

Legislative Brief

The Insurance Laws (Amendment) Bill, 2008

The Bill was introduced in the Rajya Sabha on 22nd December, 2008 and was referred to the Standing Committee on Finance (Chairperson: Shri Ananth Kumar).

The Standing Committee is yet to submit its report.

Highlights of the Bill

- ◆ The Bill allows foreign investors to hold up to 49% of the capital in an Indian insurance company. It allows for nationalised general insurance companies to raise funds from the capital markets.
- ◆ Companies or co-operative societies in the life or general insurance business must have a minimum equity capital of Rs 100 crore, while those in health insurance must have a minimum equity capital of Rs 50 crore.
- ◆ An insurer cannot challenge a life insurance policy for any reason, after a period of five years.
- ◆ Insurers who fail to meet their obligations with respect to underwriting third party motor insurance, or underwriting policies in rural and social sectors or with vulnerable sections, face a fine of Rs 25 crore.
- ◆ The Bill provides for appeals against decisions by Insurance Regulatory and Development Authority to lie with the Securities Appellate Tribunal set up under the SEBI Act, 1992.

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Key Issues and Analysis

- ◆ The Bill provides for Lloyd's of London to be included within the definition of a foreign company. However, it is unclear whether the members of Lloyd's who ultimately bear all risks of policies which are written, will be able to operate in the country.
- ◆ The IRDA Act, 1999 required Indian promoters of an insurance company to reduce their stake to 26% over a period of ten years. The Bill does away with this requirement.
- ◆ The Bill permits a policyholder to completely assign all rights under the policy to a third party, while allowing an insurer to decline such a transfer. The validity of such transfers is under legal challenge. While the Mumbai High Court has ruled that such transfers are valid, the case is currently facing appeal in the Supreme Court.
- ◆ While appeals against decisions by IRDA lie with the Securities Appellate Tribunal, the Bill does not provide for the tribunal to appoint a member with experience in insurance law.
- ◆ The Law Commission had suggested the merger of key provisions of the IRDA Act with the Insurance Act. This has not been implemented.

PART A: HIGHLIGHTS OF THE BILL¹

Context

There are a number of laws which govern the insurance business in India. The Insurance Act, 1938 provides the main legal framework within which insurance businesses function and regulates the relationship between an insurer, its policyholders, its shareholders, and the regulator. The life insurance business was nationalised in 1956 with the establishment of the Life Insurance Corporation under the LIC Act, 1956. The general insurance business in India was nationalised in 1972 with the enactment of the General Insurance Business (Nationalisation) Act, 1972.

The IRDA Act, 1999 provided for the setting up of the Insurance Regulatory and Development Authority, which regulates the industry. It also provided for the re-entry of the private sector into the insurance business. In 2007-08, the total premium income of life and non-life insurers in India was about Rs 2,30,000 crore, or 5.3% of GDP (Table 1).

In 2004, the Law Commission recommended comprehensive reforms to the Insurance Act, 1938 which included changes to rights enjoyed by policyholders and the setting up of an independent grievance redressal mechanism and an insurance appellate tribunal.² The Report of the Committee on Provisions of the Insurance Act, 1938 (Chairman: Shri K.P. Narasimhan), released in 2005, made further recommendations for changes to the Act with respect to investment and accounting norms for insurance companies.³

Table 1: Insurance Market in India (2007-08)

		Life Insurance	Non-life Insurance
Premium income (Rs crore)		2,01,351	27,823
Market Share (%)	Public Sector	74%	60%
	Private Sector	26%	40%
No. of Insurers	Public Sector	1	7
	Private Sector	20	14

Sources: IRDA Annual Report (2007-08), PRS

The Bill incorporates some recommendations of the Law Commission as well as the K.P. Narasimhan Committee. It amends the Insurance Act, 1938, the General Insurance Business (Nationalisation) Act, 1972, and the IRDA Act, 1999.

