CENTURY**

<table>
<thead>
<tr>
<th>Year</th>
<th>Significant Regulatory Event</th>
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<tbody>
<tr>
<td>1912</td>
<td>The Indian Life Insurance Company Act</td>
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<td>1928</td>
<td>Indian Insurance Companies Act</td>
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<tr>
<td>1938</td>
<td>The Insurance Act: Comprehensive Act to regulate insurance business in India</td>
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<tr>
<td>1956</td>
<td>Nationalization of life insurance business in India with a monopoly awarded to the Life Insurance Corporation of India</td>
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<tr>
<td>1972</td>
<td>Nationalization of general insurance business in India with the formation of a holding company General Insurance Corporation</td>
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<tr>
<td>1993</td>
<td>Setting up of Malhotra Committee</td>
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<td>1994</td>
<td>Recommendations of Malhotra Committee published</td>
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26 Supra n.8, p.17.
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<thead>
<tr>
<th>Year</th>
<th>Event</th>
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<tbody>
<tr>
<td>1995</td>
<td>Setting up of Mukherjee Committee</td>
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<tr>
<td>1996</td>
<td>Setting up of (interim) Insurance Regulatory Authority (IRA) Recommendations of the IRA</td>
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<tr>
<td>1997</td>
<td>Mukherjee Committee Report submitted but not made public</td>
</tr>
<tr>
<td>1997</td>
<td>The Government gives greater autonomy to Life Insurance Corporation, General Insurance Corporation and its subsidiaries with regard to the restructuring of boards and flexibility in investment norms aimed at channeling funds to the infrastructure sector</td>
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<tr>
<td>1998</td>
<td>The cabinet decides to allow 40% foreign equity to private insurance companies – 26% to foreign companies and 14% to non resident Indians and foreign institutional investors.</td>
</tr>
<tr>
<td>1999</td>
<td>The Standing Committee headed by Murali Deora decides that foreign equity in private insurance should be limited to 26%. The IRA bill is renamed as the Insurance Regulatory and Development Authority Bill.</td>
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<tr>
<td>1999</td>
<td>Cabinet clears Insurance Regulatory and Development Authority Bill</td>
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<td>2000</td>
<td>President gives assent to the Insurance Regulatory and Development Authority Bill</td>
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<tr>
<td>2000</td>
<td>Monitor Group Report</td>
</tr>
<tr>
<td>2009</td>
<td>The Life Insurance Corporation Amendment Bill, 2009</td>
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</table>
E. RECOMMENDATIONS OF LAW COMMISSION

The Insurance Act, 1938 is the principle legislation on Insurance in India, but it has undergone frequent amendments after liberalization of insurance industry so to study the strengths and weaknesses of the existing insurance laws and to suggest amendments for effective and efficient monitoring, and development of insurance business in India reforms became eminent. The United Ministry of Finance of Indian asked Insurance Regulatory Development Authority (IRDA) of India to identify the areas where amendment is needed, the IRDA wrote to Law Commission of India (LCI) and consequently a Law Commission was formed to suggest reforms in the insurance law.

The Law Commission in its 190th Report firstly, traced the importance of this sector and commended that it has enough potential which can support the growth of Indian economy. It also discussed the present regulatory legal regime and its background along with the Malhotra Committee’s Report which resulted in the set up of the present regime.

After a serious review of the situation, the law commission suggested amendments to various provisions of the Insurance Act, 1938 which are as under:

1. Changes in Definitions

It recommended changes in definitions including replacement of references in the Insurance Act, 1938 to older enactments by corresponding new legislations and reclassification of insurance businesses including changed definitions of the terms, ‘insurance’ and ‘insurer’.


It suggested the deletion of provisions of the Insurance Act, 1938 that are redundant and out of work as well as deletion of other transitional provisions of the Act.

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It also supported the merger of relevant provisions of the IRDA Act with the Insurance Act, 1938 to avoid multiplicity of legislation and the resultant confusion. The merger is seen as the first step towards the goal of streamlining legislation. It will not only help the market practitioners in understanding the role of IRDA but will also help in making future revisions in accordance with market conditions easier.

4. Repudiation

The Law Commission made very significant recommendations relating to repudiation of policy to secure the interests of the policyholders, especially in Life insurance. According to these recommendations, no life policy can be repudiated on any ground whatsoever after five years of its coming into force, date of issuance of policy, date of commencement of the policy, date of the revival of the policy, or date of the rider to such policy whichever is later.28 However, the insurer can repudiate the policy within this period of five years on the basis of fraud, misstatement, suppression of a material fact, which is material to assessment of risk either in the proposal form or any other document on the basis of which policy was issued, by communicating the same in writing to the insured.

