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CORPORATE GOVERNANCE IN INDIAN INSURANCE COMPANIES- A STUDY ON THE ROLE IRDA

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ABSTRACT

The economic reforms initiated in India in the early 90s paved the way for the growth and opening up of the financial sector. Insurance and banking are the main components of finance sector. The reforms in insurance sector started in the year 2000 with the implementation of recommendations made by the Malhotra committee. The Indian insurance industry was opened up for private players in the year 2000 with the enactment of IRDA Act and they allowed to have Foreign Direct Investment up to a limit of 26%. However to meet the capital requirement of private insurance companies the Government approved to enhance the FDI cap from 26% to 49%. In the last fourteen years of period the insurance industry has moved forward on multiple fronts. At the same time the industry is faced with many challenges. Insurance and Regulatory and Development Authority (IRDA) an authorised body to regulate the insurance companies has taken many initiatives to monitor and regulate the public and private insurance companies operating in India. Of course liberalisation in insurance sector has brought some positive changes in the industry but at the same time it demands to strengthen CSR and Governance principles for sustainable growth in the industry.

Corporate Governance is understood as a system of financial and other managerial controls in a corporate entity. In case financial sector, where the entities accept public liabilities for fulfilment of certain contracts, the relationship is fiduciary with enhanced responsibility to protect the interests of the stakeholders. As regards the insurance sector there is a regulatory responsibility to protect the interest of the policyholders and other stakeholders. To meet the regulatory demands, insurance companies are required to have good governance practices for maintenance of solvency, sound long term investment policy and assumption of underwriting risks on a prudential basis. On this backdrop the paper attempts to study the role of IRDA in regulating financial discipline and corporate governance among insurance companies in India.

KEYWORDS : Liberalisation, FDI, Corporate Governance, IRDA

INTRODUCTION :

As a financial service, Insurance is an integral part of national economy and a strong pillar of financial market. Ample of studies suggests that insurance contributes materially to economic growth by improving the investment climate and promoting a more efficient mix of activities that would be undertaken in the absence of risk management instruments (Tapen Sinha 2004). Insurance serves a number of valuable economic functions that are largely distinct from the functions served by other types of financial intermediaries. United Nations Conference on Trade and Development (UNCTAD) pronounced that a sound insurance and re-insurance market is an essential characteristic of economic growth.

Corporate Governance is a system in which companies are directed and controlled. It encompasses the means by which the board and senior management are held accountable and responsible for their actions and includes corporate discipline, transparency, Independence, accountability, responsibility, fairness and social responsibility. The presence of an effective corporate governance system helps to provide a degree of confidence that is for the proper functioning of a market and economic growth. Good Corporate Governance in the insurance sector requires a set of comprehensive internal control procedures and policies established by board of directs and implemented by skilled personnel led by effective management.

In the era of globalisation and massive cross border flow of capital, accounting and financial reporting plays a major role to attain corporate governance. The quality of accounting and financial reporting is constantly evolving in response to informational needs, expectations and demands of financial users. Fairness in accounting is an indication of good corporate governance. In India a set of principles called Generally Accepted Accounting Principles (GAAP) guide the accounting professionals in preparing accounting and financial reports. However to meet the changing requirements, India has set a road map for convergence with International Financial Reporting Standard (IFRS) commencing from 1st April 2011.The Indian insurance companies are required to comply with the requirements of the IRDA regulations in preparing and presenting their financial reports. As insurance is a long term contract it has to create continuous trust and confidence in policy holders or customers. The Insurance Regulatory (IRDA) has the responsibility to protect the interest of the policyholder and so it demands that insurers to have good Governance practices for maintenance of Solvency Margin, Sound long term investment policy and assumption of underwriting risks on a prudential basis.

OBJECTIVES OF THE STUDY

To study the significance of Corporate Governance in insurance companies
To analyse the efficiency of IRDA in Regulating and Governing insurance companies operating in India.

RESEARCH METHODOLOGY

The study is done based on primary data and secondary data. The Required information has been collected from the annual reports published by IRDA and insurance journals. The primary data has been collected through Questionnaire from insurance executives. The sample size is 120. Out of that 80 officials are from public insurance companies and 40 officials are from private life insurance companies having branches in Karnataka. The questionnaire was prepared on 'Likert scale' basis to get information about the functions and responsibilities of IRDA. The study is confined to life insurance companies operating in India. The data collected are tabulated and analysed by using percentages, Mean Score and Standard Deviation.

