International best practices to increase insurance penetration and risk management in India

Contents

Foreword 3

Executive Summary 4

Introduction 8

3. What do policyholders want 9

3.1 Freedom in pricing 10

3.2 Freedom in policy wordings 11

3.3 Freedom in deductibles and loss limits 11

3.4 Flexibility in policy tenure 12

3.5 Enhancing policyholders claims experience 12

3.6 Policyholders need financial solution, not just an insurance product 13

3.7 Allowing captives 14

3.8 Premium financing 14

4.Creating resilience in Indian insurance markets 16

4.1 Risk based solvency for enhanced risk management 17

4.2 Policyholder needs insurance market stability: Adequate protection of insurer through defining minimum Cat XL purchase limits 17

4.3 Strengthening reinsurance 18

4.3.1 Restriction on cession limits to avoid 18

4.4 Promoting alternative risk transfer solutions to increase insurance penetration & narrowing protection gaps against NAT CAT disasters 19

Annexure – Insurance penetration data for selected countries 21

Foreword

The World Bank India Development Update report 2023, stated that in the first half of FY 2023, India has emerged as the 5th largest economy of the world in terms of GDP. The report also states that the Indian economy has shown remarkable "Resilience" in the face of an uncertain and adverse external environment. This is because of the strong economic fundamentals that have underpinned the Indian growth story. It is being predicted that India is poised to grow at over 6 %, and is likely to continue as one of the world's fastest growing economies. Four key factors that are driving the India growth story are Demographics (India has one of the youngest populations), Decarbonization (Alternate energy initiatives), Digitization, and Demand (both Domestic and International).

Insurance activity, both as a provider of Risk transfer mechanisms, and as an Institutional Investor is a Facilitator and Key contributor to the economic growth of Organisations and the nation as a whole. Insurance Industry facilitates financial stability by mobilizing domestic savings, facilitating Trade and Commerce, accumulation, and utilisation of new Capital, while providing much needed liquidity in the financial system. This shows a strong causal relationship between Insurance activity and economic growth.

The positive outlook for the Indian economy, is reflected in the road map laid out by the Insurance Regulatory and Development Authority of India (IRDAI), the focus being "Insurance for all" by 2047.

National Insurance Academy, the eminent incubator of talent and thought leader in the Indian insurance industry, collaborated with RIMS, which is body of insurance and risk professionals from all over the world, on this report. We aim to share the best practices from matured insurance markets which are valued by customers and will help the Indian insurance industry reach its next phase of growth through this report.

As the Authority focuses on doubling insurance penetration within the country, this report, which provides global benchmarks on proven insurance practices, is timely, and is the need of the hour.

The report also discusses critical aspects like understanding the changed needs of the policy holder, enhancement of customer experiences, seamless Claim settlements, the emerging Industry requirement for Captives, Premium Financing, reinsurance and introduction of risk based solvency management practices.

Adoption of New Technologies like AI, Cloud based technologies, net based services is the current imperative. Moving from creating and marketing "one size fits all" generic products to "Bespoke " tailored to fit agreements, products, and services, will help the insurers match customer needs and aspirations.

Keeping in mind the current optimistic economic scenario, the time is ripe for introducing changes in both Life and General insurance industries that will provide choice and option to the policyholder and lead to growth in the industry.

On behalf of NIA and RIMS, we would like to thank all the Insurance and Risk professionals who contributed to this benchmark study on Insurance and Risk management, which will be useful, both in India and across the Globe.

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Executive Summary

The Indian Insurance market (including life and non-life) has grown significantly in recent years with a compounded annual growth rate of around 13% over seven years. Allowing Use and File and the rollout of government health insurance and crop insurance schemes has helped the market move towards its next stage of growth.

For us to reach this stage, the industry needs to realize its true potential in terms of insurance penetration. Identifying the needs of policyholders and developing a resilient insurance market which can meet these needs will help us boost insurance penetration.

This report focusses on the above two aspects based on our discussions with Senior Industry Experts and have analyzed the best practices which help in the growth of insurance penetration from selected global insurance markets.

This analysis considers best practices from the following select insurance markets – Australia, United Kingdom (UK), France, Singapore, United States of America (USA), China, Hong Kong, United Arab Emirates (UAE), Spain and Germany.