The Law Commission opposed the unilateral repudiation of a life policy and suggested following amendments to Section 45:

(a) The period beyond which no repudiation of a life insurance policy on any ground whatsoever can take place be fixed at five years.
(b) The insurer can repudiate a policy of life insurance at any time before the expiry of a period of five years on the ground of fraud.
(c) The misstatement of or suppression of fact will not be considered material unless it has a direct bearing on the risk undertaken by the insurer.

(d) No repudiation of the policy to be permitted on the ground of fraud, where the insured can prove that the suppression or misstatement of the material fact made was true to the best of his knowledge and belief.

(e) The insurer will have to communicate in writing to the insured or the legal representatives / nominees / assignees of the insured, the grounds and materials on which the decision to repudiate a policy is based.29

(f) If policy is repudiated on the ground of misstatement or suppression of material fact, premiums will be returned to insured, or his legal representatives, or his nominees, or his assignees.

5. Assignment and Transfer

Section 38 of the Insurance Act, 1938 provides for assignment and transfer of insurance policies. It deals with both absolute and conditional assignments but a lot of anomalies exist as regards the distinction between the same. Moreover, the section does not talk about partial assignments. There exists another problem when an assignment is duly executed but no notice has been delivered to the insurer under Sub-section 2. The assignment is not invalid but the assignee will not have the right to sue the insurer. Another area of litigation and controversy is the assignment and transfer of policyholder’s interests to others.30

According to Law Commission of India, there should be a clear distinction between absolute assignment and Conditional Assignment. The LCI also supported partial assignments. The provision that every assignment will be deemed to be absolute, and assignee as absolute, unless stipulated as partial, provides for partial assignment. The LCI recommended that a separate subsection be inserted to specify that liability of insurer shall be limited to the amount secured by partial assignment, and such policy holder shall not be entitled to further assign residual amount payable under the same policy. However, the policyholder has a duty to disclose to the insurer,

29 Law Commission of India 190th Report.
30 www.lawcommissionofindia.nic.in/reports.htm. Accessed on 18/12/13 at 11:00 P.M.
the reasons for assignment, and antecedents of assignee and the terms of the assignment.\textsuperscript{31}

6. Nomination

Yet another litigation prone area is the nomination issue. Section 39 of the Insurance Act, 1938 provides that the policyholder of life insurance may nominate one or more persons to whom the money secured by the policy shall be paid in the event of death of the policyholder. Another area, which required clarification, was that of a beneficial nominee as distinguished from a collector nominee.\textsuperscript{32}

Thus, the LCI recommended clarity and certainty by providing a clear distinction between beneficial nominee and a collector nominee. It also has not agreed to suggest that insurers should be totally relieved if they paid to nominee. It stated that unless contrary is expressed, nominee would be beneficial nominee and must have right to receive the amount for himself. The option must be made available to the policyholder to clearly express whether the nominee will collect on behalf of legal representatives or will become an absolute beneficiary excluding the legal representatives. The Law Commission also suggested that a proviso be added to make nomination effectual for nominee to receive the policy money in case the policyholder dies after maturity of policy but before it can be encashed.

These suggestions are based on provisions in banking sector. If these recommendations are followed, there will be a uniform and justified law with regard to nomination.\textsuperscript{33}

7. Penalties

The Law Commission recommended following penalties under Section 102-150C of Insurance Act, 1938.\textsuperscript{34}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{31} http://www.egyankosh.ac.in/bitstram/123456789/33163/1/unit25.pdf. Accessed on 12/12/13 at 12:30 P.M.
\item \textsuperscript{32} Supra n.30.
\item \textsuperscript{33} http://www.thehindubusinessline.com/2005/01/04/stories/2005010402320600.htm. Accessed on 24/12/12 at 12:30 P.M.
\item \textsuperscript{34} Ibid.
\end{itemize}
\end{footnotesize}
(a) Penalty for default in complying with, or acting in contravention of the
Insurance Act should not be exceeding Rs. 5, 00,000 for each failure and
punishable with fine;
(b) Penalty for false statement – fine up to 5, 00,000 and up to three years jail
+ fine;
(c) Penalty for wrongfully obtaining or withholding property- fine up to Rs. 5,
00,000;
(d) Offences by Companies (Section 105A)
(e) Penalty for failure to comply with provision imposing obligation of
insurance business in rural sector under Section 32B should be up to Rs. 5,
00,000 or three years jail or both (Section 105B); and
(f) Penalty for failure to comply with section 32C imposing an obligation in
respect of rural and unorganized sector and BCs, penalty should be up to
Rs. 5, 00,000 + cancellation of registration (Section 105C).

