

# GOVERNANCE IN INSURANCE SECTOR



P.S.Prabhakar, FCA

# DEFINITION

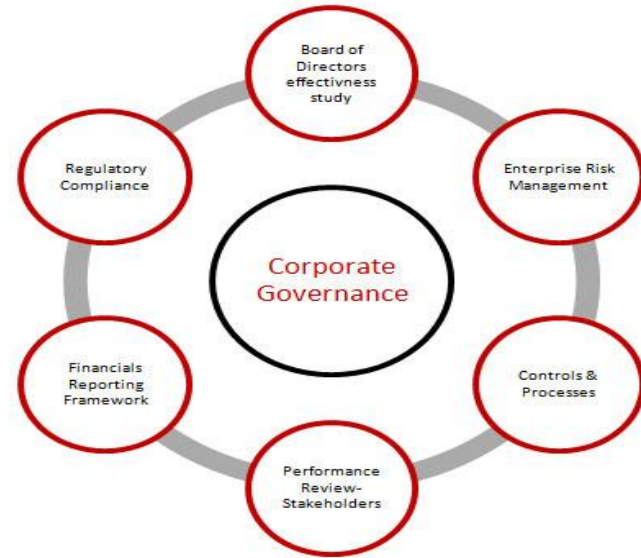
- **Governance** refers to "all processes of governing, whether undertaken by a government, market or network, whether over a family, tribe, formal or informal organization or territory and whether through laws, norms, power or language."



- It relates to processes and decisions that seek to define actions, grant power and verify performance.

# NEED FOR C.G.

- Businesses are becoming increasingly complex and with restrictions and controls placed by various State agencies, regulators, tax departments etc. and with the expectations from shareholders for maximum returns on investment while still holding on to business ethics and corporate awareness of the environmental and societal interests, there has to be a discipline from within.



If such discipline is not internally generatable, then such discipline will be enforced.

# GOOD GOVERNANCE – BETTER WITHIN

- Good governance involves a commitment to run business in legal, ethical & transparent manner
- Good governance in a corporate entity should be voluntary and not one statutorily enforceable
- Corporate Governance is a delicate balance between twin tasks of performance and compliance
- If bottomline is the solitary objective, managements tend to lose sight of their responsibilities to stakeholders



# GOVERNANCE – SINCE WHEN BECAME THE BUZZWORD?

- Seeds of modern corporate governance sown by Watergate scandal in USA in 1980s
- Cadbury Report in UK in 1992
- South east and East Asian economies crisis in 1997-98
- In India – 1992 Stock Market scam
- 2002 – Litany of scandals in the west
- Sarbanes Oxley Act – July 2002
- Narayanamurthy Committee in 2002
- Clause 49 in 2005
- Satyam scam in India – 2007
- Naresh Chandra Committee in 2009

# INSURANCE & COMPANY LEGISLATIONS

- ❖ Indian Companies Act, 1866
- ❖ Indian Companies Act, 1882
- ❖ Indian Companies Act, 1913
- ❖ Insurance Act, 1938 (amended in 1950, 1968 & 2002)
- ❖ Companies Act, 1956
- ❖ IRDA Act, 1999
- ❖ Companies Act, 2013

# OVERSIGHT INDIAN INSURANCE SCENARIO



- Much before the Western scandals, SOX, Clause 49 etc. insurance industry in India started to have a taste of Corporate Governance
- Call it regulatory activism or over precaution – or simple oversight - right from due diligence on the promoters to capital structuring to capital adequacy norms to pre-approval requirements of even ESOPs – IRDA induced corporate governance is in motion right from the time R1 is filed by an aspirant.

# GOVERNANCE IN INSURANCE

- Protecting policyholders interests by reasonable charging of premium
- Objectivity in settling claims
- Prudent and profitable investment of policyholders funds while maintaining solvency margin
- Sensitivity in terms of social obligations, micro insurances and manner of advertisement & publicity etc.
- Compliance to the legal and regulatory framework
- Disclosures of different types to the Regulator periodically



# INSURANCE – REGULATORY GOVERNANCE

- Like banking industry, insurance also is subject to what is known as regulatory governance.
- Industry deals with public funds.
- Policyholders protection paramount
- Restrictions on investments, expenses
- Regulating solvency norms, reinsurance issues
- Host of other regulations

# C.G. IN INSURANCE

- Governance is the primary responsibility of the management.
- A management is for ever answerable to the shareholders
- In view of the FDI restriction, we have a situation of at least two promoter groups – one Indian and another foreign, with diverse business cultures
- So it is a challenge for any management to be in the competitive environment, be responsive to the expectations of diverse business groups and be within the right side of the law