Key Features

The Bill redefines certain types of insurance and allows for foreign investors to hold up to 49% of the capital in an insurance company. It provides for nationalised general insurance companies to raise funds from capital markets with the permission of the central government. The Bill changes norms governing the rights of policyholders and insurers with respect to insurance policies. It enhances penalties for a range of offences and prescribes a procedure for appeals against decisions by IRDA. It allows for a number of issues, currently specified in the Act, to be specified in the rules.

Definitions

- The Bill defines health insurance separately. Health insurance includes policies issued to cover medical, surgical, and hospitalisation costs related to in-patient and out-patient treatment. Such policies can include assured benefits, cover long term care, and provide overseas travel or personal accident cover.
- A foreign company has been defined as a company or body established or incorporated under the law of any country outside India. Lloyd's, established under the Lloyd's Act, 1871 in the UK, is specifically covered by this definition.

Entry Criteria and Corporate Governance

- The Bill specifies four kinds of entities who are allowed to act as insurers – public companies, co-operative societies, foreign companies operating through a branch, and statutory bodies established by acts of Parliament to carry on insurance. It also specifies the minimum equity capital that various insurance businesses must maintain (Table 2).

Table 2: Eligibility Norms for Entry into the Insurance Business

Entity	Criteria for formation	Capital Requirements (Equity)
Company	The Company must be a public company. Foreign investors can hold up to 49% of shares in the company.	Life Insurance / General Insurance: Rs 100 crore
Co-operative Society	Must be registered under central or state Acts. Foreign investment limit of 26%. Cannot be re-insurers.	Health Insurance: Rs 50 crore Re-insurance: Rs 200 crore
Branch of a foreign company	Branches of foreign companies can only be re-insurers. Indian partner not needed.	Net owned funds of the company must be at least Rs 5000 crore.

Sources: The Insurance Laws (Amendment) Bill, 2008, PRS

- The Bill provides for the General Insurance Corporation, the National Insurance Company Limited, the New India Assurance Company Limited, the Oriental Insurance Company Limited and the United India Insurance Company Limited, to raise capital with the permission of the central government.
- The Insurance Act restricts the capital of a publicly held life insurance company to equity shares only. The Bill requires all public insurance companies to hold capital as equity and in other forms to be specified by regulations.
- The Insurance Act requires an Indian promoter to reduce their stake in an insurance company to 26% within ten years. The Bill removes this requirement.
- Insurers may invest up to 5% of assets in promoter companies. They cannot invest in private companies.
- Agents, insurance brokers or other insurance intermediaries cannot be directors of an insurance company.
- IRDA must approve any transfer of shares which results in a single investor owning more than 5% of the equity of an insurance company. The regulator must also approve a transfer of more than 1% of the equity of an insurance company by an individual or firm or group under the same management.

Insurance Policies and Rights of Policyholders

- All general insurers must underwrite a minimum amount of insurance business in third party motor insurance.
- The Bill provides for policyholders to assign or transfer the rights enjoyed by them to others. ‘Conditional’ transfers allow for only certain rights to be transferred till the policy matures. ‘Absolute’ transfers provide for the transfer of all rights of the policy unconditionally. Unless specifically allowed otherwise, all transfers are to be treated as absolute. Insurers can decline the assignment of a policy if they feel it is against the interests of the policyholder, that it is not bona fide, or that it is against the public interest. Policyholders can appeal to IRDA against such a refusal.
- The Bill distinguishes ‘collector’ nominees from ‘beneficiary’ nominees. Beneficiary nominees are entitled to benefits payable under a policy. A collector nominee must pay benefits of the policy to legal heirs or the beneficiary nominee. Unless a policyholder makes such a distinction, all nominees are to be treated as beneficiary nominees.
- The Insurance Act allows an insurer to cancel a life insurance policy within two years on the grounds that material facts, on the basis of which the policy was issued, were inaccurate or false. After two years, a policy can still be cancelled on grounds of fraud. The Bill expands the window within which policies can be cancelled to five years. However, a policy cannot be challenged on any grounds after a period of five years. If an insurer cancels a policy on grounds of misstatement or suppression of facts, premiums collected must be returned within 90 days.