8. Grievance Redressal Machinery

The next important recommendation lies in the area of Grievance Redressal
Mechanism and it states that, “it is imperative to have an independent, transparent and
accountable grievance redressal mechanism to address the concerns of the
policyholders”.35 The Commission has suggested the constitution of a GRA to deal
with the disputes between the insured and the insurer; insurer and the intermediaries;
and insurer and insurer with a provision of appeal to an Insurance Appellate Tribunal
and further appeal to the Supreme Court. GRA is supposed to have all the powers of a
civil court and the decisions of GRA are enforceable by itself in exercise of all powers
of a civil court.36 If this amendment is made, it will amount to exclusion of
jurisdiction of civil courts including the consumer courts.

26/12/13 at 6:00 P.M.
36 Supra n. 28, p.33.
Apart from this, the LCI also recommended that every insurer need to set up a fair and transparent in house grievance redressal mechanism under the overall supervision of IRDA. It stated that only after exhausting the remedy of approaching the in house mechanism, that a complaint should be entertained by the Grievance Redressal Authority (GRA). 37

9. Investigating Mechanism and Substitution of Judiciary

The LCI further suggested a mechanism to adjudicate and investigate in the name of adjudicating or investigating officers to be appointed by IRDA to enquire and investigate violations by insurers, insurance intermediaries and agents. The proposed officer will have power to adjudicate and levy prescribed penalties whereas the appeal from it will lie before the IRDA. In this regard LCI suggested necessary statutory amendments to facilitate transfer power of Central Government to IRDA.

F. RECOMMENDATIONS OF K.P.N COMMITTEE

In light of the recommendations of Law Commission of India, IRDA appointed an 11 member committee headed by K.P. Narsimhan to examine certain issues which according to law commission required detailed examination by experts, particularly, the financial aspects of the insurance industry. 38 The committee was further also called upon to indicate any other section of the Act which needs to be amended, in the light of the developments that have taken place in the insurance scene other than those covered by the Law Commission’s recommendations. 39 Apart from this it was also requested to recommend changes that are warranted in the statutory framework.

The major recommendations of the Committee are gathered hereunder:

37 Ibid., p.32.
1. Repudiation

The KPN committee opposed the changes suggested by Law Commission in context of this issue and wanted Section 45 to remain the same. It was of the opinion that, five years is a long time for insurer to leisurely raise the objections to jeopardize the rights of the insured, by putting his policy in doubt and that the period of uncertainty would be increased from two years to five years, if the Law Commission’s recommendation is followed.

2. Assignment

The KPN Committee did not favor the Law Commission’s recommendations in regard to assignments and transfer also. It wanted IRDA to have the power to regulate and restrict some assignments, without making any changes in the law.

3. Nomination

The Law Commission’s recommendations with reference to nomination are an adoption of nomination rules governing banking sector and seem very reasonable. But, surprisingly the KPN committee did not agree with this also suggesting no amendment in existing law.

4. Investment

The committee recommended that there is no need of having separate sections for life and non-life insurers. It advocated establishment of Controlled investible Fund in place of Controlled Fund. It clarified that directors or an officer, who knowingly contravenes the provisions, should make good the losses.

5. Capital

It recommended that Equity share capital by a foreign company should not exceed such % as GIC (General Insurance Council) may prescribe. It added that different classes of insurers need different limits of capital. It also recommended reduction of current capital requirement for insurer from 200 Crore to Rs 100 Crore.
6. Solvency Margins and Deposits

It advocated a controlled level of solvency along with abolition of deposits. It suggested formula based linkage between minimum capital and minimum solvency margin.

7. Tariff Advisory Committee

It suggested renaming the committee as Technical Advisory Committee and bringing it under GIC (General Insurance Council). It further recommended constitution GIC as a Self Regulatory Organization.