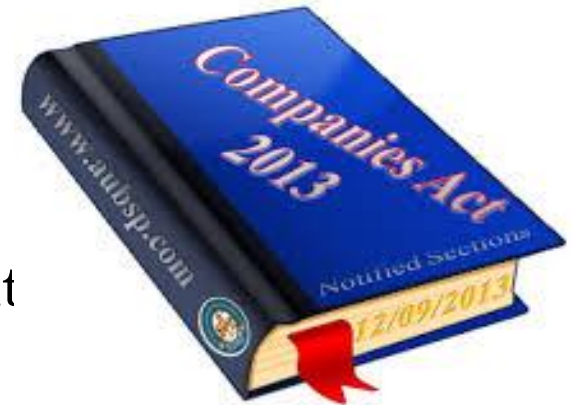
# MANAGEMENT REPORT



- Disclosures regarding overall risk exposure and strategy adopted to mitigate the same
- Operations in other countries with management's estimate of country risk and exposure risk and hedging strategy adopted
- Ageing of claims with trends of settlement for 5 years
- Review of asset quality and performance of investments portfolio wise
- Details of payments to individuals, firms, companies and organisations in which Directors are interested

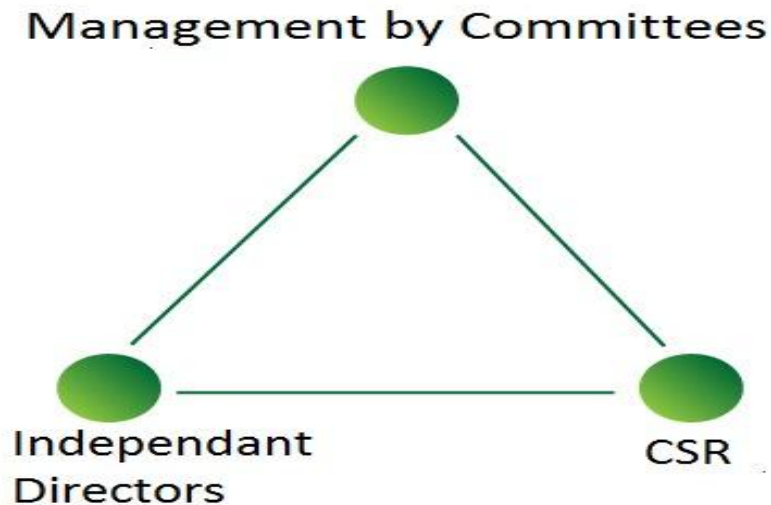
# C.G. IN THE NEW COMPANIES ACT

- Increased Reporting Framework
  - ❖ Consolidated Financial Statements
  - ❖ Revision in Financial Statements
  - ❖ Mandatory Internal Audit requirement
- Higher Auditor accountability
  - ❖ Auditors' appointment & rotation
  - ❖ Reporting requirements – escalating upto government
- Directors' Responsibilities
  - ❖ Audit Committee
  - ❖ Additional responsibilities on Independent Directors
- Corporate Social Responsibility



# IS CG SOMETHING NEW FOR INSURANCE INDUSTRY?

Three corner stones of CG are:



These are already there in most insurance companies by virtue of regulations as well as by the inherent nature of the business

# REGULATORY ACTIVISM – EXAMPLES

- File & Use – Well, Not Exactly!
- The garb of grievance redressal
- Tight guidelines on Investments
- Sec. 34B (Ins. Act) – Power to remove CEO etc.
- Sec 34C – Power to appoint Addl. Directors
- Management Report (to be certified by Auditors)
  - Disclosure re: Overall risk exposure & strategy to mitigate
  - Ops in other countries – exposure risk & hedging strategy
  - Ageing of Claims – Trends for 5 years
  - Review of asset quality & performance of investments ( portfolio-wise)



# IS THE REGULATOR HELPING COMPANIES THRIVE, GROW, BE PROFITABLE?

- Too bureaucratic and too trigger happy
- On the one side, too much compliances making the cost of compliance too high and on the other side penalising for exceeding limits on expenses
- Revenue Department making life miserable and IRDA doing precious nothing
- Motor TP pool formation, dismantling, choking the companies with huge outstanding claim provisions etc.
- The law makers not abiding by law (Sec. 64VB & RSBY) and the regulator punishing the victim

# COMPANIES – TAKING THINGS TOO EASY IN THE PAST?

- Pre IRDA scenario, when only PSUs were operating, the industry was literally ‘uncontrolled’
- Only they were responding to the intimidations of the Finance Secretary, GIC officials and Trade Unions!
- Scant regard for the insurance law.
- Competition for top line and little concern for profitability
- Rampant Customer dissatisfaction



# DIFFERENT STROKES !!!

- Current CG model – imported from west
- No great difference from the Cadbury report
- Satyam – an aberration or a pre-cursor?
- India is not West. 2/3rds in US are connected to stock market – in India, 2 or 3% only
- In the west, it is an ownerless, CEO driven paradigm. In India, it is family controlled, owner driven paradigm.
- No standard global prescription for diverse situations
- Independent Directors – how independent?