Best Practice	How it helps insurance penetration and/or policyholder?[1]	Global Benchmarks	Current Scenario in Indian Insurance Market
Freedom in Pricing	Increases affordability through competitive pricing reflecting policyholders' own loss experience and risk management practices.	Allowed in all 10 (Australia, UK, France, Singapore, US, China, Hong Kong, UAE, Spain and Germany) out of 10 markets.	Pricing in some lines of business-like fire remains fixed due to conditions imposed in reinsurance treaties.
Freedom in Policy wordings	Provides policyholders with insurance coverages which are need-based and aligned to their risk profile.	Allowed in 9 (Australia, UK, France, Singapore, China, Hong Kong, UAE, Spain and Germany) out of 10 markets.	The insurers do not have freedom in issuing customized policy wordings. Enabling insurers to customize the policy wordings in accordance to the Risk profile would encourage Product innovation and will meet the customer needs.
Freedom in deductibles and loss limits	Helps policyholders balance risk retention and transfer to optimize their insurance policy by choosing deductibles and limits which are suitable for their business.	Allowed in 9 (Australia, UK, US, Singapore, China, Hong Kong, UAE, Spain and Germany) out of 10 markets.	Majority of commercial policyholders, whose sum insured is lower than $350 million at a single location cannot have loss limit-based policies or increase their deductibles which would reduce their overall insurance cost.
Flexibility in policy tenure	Access to short term insurance policies (such as temporary medical coverage) or long term policies for projects cater to specific needs of policyholders.	Allowed in 8 (Australia, UK, Singapore, China, Hong Kong, UAE, Spain, Germany) out of 8 markets.[2]	Currently in India, non-life insurance policies are issued for a minimum period of one year. For motor insurance covers, longer term polices for up to 3/5 years are available. Project Polices can also be issued for a longer tenure (depends on the project period).

[1] Source: AXCO data, Internal analysis

[2] Analysis not available for Spain and Germany

Seamless claims experience	Helps reduce the trust deficit among policyholders through a transparent, timely and fair settlement of claims.	Allowed in 7 (Australia, UK, Singapore, China, Hong Kong, Spain and Germany) out of 10 markets.	There is strong need for simplification/ standardization of claims process, would improve the claims settlement time and also bring transparency.Delays in complex / large claims needs to be addressed.
Availability of end-to-end insurance solutions	Provide access to seamless end-to-end solutions for policyholders making insurance purchase easier.	Allowed in 4 (Australia, UK, France, Hong Kong, Spain) out of 8 markets.[3]	Insurance brokers are allowed to sell insurance products only while other financial intermediaries are allowed a wider gamut of products including insurance.
Allowing Captives	Helps in reducing the overall insurance cost for policyholders, protecting their cashflow and providing access to insurance coverages which are not available in the commercial market.	Allowed in 8 (Australia, UK, US, China, Singapore, UAE[4], Hong Kong, Germany) out of 10 markets.	Currently there is no law allowing the formation of captives in India.
Premium Financing	Increases affordability of insurance for policyholders, especially those in the MSME sector.	Allowed in 5 (Australia, France, Singapore, US) out of 7 markets.[5]	Premium financing is not explicitly allowed under the current insurance regulations; however, the same is allowed under regulatory sandbox.
Risk based Solvency	Enhances the financial soundness of insurers in India. Under this regime the capital requirements is estimated based on the risk exposures (Including Risk Appetite). It also incentives risk mitigation & Product Diversification).	Exists in 8 (Australia, UK, France, Singapore, China, UAE, Spain and Germany) out of 9 markets.[6]	Insurance companies in india needs to maintain a solvency ratio of 1.5 times - Available Solvency Margin/ Required Solvency Margin.

[3]Analysis not available for UAE and Germany

[4]Allowed in Dubai International Finance Centre (DIFC) in Dubai

[5]Analysis not available for Hong Kong, UAE, Spain and Germany

[6]States may have their own capital and surplus requirements in the US; in Hong Kong, there are legislative proposals underway for introducing a risk based capital regime.

Minimum CAT XL purchase limits	Improves the stability of Insurance market by ensuring that insurance companies have adequate protection to cover catastrophic losses.	Global rating agencies recognize minimum level of purchase.	No minimum level of purchase mandated as per regulations.
Option for Alternative Risk Transfer Solutions	Provides a viable and financially sound tool for post-disaster recovery and helps in bridging the insurance protection gap.	Offered in 6 (Australia, US, UK, Singapore, China and Germany) out of 7 markets[8].	Alternative risk transfer solutions are recognized by regulator but limited solutions currently in place.