8. Insurance Surveyors

It suggested abolition of licensing of surveyors and to bring in legal provisions prescribing minimum qualification to work as surveyor. It further recommended that amalgamations of insurers should be based on report of an independent actuary.

9. Raising Foreign Direct Investment Cap

The KPN Committee recommended that the present FDI limit of 26% should be increased and that the FDI should be as prescribed by the Government. This decision would have far reaching consequence in terms of effective regulation by IRDA.

10. Appointed Actuary

The KPN Committee recommended that the amalgamation or transfers should be based on the report of an independent actuary in accordance with regulations and that a provision may be made in the Act to make it mandatory for every insurer to appoint an “appointed actuary”.

Further, the committee was also called upon to indicate any other section of the Act which needs to be amended, in the light of the developments that have taken place in the insurance scene other than those covered by the Law Commissions Recommendations.\[40\]

G. INSURANCE REGULATORY REGIME AND INSURERS


Apart from these regulations IRDA has emerged as the most powerful regulator the IRDA Act, 1999 and the twenty plus regulations made by the IRDA regulate the insurance business and the insurers. Besides them, other regulators such as the Central Government, Registrars of Companies, and Securities Exchange Board of India (SEBI) also regulate the insurance business and insurers.41

1. Regulation of Insurer under Company Law

In early days, when there was no specific law to govern the insurance business, the company law governed it. The Company Act, 1913, was governing the insurance business, when it was undertaken by the Company. Until 1950, in addition to the companies, the provident societies, partnership firms and group of individuals undertook the insurance business, and corporate bodies registered under the company law undertook the insurance business thereafter. The company law governed corporate insurers other than public sector operators before and after liberalization of insurance business. To undertake the insurance business, the intended business entrepreneur has to form a company and incorporate the same with the Registrar of Companies as per the provisions of the company law. Insurers have to strictly follow and adhere to the provisions stated in the company law relating to a company’s incorporation, its capital structure, shareholding, transfer of shares, allotment of

shares, borrowings, management, conduct of meetings, filing of returns and statements, declaration of bonuses and dividends, and winding up of companies.

2. Regulation of Insurer under Law of Contract

A contract of life insurance is in many respects governed by the general law of contract. A contract of insurance is basically a contract of utmost good faith technically known as *Uberrimae fides*. According to this principle the proposer is bound to disclose all material information likely to affect the judgment of the insurer. Misrepresentation, non-disclosure or fraud in any document leading to acceptance of risk automatically discharges the insurer from all liabilities under the contract. Moreover, a contract of life insurance is a standard form of contract where there is no room for negotiations. The policy holders have no bargaining power. He has only two options either to accept the proposal or to reject the same.

3. The Insurance Act, 1938 and the Insurer

In 1938, with a view to protect the interests of the insurable public, the earlier legislation was consolidated and amended by the Insurance Act, 1938 with comprehensive provisions for the effective control over the activities of insurers. It came into effect from 1st July 1939 and was amended in 1950 and later in 1999. It is the principal enactment relating to the business of insurance in India. The Act contains provisions regarding Licensing of Agents and their remunerations, prohibition of rebates and protection of policyholders’ interest. It also has provisions placing limits on the expenses of insurers, use of funds and patterns of investments, maintaining solvency levels and constitution of Insurance Associations and Insurance Councils.42

4. Regulation by Central Government

Insurance business is a central subject and therefore the central government has power to make rules for the smooth conduct of insurance business in India. The

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42 Supra n.17, p.243.
Central Government is authorized to make rules relating to share capital, deposits, registration and renewal of licenses of insurance companies. Apart from this, the central government has unlimited powers to interfere in the insurance business and to frame rules, lay down policy and to Act in the direction of fulfilling the policy. All the insurers are bound to submit their financial statements and other information by way of returns to IRDA; in turn, IRDA consolidates the information and submits the same to the Central Government. The Central Government places it before the parliament and later publishes the financial information of insurers.\textsuperscript{43}

5. Regulations of SEBI

Reforms in Indian Capital Market have undoubtedly strengthened the regulatory mechanism, although the overall market control remains with the ministry of Finance, Government of India. One remarkable contribution of these reforms is the establishment of the Securities and Exchange Board of India (SEBI) for supervision of capital market.\textsuperscript{44} The SEBI Act, 1992 empowers SEBI to promote and develop the securities market and protect the interests of investors. It has taken a number of steps to remove the constraints of growth and make the market operations more transparent, investor friendly and technologically efficient. From time to time, SEBI give recommendations to protect interest of investors by providing greater disclosures/transparency and at the same time help in avoiding and mitigating conflicts between the regulatory provisions of SEBI and IRDA.\textsuperscript{45}

6. Insurer under IRDA Act, 1999

The Insurance Regulatory and Development Authority Act, 1999 provides for establishment of IRDA. Since 1999, IRDA has replaced the Controller of Insurance. The Insurance Act vests the IRDA with powers to:

(a) Register insurance companies and also cancel their registrations.