Solvency and Investments

- All insurers and re-insurers must maintain an excess of assets over liabilities (solvency margin) of 50% of the minimum amount of capital prescribed. A further ‘control’ level of solvency shall also be prescribed in the rules.
- The Bill specifies investment norms for insurers (Table 3). Investments other than those approved by IRDA must be cleared by all directors and reported to the regulator.

Table 3: Investment Norms (% of total assets)

Investment	Life Insurance	General Insurance
Government Securities (minimum)	25%	20%
Government/other approved Securities (minimum)	25%	10%
Approved Investments (maximum)	50%	70%
Other Investments (maximum)	15%	15%

Sources: Insurance Laws (Amendment) Bill, 2008; PRS

Penalties and Adjudication Mechanism

- The Bill provides for the Securities Appellate Tribunal, established under the SEBI Act, 1992, to be the appellate authority for decisions made by IRDA.
- Insurers who violate norms on investment and the underwriting of third party motor insurance, or obligations towards rural and social sectors or vulnerable sections, face a fine of Rs 25 crore.

Miscellaneous

- The Bill does away with the requirement that insurance agents be licenced by IRDA. It allows insurers to appoint persons with specified qualifications and training, as insurance agents. No person can act as an agent for more than one life insurer or general insurer. Norms for commission and brokerage are to be specified in regulations.
- The Bill provides for separate Life and General Insurance Councils to be constituted from amongst industry representatives and nominees of IRDA. The councils will set standards of conduct for insurers and advise the regulator. The Bill deletes provisions in the Act which provide for a Tariff Advisory Committee.

PART B: KEY ISSUES AND ANALYSIS

Entry into the Insurance Business

Lloyd's of London

Clause
3(iv),
Statement
of
Objects
and
Reasons

The Bill provides for Lloyd's, covered by the Lloyd's Act, 1871 of the UK, to be treated as a foreign company. The Statement of Objects and Reasons specifies one of the aims of the Bill as being to "facilitate entry of Lloyd's of London in insurance business in India..."

Lloyd's is not a company but an insurance market, established as a society and comprised of members, who are distinct legal entities in their own right. It is the members, rather than Lloyd's itself, who bear the risks of any policies written. While the Bill allows for the entry of Lloyd's, it is unclear as to whether the individual members will also be allowed to practice in the country.

In India, the Insurance Act, 1938 currently defines an 'insurer' to include persons in India who have contracts with Lloyd's underwriters.⁴ Lloyd's is regulated by the Financial Services Authority, which regulates financial services in the UK. In China, Lloyd's has a licence only for reinsurance and operates through a wholly owned subsidiary, incorporated as a company.⁵ In the US, Lloyd's is an accredited reinsurer in all states.

Capital Structure

Capital Requirements specified in the Bill

Clause 3

The Bill requires life and general insurers to have a minimum capital of Rs 100 crore. Health insurers are required to have a minimum capital of Rs 50 crore. The Bill does not give any flexibility to the regulator to revise capital requirements upward over time. This regulatory structure for insurers differs from that for banks.

The Banking Regulation Act, 1949 allows the RBI to licence banks who fulfil conditions imposed on them by the central bank.⁶ The Act gives broad guidelines as to what those conditions should be but leaves it to the central bank to impose specific conditions, including minimum capital norms, without needing to seek parliamentary approval.

The Insurance Act and LIC

The state-owned LIC is incorporated under the LIC Act, 1956 and is the country's largest life insurer. The IRDA Act, 1999 did away with LIC's exclusive privilege to carry on life insurance in the country and applied all the provisions of the Insurance Act, 1938 to LIC.⁷ However, unlike other life insurers in the country, all policies issued by LIC are guaranteed by the government.

LIC currently does not meet the minimum capital requirement of Rs 100 crore specified in the Insurance Act as its paid up equity capital is Rs 5 crore. The Life Insurance Corporation (Amendment) Bill, 2008, introduced in December last year in the Lok Sabha provided for an increase in LIC's capital to Rs 100 crore. It also allowed for the government to specify the extent to which it guarantees policies issued by LIC. However the Bill will lapse with the dissolution of the 14th Lok Sabha.

Divestment by Indian Promoters

Clause 14

The IRDA Act, 1999 amended the Insurance Act, requiring Indian promoters to reduce their stake to 26% within ten years. The Bill does away with this requirement.