INSURANCE INDUSTRY IN INDIA- AN OVERVIEW

The Indian insurance industry is more than 150 years old. It has witnessed many phases of the working from the days when there were many private sector companies initially and then moved to nationalisation and again to the private sector. There is a remarkable improvement in the Indian insurance business soon after the liberalisation of insurance sector. The Indian insurance industry was opened for private insurers in the year 1999, with the enforcement and establishment of industrial regulatory and development authority Act (IRDA). The private players are allowed to register in collaboration with foreign partners, again foreign partners permitted to have an equity capital of 26% (now it is increased to 49%).

Milestones in insurance reforms in India:

1956 - Nationalization of insurance industry and establishment of LIC.
1957 – Framing of a code of conduct by the general insurance council to ensure fair conduct and ethical business practice.
1972- Nationalization of general insurance. Establishment of GIC with four subsidiaries.
1991 – Beginning of economic liberalization.
1993 – Malhotra committee set up to complement the reforms initiated in the financial sector.
1999 – Insurance Regulatory and Development Authority (IRDA) bill passed in parliament
2000 – IRDA incorporated as the statutory body to regulate and register private sector insurance companies.

INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY (IRDA):

Insurance Regulatory and Development Authority (IRDA) is a statutory body set up for protecting the interests of the policyholders and regulating, promoting and ensuring orderly growth of the insurance industry in India. Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA opened up the market in August 2000 for private players with the invitation for registrations. The entry of private players with FDI has led to tremendous changes in Indian life insurance industry. Since opening up, the number of participants in the industry has gone up from seven insurers in the year 2000 to 52 insurers in 2015, operating in the life, non-life and re-insurance segments. As at the end of September 2015, there are 24 life insurance companies operating in India, of which one is LIC the state owned Life Insurance Corporation and the remaining 23 are in private sector. The increase in the Number of insurance companies has brought many changes and challenges in the industry.

The insurance laws (Amendment) Act 2015 and hike in FDI cap from 26% to 49% is a second stage reforms in insurance sector. The Act is aimed to allow insurance companies to generate capital and to generate resources for business. The life insurance industry is capital intensive, and insurers are required to infuse capital at regular intervals to meet the expenses like, training costs for development of the distribution channels, creating niche market, expansion of branches and other developmental activities. The experience of the insurance markets globally indicates that companies in the life sector take seven to ten years to break-even .Against this backdrop there was a huge demand from private insurers to hike FDI cap from 26% to 49%, and it was approved by the Government by the enactment of Insurance laws (amendment) Act 2015. The Act will also enable empowering IRDA to regulate key aspects like solvency, Investment structure, operational expenses and commissions of insurance companies.

FINANCIAL REPORTING AND CORPORATE GOVERNANCE – Guidelines:

The Companies Act 1956 provides the basic requirements relating to financial reporting of all companies incorporated in India. The companies Act requires the preparation, presentation, publication and disclosure of financial statements and an audit of all companies by a member in practice certified by the Institute of Chartered Accountants of India (ICAI). Schedule VI to the Act prescribes the form, content and minimum disclosure requirement of financial statements. The Insurance Regulatory and Development Authority (IRDA) regulates’ the financial reporting practices of insurance companies under the IRDA Act.

All insurance companies are required to appoint two firms of auditors for a period of four years. The firms are selected from the list of approved auditors maintained by IRDA. Section 11 (1) of the insurance Act, 1938 states that every insurer shall at the end of each financial year prepare the given statements.

•A balance sheet in the forms set forth in part11 of the first schedule and in accordance with the regulations contained in part1 of that schedule.

•In respect of each class of subclass of business, insurer is required to keep separate accounts of receipts and payments, a revenue account in accordance with the regulations contained in part1 and in the forms set forth in part11 of the third schedule applicable to that class or sub class of business.

•In case of life insurance, Revenue account has to be prepared in the form D specified by the Act. The difference in the revenue account that is profit to be named as Life Assurance Fund.

Like any other industry, insurance is also prone to the risk of fraud. Insurance frauds are very diverse and they occur in all areas and stages of insurance. With the privatization and increased competition, underwriting has taken a backstage. Increase in non-medical scheme limits and waiving of financials, the relaxation of processes have opened the gates to fraudulent claims. To protect the interest of policyholders and the stakeholders the Insurance Regulatory body (IRDA) has taken many initiatives through corporate governance guidelines.

Financial Reporting and Actuarial Standards are strengthened by the additional measures which were taken by the Authority to improve transparency and disclosures in reporting the financial statement. Effective from the financial year 2008-09 onwards, all insurers have been advised to file details of penal actions taken by various Government authorities. The said information is required to be duly certified by the Statutory Auditor of the insurer.