\textsuperscript{43} Supra n.41, p.46.
\textsuperscript{44} Supra n.19, p.49.
\textsuperscript{45} http://m.thehindubusinessline.com, Accessed on 23/12/13 at 2:00 P.M.
(b) Monitor and certify the soundness of the terms of life insurance business.

(c) Make regulations relating to conduct of the business of insurance.

(d) Inspect documents of insurers.

(e) Appoint additional directors.

(f) Issue directions.

(g) Takeover the management of an insurer and appoint administrators.

(h) Adjudicate on disputes between insurers and intermediates or between intermediates.

7. Insurer under Regulations of IRDA

The IRDA regulates the insurers on various aspects of the financial matters such as the share capital, calculation of premium, accounting of premium, transfer of funds to various reserves, investment of funds in various securities and deposits with banks, payment of commission to the agents, incurring of expenditure on the administration and management of company, claim settlements, investments in assets, valuation of assets preparation of financial statements, appropriation of excess incomes, audit and inspection of books and accounts, disclosures relating to financial matters and maintenance of solvency margins. Nothing is left to the discretion of the management of an insurance company.46

By the end of December 2006, the IRDA had issued more than 25 regulations and also issued several guidelines to insurer on a variety of matters.

(a) IRDA (Obligations of Insurers to Rural or Social Sector) Regulations, 2000

Section 30 of IRDA Act, 1999, facilitates the insertion of Section 32B and 32C into the Insurance Act 1938. These provisions impose obligations on insurers to undertake insurance business in rural and social sectors. They also impose a responsibility to undertake the business to unorganized sectors, backward classes,

46 Supra n.41, p.41.
economically vulnerable and other categories of persons. The IRDA regulates the business of insurance companies and lays down the norms for fulfilling social obligations through its IRDA (Obligations of Insurers to rural or social sectors) Regulations, 2000. Accordingly, every insurer has to carry on insurance business in the rural sector and concentrate at least 15% of its business in the rural areas. Every insurer has to insure at least 20,000 lives every financial year in and after 2004. These rules have directed all the existing insurers and newly registered companies to move in the directions of social insurance.

(b) IRDA (Preparation of Financial Statements and Auditors Reports of Insurance Companies) Regulations, 2000

The insurers are under obligation to maintain books of accounts as required under the Companies Act, 1956 and also under Insurance Act, 1938. The IRDA (Preparation of Financial Statements and Auditors Reports of Insurance Companies / Regulations, 2000), explains the methodology and accounting principles to be used for the preparation of financial statements. These regulations provide for variant formats, define the accounting standards required to be adhered to, lay down the procedure to determine the value of investments the insurance companies make, and the contents required to be stated in the report that the management submits. Part II of the regulations require the insurer to disclose information such as contingent liabilities, encumbrance of assets, commitments made, outstanding for loans, investments and fixed asset claims, actuarial assumptions for claim liabilities and other related matters.

Every insurer has to arrange audit balance sheet, profit and loss account, revenue account, and profit and loss appropriation account by an auditor. The insurers are directed to maintain separate accounts for each class of business.

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(c) IRDA (Insurance Advertisement and Disclosure) Regulations, 2000

The insurers are bound by the IRDA (Insurance Advertisement and Disclosure Regulation, 2000). In fact, the law relating to advertisements binds the insurers while they issue advertisements to market their insurance products. In addition to the existing law of advertisements, all insurers are bound by the IRDA regulations. The IRDA regulations on advertisements are made with an objective to check misleading advertisements from being issued by the insurance companies and protect the common person from ornamental and ambiguous advertisements. Every advertisement, the insurer issues, is subject to inspection and review by the authority. Every insurer has an obligation to have a statutory warning as prescribed under section 41 of the Insurance Act, 1938, which states that ‘no rebate is given or commission is payable to any person who directly or indirectly induces a person to purchase the policies’. Thus, the insurers are bound tight under the IRDA regulations.