The Reserve Bank of India requires promoters of private sector banks to reduce their stake to 40% within one year.⁸ The RBI, at its discretion, can allow promoters to dilute their stake over a longer period.

Insurance Policies

Assignment and Transfer of Policies

Clause 48

The Bill provides for a policyholder to assign or transfer their rights under a policy, either completely or only partly, to a third party.

A basic requirement for any policy of life insurance to be issued is that of 'insurable interest' i.e. whether the person who enjoys all rights under the policy also has an interest in the insured person remaining alive. If a policyholder sells the policy, it is unclear whether the new buyer is also required to have insurable interest. The Mumbai High Court has ruled that while insurable interest must exist when the policy is first taken, it is not necessary for such interest to exist when rights in the policy are subsequently transferred to a third party. It ruled that such assignments are legal in India.⁹ The case is currently facing appeal in the Supreme Court.¹⁰

Internationally, the ability to completely assign all rights under a policy to a third party has led to a secondary market for life insurance policies. Policies can be sold for a price which is lower than the face value of the policy but higher than the surrender value. The buyer pays the remaining premiums on the policy and is entitled to the sum paid by the insurer when the insured person dies or the policy matures. In the US, the market for such policies was estimated at about \$13 billion in 2005.¹¹

In the US, such secondary market transactions in life policies are regulated in 28 states. Thirty-eight states regulate such transactions in cases where the insured person has a short life expectancy (2-3 years).¹² In Canada, such transactions are illegal in 9 provinces.¹³

India does not have laws which specifically regulate the secondary market in insurance policies. The Bill allows an insurer to decline to recognise the transfer of rights of a life policy to a third party. While this is in line with recommendations made by the Law Commission, it could deter the growth of a secondary market in such policies. The K.P. Narasimhan Committee had suggested that IRDA be given the power to regulate such transfers of rights.

Reports of the Law Commission and the K.P. Narasimhan Committee

Grievance Redressal

Policyholders with complaints can approach the consumer courts or insurance ombudsmen. Such ombudsmen are appointed based on recommendations made by a committee consisting of the chairpersons of IRDA, LIC, General Insurance Corporation and a representative of the central government. This creates the possibility of a conflict of interest. In comparison, ombudsmen in the banking sector are appointed by a committee comprising the deputy governors of the Reserve Bank of India and a representative of the finance ministry.

The Law Commission found the ombudsmen system in insurance unsatisfactory and said that alternative fora such as the Consumer Courts were also ineffective given the large backlog of cases still pending. It proposed that amendments be made to the Insurance Act to put in place an independent grievance redressal authority (GRA) with all powers and functions of a civil court and composed of judicial and technical members. It proposed that existing cases in consumer courts be transferred to the GRA.

The K.P. Narasimhan Committee disagreed, saying that consumer courts were more easily accessible than a GRA would be. Further, it was not clear whether consumer courts were so overburdened as to be unable to handle complaints by policyholders. It suggested instead that the existing system be continued with some changes. The Bill does not provide for an independent GRA.

Appeals Process

The Bill provides for appeals against decisions by IRDA to lie with the Securities Appellate Tribunal, set up under the SEBI Act, 1992. This is in line with recommendations made by the K.P. Narasimhan Committee. Since SAT currently deals with issues related to the capital markets only, its expertise in dealing with matters of insurance law may be limited. The committee had suggested that amendments be made to the SEBI Act to provide for the appointment of a member with a background in insurance. This recommendation has not been implemented.

The Law Commission had suggested a separate appellate authority for the insurance industry, which would hear appeals against decisions by IRDA or the GRA (see above). Appeals against decisions by the proposed insurance appellate authority (IAT) would lie directly with the Supreme Court.