[7]Analysis not available for Spain.

[8]Analysis not available for UAE, Spain and France

Introduction

Through this report, we aim to highlight the best practices followed in matured insurance markets, which are characterized by high penetration and are valued by commercial policyholders. Using inputs from risk managers and other members of the RIMS in India and insurance fraternity, our report discusses the Indian insurance market in the present context and offers benchmark based on the global best practices that could be implemented for Corporate / commercial policyholders in India.

The report discusses global benchmarks, which widely prevalent globally, are fundamentally good for Policy Holder and will drive high insurance penetration and reduce Protection Gap.

Growth of insurance in India

The insurance business has existed in India for more than 200 years. However, the sector witnessed real growth since it was opened up in the year 2000. Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry in April 2020.

The IRDAI opened up the market in August 2000 with the invitation for application for registrations from private insurers. Foreign companies or insurers were allowed ownership of up to 26% at the time and today, foreign insurance companies can own up to 74% stake in India. While insurance intermediaries can own upto 100% stake in its Indian arm.

Over the last two decades, the Indian insurance industry has witnessed steady growth at a CAGR of 17%, led by substantial investment in capital, improvement in capabilities, and efficiency and distribution system. Today, the industry comprises 58 insurance companies, including 34 non-life insurers (25 general insurers, 7 standalone health, 2 specialized insurers).

In terms of size, Indian insurance market stands at $131 billion as of FY22 and is expected to reach $222 billion by FY26, driven by the growing middle class and increasing digital access, according to a report by homegrown consultancy firm, Redseer.

India is ranked 11th in global insurance business. India's share in global insurance market was 1.72% during 2020 and total insurance premium volume in India increased by 0.1% India's insurance penetration was pegged at 4.2% in FY21 (from 3.76% in 2019-20), with life insurance penetration at 3.2% and non-life insurance penetration at 1%.

The Non-Life industry

With India being one of the most under-penetrated market for non-life insurance, there is huge potential to grow. According to IRDAI data, the non-life insurance industry's premium collection rose 11% on a year-on-year basis to INR 2.20 trillion in 2021-22, compared to INR 1.98 trillion a year ago. According to various market estimates, the Indian general insurance market is expected to grow by 15-17% over the next 3-5 years.

The growth of the insurance market is being supported by important government initiatives, strong democratic factors, conducive regulatory environment, increased partnerships, product innovations, and vibrant distribution channels. The increase in the FDI in Insurance from 49% to 74% announced in the Union Budget (Feb'21) shall further help in driving increased penetration and coverage by enabling additional avenues for capital support required for the expansion of the insurance industry in India.

The recent pandemic has emphasized the importance of healthcare on the economy, and health insurance would play a critical role in the effort to strengthen the healthcare ecosystem.

The other important factors driving the growth of the insurance market are factors like India's favorable demographics, with 68% of its population being young and 55% of the population in the age group of 20-59 (working population) in the year 2020, which is estimated to reach 56% of the total population by 2025. These point towards a young insurable population in India. Additionally, India will add 140 million middle-income and 21 million high-income households which will drive the demand and growth of Indian insurance sector. Lastly, digital behavior patterns, will also play a role in this growth. Given the demographic advantages, a large section of the population and customers are now starting to prefer digital modes for their insurance needs. Reports indicate that around 73% of customers preferred the online mode for general insurance products in 2020. Agents' ease with digital tools has also grown, with 63% of agents comfortable with video-calling clients and more than 50% open to virtual renewals. With India being the 2nd largest in the world in terms of internet users and expected to touch one billion internet users by 2026, these trends are only like go up.

The creation of value for the policyholder lies at the core of the insurance business. The changing insurance landscape demands for innovation from insurance market participants on various aspects like freedom in pricing & policy wordings, claims management, Technology platforms etc. which can benefit the policyholders in terms of contract certainty, increased efficiency, and transparency in the claims management process.

3

What do policyholders want

With the rise of the digital economy, the risks faced by policyholders are changing. The creation of innovative solutions which keep pace with emerging risks is the need of the hour. Competitive pricing is no longer the only criterion for policyholders due to a growing emphasis on the quality-of-service offerings and add-ons.