(d) IRDA (Assets, Liabilities and Solvency Margins of Insurance) Regulations, 2000

Asset liability management is an extremely important area of investment management particularly for an insurance company which deals with financial risks of human lives and the small investors.

India has adopted the Solvency Model, which may be characterized by Fixed Ratio Models. The IRDA guidelines provide the outline of valuation of Assets and Liabilities and Determination of Solvency Margin. Every insurer shall determine the

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50 Supra n.37, p.43.
51 Insurance Regulatory and Development Authority, (Insurance Advertisement and Disclosure) Regulations.
Required Solvency Margin, the Available Solvency Margin and the Solvency Ratio as specified under IRDA (Actuarial Report and Abstract), Regulation 2000.\(^{52}\)

At present the life insurance companies in India have to maintain 150 percent solvency margin which includes a 50 percent additional cushions over and above the norms specified in the regulations. To maintain this solvency ratio, the insurance companies are allowed to bring in additional capital.

**\(\text{(e) IRDA (Protection of Policy-holder’s interest) Regulations, 2002}\)**

Insurance business is people centric and the insurance policyholder is a consumer of the insurance services. He is the ultimate user of the company’s services. The insurance company is obliged to treat the policyholder as an important component of insurance business. The IRDA has framed regulations called, ‘*The IRDA (protection of policyholders’ interests) regulations 2002*’.\(^{53}\) These provisions impose duties on the insurer. Insurers have to undertake insurance business in accordance with the IRDA prescribed code of conduct, and with the councils established under Section 64C of the Insurance Act.

The insurers are under a duty to clearly inform about the scope of the benefits of the insurance policy, the extent of insurance cover, exceptions and conditions of the insurance cover, and claims whether they are earning profit or not. This information should be stated in a simple and explicit manner without any ambiguity.

The insurer is bound to provide all material information in respect of the insurance product which he proposes to market to the prospective purchaser. The agent appointed by the insurer has to fulfill this function whenever required and pass the information to the policyholder as and when required.\(^{54}\)

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\(^{53}\) The IRDA (Protection of Policyholder’s Interests Regulations 2002 is perhaps the best example of a model consumer production code introduced by any regulator to protect the interests of insurance customers.

\(^{54}\) Protection of Policyholders Interests Regulations is acting as the benchmark of insurer’s performance, towards the consumer.
(f) IRDA (Standard Proposal Form for Life Insurance) Regulations, 2013

Through this regulation IRDA asked all life insurers to adopt a standard Proposal Form for policyholders seeking insurance cover. This move will go a long way in bringing uniformity and transparency.55

The objective of this regulation is to provide for a standard proposal form for individual policies in life insurance that has an inbuilt flexibility for seeking specialized information that is product specific to a particular category. The “Standard Proposal Form” notified by IRDA contains columns for personal information and suitability analysis for policyholder.56

The new regulation will require insurers to have in place a process and system to assess the needs analysis carried out for each and every proposal received and the soundness of a recommendation about a particular product. The regulation applies to all individual policies issued by life insurance companies, irrespective of segment or type of product.57

(g) IRDA (Life Insurance – Reinsurance) Regulations, 2013

Insurance Regulatory and Development Authority (IRDA) has mandated life insurance companies to reinsure with domestic reinsurers, a percentage of sum assured on each policy. In the regulation, it is said that this percentage will be notified by the regulator and will not exceed 30 percent of the sum assured.58 Further, IRDA has asked life insurers, in their re-insurance program, to have maximum retention

55 www.indiainfoline.com/Market/News/Life-insurers-to-adopt-form-for-policyholders /5642376817. Accessed on 30/3/14 at 11:00 A.M.
56 Ibid.
58 www.irda.gov.in/ADMINCMS/cms/fromgeneral-No.4-earliest.aspx?DF=RL&mid=3.1.1. Accessed on 24/3/14 at 3:00 P.M.
within the country. As per the gazette notification, the retention limit ranges from Rs. 5 Lakhs to Rs. 30 Lakhs, based on the age of the insurer and the type of the product.59

