Corporate Governance

IRDA guidance to the insurance players

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Foreword

31st August 2009

It gives me immense pleasure in sharing our thoughts on designing and implementing good governance practices in the Insurance sector. The recent guidance from IRDA on Corporate Governance highlights the fact that the Indian Insurance industry has come of age especially good governance practices which will now be at the center stage of business strategy going ahead. The guidelines are comprehensive with mandatory and non-mandatory clauses with the intent of briniging the sector closer to "best in class" governance practices and setting up the stage for the public listing of Insurance companies in India.

This paper highlights the key aspects emanating from the recent IRDA guidance and focussed industry reactions on the guidelines with a suggested implementation road map. We would be delighted to have your views and feedback to make this a evolving process until the guidelines move into a implementation mode in the next few months.

Kind regards,

Sunil Sharma
Chief Executive Officer

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Background

From as early as 1947 to date, the insurance industry has gone through several reforms in the form of liberalization and nationalization. With the formation of The Insurance Regulatory & Development Authority (IRDA), passing of the insurance act, and passing of various reforms, this industry has become competitive and continues to attract interest from foreign countries. The insurance industry in India has grown at a staggering rate of 16% on a year on year basis. However, the recent economic recession has affected this industry. The insurance penetration 4.7 and density 46.6 has steadily grown over last years but still remains a far cry in comparison to developed nations. Indian insurance penetration and density compared with other developed and developing nations is as under :

Country	Penetration#	Density#
Developed Countries		
United States	8.90	4086.5
United Kingdom	15.70	7113.7
Japan	9.60	3319.9
Developing Countries		
Brazil	3.00	202.2
Russia	2.40	209.4
India	**4.70**	**46.6**
PR China	2.90	69.9
World	**7.50**	**607.7**

#*Source*: IRDA, *Penetration is measured as a ratio in per cent of premium* (*in* USD) *to* GDP (*in* USD) *and Density is measured as a ratio of premium* (*in* USD) *to population*.

The IRDA is established to protect the interests of the policyholders, to regulate, promote and ensure orderly growth of the insurance industry. The IRDA has issued Guidelines on Corporate Governance dated August 5, 2009 addressing comprehensively governance framework, structure, responsibilities and requirements for insurance companies. These guidelines are in addition to the requirements of Companies Act, 1956, Insurance Act 1938 and rules/regulations framed under them. The emergence of Insurance Companies as a part of financial conglomerates and as a key player in the financial sector has added an additional emphasis on the need for good governance practices to be followed by the insurers to protect the interests of the policy holders and other stakeholders. **The key objective of the guidelines is to ensure that structure, responsibilities and functions of the Board of Directors and the senior management of the insurance company fully recognize the expectations of all stakeholders as well as those of the regulator.**

The Governance Building Blocks

Some of the components of good corporate governance for insurance companies include:

- Governance Structure
- Board of Directors – Structure and Responsibilities
- Control Functions
- Senior Management Functions and Responsibilities
- Disclosures
- Oversight on Outsourcing Activities
- Relationship with the Regulator
- Interaction with Supervisor
- Whistle Blowing Policy

Key steps to be taken by insurers

Some of the key steps to be taken in achieving compliance with the guidelines are:

- Formulation (and effective operation) of long-term strategic business policies including investment policies, underwriting policies, re-insurance policies etc.
- Formulation (and effective operation) of risk taking, risk identification, risk measurement, assessment and management policies within the overall risk appetite and risk profile of the insurer.
- Formulation (and effective operation) of standardised operational procedures for all the key operations of insurance business.
- Formulation (and effective operation) of mandatory and non-mandatory committees with appropriate terms of reference, roles and responsibilities. Mandatory committees include Audit Committee, Investment Committee, Risk Management Committee, Assets Liabilities Management Committee and Policyholder Protection Committee. Non-mandatory committees include Remuneration Committee, Ethics Committee and Nomination Committee.
- Formulation (and effective operation) of Management Information System for reporting to the Board of Directors and its committees key business issues and reporting events for appropriate decision making and actions.

- Formulation (and effective operation) of Business Continuity Planning, Crisis Management and Disaster Recovery Planning.
- Demonstrating Data Confidentiality and Integrity for outsourced operations.
- Formulation (and effective operation) of standards of business conduct and ethical behaviour and standards for servicing and redressing the grievances of policy holders.
- Formulation (and effective operation) of internal control systems (including IT, Information Security & Data Protection Controls) relating to key business operations
- Assessment by the Board of Directors of design effectiveness and operating effectiveness of internal control systems including operational, financial reporting and compliance related internal controls.
- Independent audit of design and operating effectiveness of internal controls systems including operational, financial reporting and compliance related internal controls. reporting and compliance related internal controls.

Industry Insights:

The guidelines have been welcomed by the insurance players stating that they are forward looking, timely and comprehensive given the backdrop of Insurance companies preparing for the public listing once the regulatory road map is finalized. The BDO Haribhakti team interviewed representatives from Tata AIG General Insurance and Birla Sun Life to seek their feedback and views on the recent IRDA guidelines on Corporate Governance. The extracts of the conversation are presented hereunder:

First thoughts:

The guidelines could have been broader to include specific aspects such as "Stress Test" in respect of risks, solvency and capital requirement as pronounced by the International Association of Insurance Supervisors and Organization for Economic Cooperation and Development (OECD) – July 2009 noted **Mr. Vijay Pandit**, Head Internal Audit, Tata AIG General Insurance Co. Ltd in his reactions.