In this report, we have tried to look into some of the most mature and developed insurance markets and tried to analyze how India is placed on different aspects which would impact policyholders' interests. While analyzing countries like the US, UK, France, Australia, Singapore, China, Hong Kong, and UAE, we have seen most of the markets are pro-policyholders and allow considerable freedom, and flexibility to customers and insurers. The insurance intermediaries are also more like risk advisors as the regulations played a key role in building trust factor between policyholders, insurers, and brokers.

Let us look at some of these aspects which are crucial for developing a policyholder centric insurance market in India.

Ensuring competitive market and fair price discovery

Over the years, since the insurance sector was opened up in 2001, the regulator, the IRDAI has played a key role in its growth and development. However, the insurance penetration, particularly for the general insurance market is still low at 1%.

Considering this, the main focus of all the industry stakeholders should be to increase insurance penetration in the country and make simple and affordable insurance products available to the masses which will reduce the existing protection gap. So in order to develop a policyholder-centric insurance market, we should first understand what are the needs of policyholders. This can be summarised into following categories:

- Freedom in Pricing
- Freedom in deductibles and loss limits
- Freedom in Policy Wordings
- Flexibility in policy term period
- Enhancing Policyholders Claims Experience
- Customers need Solutions and Not products
- Allowing Captives
- Premium Financing

3.1 Freedom in pricing

In a bid to allow greater competition and growth, the IRDAI in 2007-08 allowed price de-tariffication. This was a major reform in line with the global best practices that helped increase insurance penetration rapidly at an affordable cost in the last decade. This change also brought in efficiency, and incentivized improved risk management practices, while eliminating the "pass-back" with flexible and competitive premium pricing.

In 2019, the national reinsurer prescribed a minimum mandatory re-insurance price for the insurers to cede their risk (for FLEXA perils) in the treaty. This effectively brought back the fixed pricing regime in the property insurance market for fire insurance policies.

This kind of arrangement has several disadvantages:

- This disincentivizes prudent risk management practice. Without any price differentiation, all the risks under the same occupancy will attract the same rates, policyholders would no longer be incentivized to invest in proactive risk management.
- Economic Loss: This may lead to an overall increase in the economic loss for the country as claims may go up. Without prudent risk management practice, total claims and insured loss is likely to go up.
- Impact on risk underwriting skills: With uniform pricing, the premiums are likely to remain the same irrespective of the policyholder's risk portfolio. There will be no incentive for proper risk evaluation and risk underwriting.

Global trends:

In terms of implementing tariff for property lines, it is observed that almost all the mature markets like UK, France, China, Australia, Singapore etc., allows freedom to decide the premiums. Only in the US, insurers file property insurance rates for approval on a state-by-state basis.

Recommended global best practices:

- Price competition should be encouraged, and insurers should be allowed to determine the premium rates based on the clients risk profile.
- Insurance companies should use prudent underwriting and Risk based pricing which would allow them to make the portfolio sustainable.
- Reinsurer in India should prescribe the reinsurance rates for treaties in line with international best practices.

3.2 Freedom in policy wordings

Policyholders deserve the best-in-class protection in line with emerging risks and globally competitive market wordings. This is because,

- Inferior and outdated wording which do not provide adequate coverage, act as an impediment to insurance penetration.
- Similarly, for retail products, simple policy wordings which provide the right coverage and clear exclusion in customer-friendly language are also important for policyholders.
- This would also enable for product innovation - designing customized policies I,e, bundling as well as dissecting of risks according to the customer needs.
- The reinsurance Regulation should encourage competitive pricing & adequate support which would help the insurers to absorb more new risks and innovation on policy coverage.
- If we are talking about retail product having simple wording reaching out to general public (presently uninsured), new products of small premium size with wider coverage can be encouraged which can fit into the company's capacity .(Mix & match type products)

Example – small shopkeeper – mixing all his exposures into one single sum insured.

Global trends:

When we look at the developed insurance markets, there is freedom and flexibility about policy wordings where brokers are allowed to design policies, and draft insurance clauses and policy wordings for their clients. Even clients have the flexibility to customize their fire policy wordings based on their risks. In the US there are some restrictions for instance, certain states have statutory fire policy wording. Policies may not contain more restrictive terms than the statutory wording, but otherwise can be customized.

Recommended global best practices:

- There should be freedom and flexibility regarding the policy wordings for all commercial as well as retail policyholders.
- Wordings should be customized as per policyholder need and the type of risks. It would also allow for simplification of products.
- Local policy wordings should be adapted to follow global wordings as much as possible to minimize difference in condition (DIC) situation in local underlayer cover.