(h) IRDA (Licensing of Banks as Insurance Brokers) Regulations, 2013

Insurance Regulatory and Development Authority (IRDA) has allowed banks to act as brokers and sell products of more than one insurer so as to increase the penetration of the sector across the country. According to IRDA (Licensing of Banks as Insurance Brokers) Regulations, 2013, there is no capital requirement for insurance broking carried out by banks.60 To qualify for the license, each bank will have to have the principal officer, an officer of general manager or equivalent category, who is appointed exclusively to carry out the functions of an insurance broker. Every insurance broker will, before the commencement of business, deposit and keep deposits with any scheduled bank as sum of Rs. 50 Lakh. The license once issued will be for three years from the date of issue, it said, adding that the renewal of license can be applied 30 days before its expiry. While The Reserve Bank of India’s approval is required for the banks to become brokers, IRDA is of opinion that in case of any dispute arising out of insurance transactions, its jurisdiction should prevail.61

(i) IRDA (Investment) (Fifth Amendment) Regulations, 2013

IRDA recently amended the Investment Regulations for the sector. The amendments in investment regulations aim to address the difficulties faced by housing and insurance companies in securing long term funding.62 With the new amendment IRDA tweaked norms for Insurance Companies to invest their funds in different

61 Ibid.
market instruments like government securities and corporate debt to channelize long term savings in infrastructure sector.\textsuperscript{63}

Life insurance companies can now invest in central government securities which should not be less than 25\% of the total corpus. However, the total investment in central government securities, state government securities and other approved securities cannot be less than 50 percent taken together. At the same time, it has allowed life insurers to invest in housing and infrastructure bonds, with ratings of not less than AA by credit rating agencies. The total investment in the category will not be less than 15 percent.\textsuperscript{64} These initiatives taken by IRDA are in sync with the recommendations of planning commission which pondered on the issue of funding constraints faced by housing and infrastructural companies.\textsuperscript{65}

(j) IRDA (Issuance of Capital by Life Insurance Companies) Regulations, 2011

India’s Insurance regulator has released the long anticipated norm that will govern initial public offerings (IPOs) by life insurance companies in a bid to help them raise capital from public. According to the regulation only those insurers who have completed 10 years of operations will be allowed to float IPOs.\textsuperscript{66}

No life insurer can approach market regulator Securities and Exchange Board of India (SEBI) for IPO approval without going to IRDA’s approval, the guidelines say. Moreover, IRDA’s approval for an IPO will only be valid for a year, within which the company can approach SEBI. This is in the line of listing norms laid down by SEBI for companies wanting to raise capital through public markets.

\textsuperscript{63} Development of infrastructure is critical for growth of Indian economy.
\textsuperscript{64} www.articles.economictimes.indiatimes.com/2013-12-06/news/44864278-1-surrender-value-life-insurance-regulatory. Accessed on 31/3/14 at 3:00 P.M.
\textsuperscript{65} Supra n.62.
\textsuperscript{66} www.caclub.in/2011/12/irda-issuance-of-capital-by-life.html?m=1. Accessed on 30/1/14 at 2:00 P.M.
Companies going public have to mandatorily disclose a record of policyholder protection and the pendency of the policyholder’s complaints for the last five years in the draft red herring prospectus to be filed with SEBI.67


A summary of the specifications and areas covered under the new regulations is as follows:68

i. Minimum death benefit specification for single and regular premium products, varying by age of the insured

ii. Minimum policy term and premium term of five years for individual products

iii. Commission caps for individual regular premium products varying by premium payment term; absolute commission caps for group insurance products at scheme level.

iv. Enhanced minimum guaranteed surrender value varying by policy duration

v. Benefit illustrations at gross investment returns of 4 per cent and 8 per cent and as specified by the IRDA and Life Insurance Council

vi. Conditions on charges levied on linked products, including the requirement to submit comprehensive documentation on guarantee charges levied

vii. Requirements for with profits fund management

viii. Separate category of variable insurance products and governing provisions (for both linked and non-linked products)

ix. Provisions for pension and group products (for both linked and non-linked products)


68 www.towerwatson.com/en-IN/insights/Newsletters/Asia-Pacific/india-market-life-insurance/2013/Regulatory-Update-April-2013. Accessed on 31/3/14 at 5:00 P.M.
(l) Miscellaneous

i. The IRDA has released regulations on scheme of amalgamation and transfer of life insurance business. The regulations specify the disclosure and valuation requirements to obtain approval of the regulator for any life insurance mergers or acquisitions.