Other Recommendations

Table 4: Status of Other Recommendations made by Law Commission

Topic	Recommendation	Status
Simplification of laws	Suggested the merger of a number of key provisions of IRDA Act with Insurance Act.	Not implemented.
Cancellation of Policy	Insurer should be allowed to challenge a policy on grounds of misstatements/suppression of facts or fraud within 5 years. No challenge to be allowed on any grounds after 5 years.	As recommended.
Nomination of policies	Allow policyholders to distinguish between beneficiary and collector nominees.	As recommended.
Penalties	Increase penalties for violation of investment norms, or obligations towards rural /social sectors or vulnerable sections.	As recommended.

Sources: Insurance Laws (Amendment) Bill, 2008; PRS; Law Commission Report.

Table 5: Status of Other Recommendations made by K.P. Narasimhan Committee

Topic	Recommendation	Status
Definitions	Define 'Contract of Insurance' as any contract effected by an insurer by which he assumes a degree of risk of loss or assured benefit as may be specified by regulations made by the Authority.	Not implemented.
Investments	Minimum of 25% of investible funds in government securities and a further 25% in government/approved securities. Types of approved investments to be specified in regulations. Specify limits on non-approved investments in regulations.	As recommended. Types of approved investments to be specified in regulations. Act specifies a maximum limit of 15% on non-approved investments.
Capital Requirements	Minimum capital of Rs 100 crore prescribed for life and general insurers and Rs 200 crore for general insurers. Minimum capital for health/agricultural insurance to be specified in regulations.	As recommended. Act prescribes minimum capital of Rs 50 crore for health insurers.
Solvency	Specify valuation norms for assets/ liabilities in regulations. Every insurer to maintain an excess of assets over liabilities of 50% of minimum capital.	As recommended.
Actuaries	Insert provision in the Insurance Act which makes it mandatory for every insurer to appoint an actuary.	Not implemented. Currently required by IRDA regulations.
Powers of Statutory Councils	Shift power to set rates and terms from Tariff Advisory Council to General Insurance Council. Bring TAC under the General Insurance Council.	TAC done away with. Powers of General Insurance Council left unchanged.
Insurance Agents	Do away with licensing of insurance agents while allowing IRDA to specify minimum qualifications. Entrust insurers with the power to appoint agents.	As recommended.
Cancellation of Policy	No change to Act.	Window within which policy can be cancelled on grounds of misstatement/suppression of facts or fraud expanded to five years from two. However, policy cannot be challenged on any grounds after five years.

Sources: Insurance Laws (Amendment) Bill, 2008; K.P. Narasimhan Committee; PRS

Notes

1. This Brief has been written on the basis of the Insurance Laws (Amendment) Bill, 2008, which was introduced in the Lok Sabha on December 22nd, 2008 and referred to the Standing Committee on Finance (Chairperson: Shri Anant Kumar). The Standing Committee is yet to submit its report.
2. Law Commission of India, "The Revision of the Insurance Act, 1938 and the IRDA Act, 1999", 190th Report.
3. Report of the K.P. Narasimhan Committee on Provisions of the Insurance Act, 1938 (Chairperson: Shri K.P. Narasimhan). Report submitted in July 2005.
4. The Insurance Act, 1938, Clause 2(9)(c).
5. See Lloyd's Annual Report, 2008, p. 27:
http://www.lloyds.com/Lloyds_Market/Financial_performance/Financial_reports/2008_Annual_Report.htm
6. Banking Regulation Act, 1949, Section 22.
7. See LIC Act, 1956, Section 30A.
8. See RBI website: http://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=4350
9. Writ Petition No. 2159 of 2004, Insure Policy Plus Services and others vs. The Life Insurance Corporation of India and others.
10. Special Leave Petition (Civil) No. 10783 of 2007, LIC of India vs. Insure Policy Plus Services and others.
11. Blake, David and Debbie Harrison, "And death shall have no dominion: Life settlements and the ethics of profiting from mortality", July 2008, Pensions Institute, p. 5. Available at :
http://www.pensions-institute.org/DeathShallHaveNoDominion_Final_3July08.pdf
12. See 'Life Settlement ABS Developments', DBRS, June 2008, p. 11.
<http://www.dbrs.com/research/221027/select-commentaries-life-settlement-abs-developments.pdf>
13. Study Paper on Viatical Settlements, Canadian Centre for Elder Law Studies, May 2006, p. 11.

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