The Insurance Regulatory and Development Authority (IRDA) has introduced corporate Governance guidelines for insurance companies. The objective of the guidelines is to ensure that the structure, responsibilities and functions of the board of directors and senior management of the company recognize the expectations of all stakeholders as well as those of the Regulator. The success in bringing the company under the corporate governance will largely depend on the real commitment, dedication and sincerity of the board. The duties and responsibilities to be performed by the Board of Directors are—

•Always act in good faith with accountability, transparency and disclosure in conducting business.

•Always make decision on a fully informed basis with prudence and without any conflict of interest.
•Always act in fairness and equity to policyholders and stakeholders.
•Setting goal, objectives and strategic business plan for the company in the interest of policy holders and stakeholders.
•Ensure that the company is well equipped with audit system to ensure compliances with the laws, rules and regulations

The Board can establish several committees to undertake specific functions depending on the size and level of the complexity of the operation. The committees to be formed are—

1.Audit committee
2.Risk management committee
3.Investment committee
4.Asset – Liability management committee
5.Nomination committee
6.Remuneration committee
7.Ethics committee
8.Policyholder protection committee

The Act seeks to regulate the expenses of an insurer. Managers cannot be paid any remuneration by way of commission or bonus or share in profits. There are limits on the commission that may be paid to licensed agents. Insurers are required to transact business from the rural areas and also among the unorganized sector and backward classes. The minimum business requirements from these sectors are prescribed by the IRDA.

Consumer affairs department; Grievance Redressal:

The consumer affairs department of IRDA handles policyholders' grievances, apart from carrying out awareness campaigns on insurance. The department has grievance Redressal cells for life insurance and general insurance. Recently IRDA has provided an alternative channel for prospects and policyholders to lodge complaints with the grievance cells by launching the IRDA Grievance Call Centre (IGCC). The IGCC receives and registers complaints through a toll free number.

The Authority has implemented the Integrated Grievance Management System (IGMS) working on automation of the grievance cell, by which complaints can be registered on line. The automated system also enables on-line verification of status and Redresses of the consumer complaints of both life and nonlife insurance companies. The IRDA has also appointed Ombudsmen. Their function is to resolve complaints in respect of disputes between policyholders and insurers in cost effective, efficient and impartial manner.

RESULTS AND DISCUSSIONS

The opinion of insurance Executives towards the efficiency of IRDA in discharging its functions and responsibilities are collected through Likert Scale Questionnaire and the collected data analysed by the application of Mean score and Standard Deviation.

The study reveals that insurance executives are satisfied with regulatory measures of IRDA towards maintenance of solvency margin and claim settlement process, but they opine that IRDA should protect the interest of the policyholders by strengthening its Corporate Governance policies. As far as Transparency is concerned, Executives are expecting still more measures to strengthen the investment pattern and financial soundness of insurance companies.

Table:
Opinion of insurance executives about that the IRDA is functioning Efficiently in regulating Corporate Governance in insurance business

Sl. No.	Statement	Mean Score	Standard Deviation
a .	Promoting and regulating insurance business	3.78	0.976
b.	Issue of license to agents and brokers	3.73	0.880
c.	Protection of interest of policy holders	3.43	1.226
d.	Improve the market efficiency	3.38	1.277
e.	Regulating solvency margin	3.50	1.112
f.	Promote the stability of financial system	3.32	1.186
g.	Monitoring the claim settlement	3.55	1.141
h.	Administer the safety and soundness of insurers	3.30	1.197
i.	Regulating accounting disclosures (Transparency in insurance business)	3.12	1.296
j.	Meet the corporate social responsibility by rural coverage	3.13	1.291

The mean values and Standard Deviation values shows that IRDA is playing a very significant role in regulating and governing insurance business, however by going through the data it is found that IRDA needs to work more on accounting disclosures and financial soundness of insurance companies. The mean values related to Regulating Accounting Disclosures and Corporate Responsibility are least compared to other variables, which shows that IRDA needs to work more on Accounting Disclosures and CSR to meet the Expectations of the stakeholders.

CONCLUSION:

High quality financial reporting depends not only on having appropriate accounting and auditing standards, but also on a proper monitoring and enforcement mechanism. Top management need to make necessary arrangements for ensuring that financial statements are prepared in compliance with the applicable accounting and financial reporting requirements. Again, Auditors need to be independent and competent for ensuring that auditing is conducted in compliance with the applicable auditing standards. Thus the ultimate goal of Corporate Governance is to enhance investors' confidence, to improve financial soundness, encouraging disclosures and transparency, strengthen internal controls and improve risk management. As the policyholders are investing their savings in long term plans of insurance companies, the regulator, IRDA has greater responsibility to ensure the smooth functioning and consistent growth of insurance sector through the formulation of suitable regulations and policies.

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