ii. The IRDA has issued an amendment to the Registration of Indian Insurance Companies Regulations wherein the definition of Indian promoter has been expanded to include a limited liability partnership formed under the Limited Liability Partnership Act, 2008 with no partner being a non-resident entity/person as per the Foreign Exchange management Act, and not being a foreign limited liability partnership.69

iii. The IRDA is looking for ways to implement regulations that would allow experienced senior agents to mentor junior agents, without encroaching upon the provisions of the Insurance Act. The Insurance Act prohibits entities like chief agents since they encourage multi-level marketing. Keeping in view the 70 to 80 per cent drop out rate of agents, the IRDA had circulated draft norms on 9 November 2011 for creating a career path for agents. The IRDA has issued a direction to all life/non-life/health insurers advising them to not repudiate claims due to late intimation of claims or delayed submission of claims without proper justification for their repudiation. The guideline is expected to address the issue of rejection of genuine claims which are reported late on account of unavoidable circumstances at the policyholders’ end.

iv. In order to control frauds, the IRDA has issued a circular for insurers according to which companies would now be required to put a risk-based management system in place for continued monitoring of risks across all lines

69 Ibid.
of business and also initiate measures to address them. The anti-fraud policy, covering areas exposed to fraud and procedures to monitor fraud, would require the approval of the Board of the respective company followed by an annual review of the policy. It would be required of the insurers to inform potential and existing clients of their anti-fraud policy and the consequences in case of fraud would have to be highlighted in the insurance contracts and relevant documents.\textsuperscript{70}

v. The IRDA is planning to examine the regulations for micro-insurance products and incorporate changes which include reducing the premium levels and improving delivery models. In an effort to increase penetration, the regulator is likely to permit district-central co-operative banks, agricultural co-operative societies and individuals to vend micro-insurance products in rural and semi-urban areas. In its directive to the LIC, the IRDA has asked the insurer to adhere to the guidelines governing the micro-insurance business.\textsuperscript{71}

vi. The IRDA has released a new mortality table, “Indian Assured Lives Mortality (2006-08)”, based on revised life expectancy ratios, which will come in effect from 1 April 2013. The new table incorporates regional and gender variations in the mortality rates. Life insurance premiums are indicated to fall modestly after the introduction of the same.

vii. The IRDA has proposed to reduce the solvency margin requirement to 145 per cent from the existing 150 per cent from FY2013-14, after the imposition of a risk charge for debt investments of insurers.\textsuperscript{72}

\textsuperscript{70} Ibid.
\textsuperscript{71} Ibid.
\textsuperscript{72} Ibid.
H. REVIEW

The insurance business in India went through various sets of regulations in the pre and post-independence period. Prior to independence, insurance business was fragmented and a number of insurers, both local and international, were operating in limited market segments without much regulation. After independence, to meet the objectives of socialistic pattern of the society and to take the concept of insurance to every nook and corner of the country, insurance business was nationalized in two phases – first, the life insurance business in the year 1956 and second, the general insurance business in the year 1972. Thereafter, the insurance business went into the hands of the public sector. Later in 1990’s, with economic liberalization sweeping across the globe, there was a shift in the government’s approach towards insurance industry and it was opened to private players and an independent authority, the Insurance Regulatory and Development Authority was established under the provisions of the IRDA Act, 1999. In every phase the regulation of insurance business changed in accordance with the government policy and approach to the society.73

The insurance industry has now become liberalized and globalised with an exemplary shift in its application. Its rapid expansion warrants a regulatory regime that checks insurance transactions in the interests of bonafide stakeholders such as insurance service providers, service users, society and the government without taking away the liberty of insurers. The government and its agents need to follow the policy of minimum interference in the business giving the insurers enough freedom to plan and execute their business for the benefit of people and the enterprise.

But, still in the current liberalized economy, where free trade is openly advocated the insurance business in India is being regulated at various stages. Most of these regulations are directed towards the operation of the insurers such as the registration of insurance companies, management structure and governance models,

73 Supra n.41, p.34.
the class of insurance business undertaken by the insurers, financial matters, product designs, calculations and fixing of premiums, marketing of insurance products and insurer’s obligation towards the government, customers and other stakeholders are regulated by the existing law.\textsuperscript{74}

Thus, there is a need to liberalize the industry in real sense. It should be given enough freedom to facilitate the insurer to provide better services to people at low cost and less effort. Therefore, a rational and logical balance between regulation and freedom need to be achieved, and the insurer should be carefully supervised only from outside giving them an opportunity to utilize their resources effectively.\textsuperscript{75}

\textsuperscript{75} Supra n.41, p.47.