There has been a rapid expansion in the Insurance domain. This is coupled with stringent regulatory norms. Though Insurance companies are still in the initial years, the need for business continuity preparedness cannot be undermined. Companies need to have a robust PDCA (Plan Do Check Action) approach to the business continuity embedded in the business culture stated **Mr. Lalit Vermani**, Vice President, Compliance Risk and Internal Audit, Birla Sun Life Insurance.

Implementation Impediments – Controls over Outsourced Operations

Implementing the stringent data protection controls could be a challenge as the insurance industry works with variety of vendors. Data Protection (Privacy) risks related to outsourcing in insurance industry should be guarded by the terms of contract and should also be supplemented by regular independent audits of the vendors. Further, in coming years Industry needs to address the challenge in respect of sufficient availability of independent directors with requisite industry experience, especially when companies go public to ensure minimum number of independent directors as per clause 49 stated Mr. Vijay Pandit, Head Internal Audit, Tata AIG General Insurance Co. Ltd.

The guidelines in reference to Outsourcing clauses are a challenge to implement as well as instituting data privacy measures for outsourced vendors. Data protection is a key business risks especially if the process has been outsourced. Vendor risk assessment should be conducted prior to going live to make sure that the vendor has appropriate data protection procedure. Vendor review and audit at the pre defined timelines with specific focus on data protection said Mr. Lalit Vermani, Vice President, Compliance Risk and Internal Audit, Birla Sun Life Insurance.

Globally data privacy and information security have emerged as major risk factors for various businesses and since these risks go beyond the internal information chain of any organization it is important that the information security controls are implemented in the extended information chain i.e. at the premises of the vendors. Generally vendors resist multiple third party control assessments as they deal with number of clients and this resistance perhaps weakens the resolve to implement information security best practices in the extended information chain therefore there could be a case of promoting Shared Assessments in the Insurance industry as Controls over outsourced work appears as a major implementation impediment in India. Shared Assessments are in vogue in the Banking and financial services industry in developed economies said **Mr. Huzeifa Unwala**, National Leader, Risk Advisory Services, BDO Haribhakti. He also suggested that the Insurance industry could reduce their compliance costs through such a collaborative approach.

Implementation Road Map

A complete Roadmap for two and half years need to be drawn up and resolved at the Board level for implementing a comprehensive internal controls system in the lines of Clause 49 of the listing agreement. The timelines would obviously depend upon the deadlines determined for listing in Indian stock exchanges. A steering committee of executive management formed for overseeing the progress and timelines of implementation with periodic reporting to the Board would be helpful said Mr. Vijay Pandit, Head Internal Audit, Tata AIG General Insurance Co. Ltd

One of better approaches of validating the internal control design and effectiveness is to have a robust operational risk management framework in lines with the Solvency II. Key components such as Risk control self assessment reporting to the board would ensure that the gaps in the control design or effectiveness are proactively addressed and managed suggested Mr. Lalit Vermani, Vice President, Compliance Risk and Internal Audit, Birla Sun Life Insurance.

BDO's suggested approach

Phase 1

Current State Assessment: To assess the current state of governance processes and internal control systems.

Phase 2

Governance and Compliance Roadmap: To develop key policies and procedures, and a high-level strategic Governance and Compliance Roadmap plan for the initiatives to be implemented over the next 6 months.

Phase 3

Implementation of Governance Controls and Policies: The Senior Management should develop Roles and Responsibilities for implementing various policies and internal controls, and should implement these policies and controls in a given time frame.

Phase 4

Operate and Monitor: Annual plan should be made to review the governance framework, strategic and governance policies, and internal control systems. Annual assessment of design and operating effectiveness of internal control systems should be conducted by the Board of Directors as well as by internal auditors independently.

Implementing Guidelines on Corporate Governance for Insurance Companies

Phase 1 – Current State Assessment	Phase 2 – Governance and Compliance Roadmap	Phase 3 – Implementation of Governance Controls and Policies	Phase 4 – Operate & Monitor
Key Steps			
1.1 Understand the existing framework of internal controls and governance 1.2 Assess all the legal and compliance requirements 1.3 Assess the application of components of Corporate Governance as applicable to Insurance Companies 1.4 Benchmark the existing framework and internal controls against: > Clause 49 of Listing Agreement > IRDA Guidelines for Implementing Corporate Governance	2.1 Develop a strategic level Governance and Compliance Roadmap of policies to be implemented and time-frame 2.2 Design the policies and operational procedures in following areas: > Strategic Business Policies including investment and underwriting policies > Governance Policies including Risk Management and Internal Control policies > Charters and terms of reference for all the mandatory and non-mandatory committees > Management Information and Reporting Systems for reporting to Board of Directors	3.1 Strategic business, Governance and Internal Control policies need to be implemented by Management as per the decided time frame 3.2 Determine the roles and responsibilities for implementing different policies and procedures	4.1 Review compliance with the Strategic and Governance policies and procedures annually 4.2 Review the governance framework including Strategic Business policies /procedures and Governance (including internal controls) Policies/ procedures annually 4.3 Assessment by the Board of Directors of the design and operating effectiveness of internal control systems 4.4 Independent assessment by the Internal Auditors of the design and operating effectiveness of internal control systems
Outcomes Orientation			
> Current State Assessment Report	> Governance and Compliance Roadmap plan for 6 months	> Roles and responsibilities for implementing and operating Strategic and Governance Policies/ Procedures	> Review Reports > Audit Reports > Assessment Reports

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- Sincerity and Integrity
- Accountability
- Building strong & sustainable relationships
- Mutual support

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