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IRDAI FINDS A WAY TO LOOSEN THE KNOT ON INSURERS' EXPENSES

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After the recent announcements announced by the Insurance Regulatory and Development Authority of India (IRDAI), India's insurance sector is set to undergo further significant changes. The IRDAI has introduced the following new regulations aimed at offering insurers flexibility in managing their expenses and promoting ease of doing business:

(i) IRDAI (Payment of Commission) Regulations 2023 (2023 Commission Regulations) which replaces the IRDAI (Payment of commission or remuneration or reward to insurance agents and insurance intermediaries) Regulations 2016 (Erstwhile Commission Regulations);

(ii) IRDAI (Expenses of Management of Insurers transacting General or Health Insurance Business) Regulations 2023 (2023 Non-Life EOM Regulations) which replaces the IRDAI (Expenses of Management of Insurers transacting General or Health Insurance Business) Regulations 2016 (Erstwhile Non-Life EOM Regulations); and

(iii) IRDAI (Expenses of Management of Insurers transacting Life Insurance Business) Regulations 2023 (2023 Life EoM Regulations) which replaces the IRDAI (Expenses of Management of Insurers transacting life insurance business) Regulations 2016 (Erstwhile Life EoM Regulations).

Expenses of Management (EoM)

Per the 2023 Non-Life EoM Regulations and the 2023 Life EoM Regulations (collectively "2023 EoM Regulations"), EoM includes: (i) all operating expenses of the insurer; (ii) commission paid to insurance agents and intermediaries; and (iii) commission and expenses on reinsurance inward which are charged to the insurers' revenue account. Any charges against the profits of an insurer, such as income tax, goods and services tax etc., are excluded from the purview of EoM.

The 2023 Life EoM Regulations has retained the form and essence of the Erstwhile Life EoM Regulations and as such, the ambit of EoM remains the same. Further and more importantly, the segment wise (linked, non-linked (participating), non-linked (non-participating)) compliance with EoM limits has been retained. However, the percentage of premium permitted for determining EoM limits has been increased for a select few segments of life business leading to an overall increase in EoM limits for life insurers.

On the other hand, the 2023 Non-life EoM Regulations has been significantly overhauled – and now, EoM limits are no longer to be linked to premium received under individual segments of non-life business. The EoM limits are now required to be determined on an overall basis and have been set at 30% and 35% of the gross written premium (in a financial year) for general and health insurance business respectively.

The 2023 EoM Regulations also permit insurers to incur certain additional expenses in relation to 'insurtech' and insurance awareness, head office expenses and issuance of policies under various government schemes such as the Pradhan Mantri Suraksha Bima Yojana and the Pradhan Mantri Jeevan Jyoti Bima Yojana.

In terms of checks and balances, the requirement to submit the annual board-approved policy has been retained under the 2023 EoM Regulations. The chief financial officer and the appointed actuary have been specifically made responsible to ensure that the insurer complies with the allocation and apportionment of EoM under the board-approved policy. To further ensure that insurers observe fiscal discipline, the 2023 EoM Regulations have introduced an obligation on insurers to formulate an annual board-approved business plan prior to the beginning of each financial year. This business plan is required to contain the projected requirements of capital for the upcoming year, the projected solvency margin on a quarterly basis as well as the projected EoM and compliance with the specified limits. To put impetus on the business plan, the 2023 EoM Regulations also specify that if an insurer's EoM exceeds the projected EoM under the business plan by more than 10% (ten percent), then the managerial personnel of the insurer will not be eligible to receive any variable pay.

The consequences of non-compliance with the EoM limits continue to remain the same as those under the Erstwhile Non-Life EOM Regulations and the Erstwhile Life EOM Regulations – these include the IRDAI's powers to penalise the insurer, restrict it from opening new places of business, withhold the payment of performance incentives to the managerial personnel or even dismiss such managerial personnel. That said, any expenses in excess of the EoM limits under the 2023 EoM Regulations will be required to charged under the profit and loss account of the insurer rather than from the shareholders' account.

Payment of Commission

The 2023 Commission Regulations provide for a liberalised framework for the payment of commission. In a major departure from the Erstwhile Commission Regulations, the 2023 Commission Regulations provides for the commission rates to be unbundled and the commission is no longer capped for each product.

The Erstwhile Commission Regulations bifurcated payments made by insurers to insurance agents as 'commissions' and payments made to insurance intermediaries as 'remuneration'. 'Rewards' under the Erstwhile Commission Regulations were defined as incentives paid to agents and intermediaries over and above the commission / remuneration limits. The concept of commission has now been simplified and made all-encompassing to include 'remuneration' and 'reward'. We believe this will lead to simplicity and greater transparency vis-à-vis payments and benefits paid to insurance intermediaries and agents.

Further, under the Erstwhile Commission Regulations, corporate agents such as banks, whose revenue from activities other than insurance intermediation activities comprises more than 50% of their total revenue, were not eligible to receive rewards. However, the concept of rewards has now been subsumed under the concept of commission and as such, all insurance intermediaries will be treated on the same footing.

The 2023 Commission Regulations, similar to the Erstwhile Commission Regulations, provide for the implementation by insurers of a board-approved policy for the payment of commission. However, the board-approved policy will now be the primary source for regulating commission limits. The IRDAI has also released a guidance note on 31 March 2023, which provides for the broad principles and subjects to be provided for by insurers in their board-approved policies.

Thus, the 2023 Commission Regulations provides flexibility to insurers to determine the commission payable on individual products so long as the total amount of commission paid by an insurer in relation to all its products, does exceed the EoM limits specified by IRDAI (*as detailed in the section above*).

Conclusion

Breach of EoM limits and payment of excess commissions over regulatory limits have been long-standing issues in the industry. These amendments are a welcome step towards the further liberalisation of the insurance sector. Continuing its recent approach of transitioning from a rule-based system to a principle-based one, the IRDAI has acknowledged the maturity of the insurance industry over the past two decades, granting insurers the freedom to allocate costs based on their priorities. Accordingly, if an insurer can efficiently manage its operating expenses, it will have greater corpus and flexibility to pay commissions to its agents and intermediaries, thereby improving its distribution efficiency and market share. We believe these new regulations introduced by IRDAI will ensure that the regulatory regime is reflective of market dynamics and will accordingly lead to higher compliance.

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