3.3 Freedom in deductibles and loss limits

The deductibles and loss limits should be based on the risk of the insured. Under the current regime, policyholders are not getting any freedom to choose limits and deductibles for fire insurance policy.

- Currently in India very large companies having huge property exposure at a single location with a sum insured above $350 million, are allowed to buy re-insurance driven policies, which are often more competitive.
- For many of the corporates, whose sum insured is lower than $350 million at a single place, since 2019, there is no price competition and no freedom with regard to policy wordings and deductibles.
- In a free market, usually deductibles go up significantly reducing losses to insures, improving risk management, and making competitive pricing sustainable.

Global trends:

Globally across all the markets, policies are loss limit based where the policyholder and insurer can mutually decide the loss limits and deductibles for the policy (depending on the risk management practice of the policyholder). Analysis of different market shows, barring France, in all the markets, the corporate/commercial policyholder can choose deductibles for property/fire insurance and get premium differentiation. About loss limits, generally, for corporate or commercial clients fire insurance policies are on loss limit basis, not on a sum insured basis. Only in China, it is mandatorily based on a full sum insured basis.

Recommended global best practices:

- In line with the global best practices, there should be freedom in limits and deductibles. The policyholder and the insurer must mutually decide how much protection to buy.
- Also, policyholders should be allowed to buy limit-based policy. These limits need to be decided based on the risk management and risk evaluation of the policyholders' assets, risk appetite, need and insurer's reinsurance program.

3.4 Flexibility in policy tenure

Flexible policy terms can play an important role in addressing the policyholder specific needs and thus can boost insurance penetration.

- Short-term insurance plans can be instrumental in providing policyholders with temporary medical coverage when outside enrollment periods or when they need some coverage in case of an emergency or for some other reasons.
- Currently in India, non-life insurance policies are issued for a minimum period of one year. For some motor insurance covers, longer term policies for up to 5 years are available for Motor Third Party insurance which is mandatory as per Motor Vehicle Act.

Global trends:

The usual practice is to issue a policy for a one-year period, but short-term policies are available in most markets and insurers have the provision to issue short-term policies if the customer demands for it. For instance, in the US short-term policy is uncommon (though generally not prohibited) for an insurance policy to have a term of fewer than 12 months, however long-term policies are permissible.

Recommended global best practices:

Allow all insurance policies to have flexible tenures. Policyholders should have flexibility to decide on the policy tenure in sync with their needs meeting their short-term and longer-term goals and the insurers should be able to underwrite/design the policy terms accordingly.

This would enable insurers design embedded insurance or parametric insurance / usage-based covers / affinity insurance meeting certain unique needs of the customers.

3.5 Enhancing policyholders claims experience

The primary objective of buying an insurance policy for every policyholder is to get adequate claims at the time of need. Hence, seamless, fair, and timely settlement of a claim is the true test of the insurance contract for a policyholder.

- With Improved Technological Adaption, retail & simple claims are being settled by the insurers within reasonable time , however settlement of large & complex claims in property/ marine and liability line of Business takes longer time due to do differences in the documentation requirements and lack of timely communication.
- In the Indian insurance market, loss adjustors may often take a rigid view in claim settlement and are inflexible on the submission of documents regardless of the insured's challenges in doing so.
- For certain complex and high value claims, a policyholder may feel the need to bring in specialist advisors to help them with the claims settlement process. For such cases, policyholders need complete freedom to engage specialists of their choice to support them through the claims settlement process without any restrictions.
- Embracing the New age Technologies like AI/ ML by the insurers and intermediaries would enable faster & fair claim settlement with transparency for retail claims.
- Complex commercial claims, requires improved competency and upgradation of technical knowledge by insurers and intermediaries.
- Professional competency of the surveyor should be upgraded periodically
- Standardization of Claim settlement process for claims should be introduced.

Global trends:

In our observation, protocols on the settlement of a claim emphasize on ease to the policyholder and loss adjustors are expected to be accommodating when it comes to the document requirement, when certain documents are difficult for the insured to submit.

In most countries like Spain, Germany, Australia, Singapore, China, UK, and Hong Kong, insurance intermediaries are allowed to offer claims consultancy service to policyholders, with some basic conditions related to fair price and conflicts of interest. In the US, there are restrictions in certain states where an insurance adjuster license is required to engage in such activities. Whereas in France, the legal consulting must be performed by lawyers if the client is not a brokerage client.

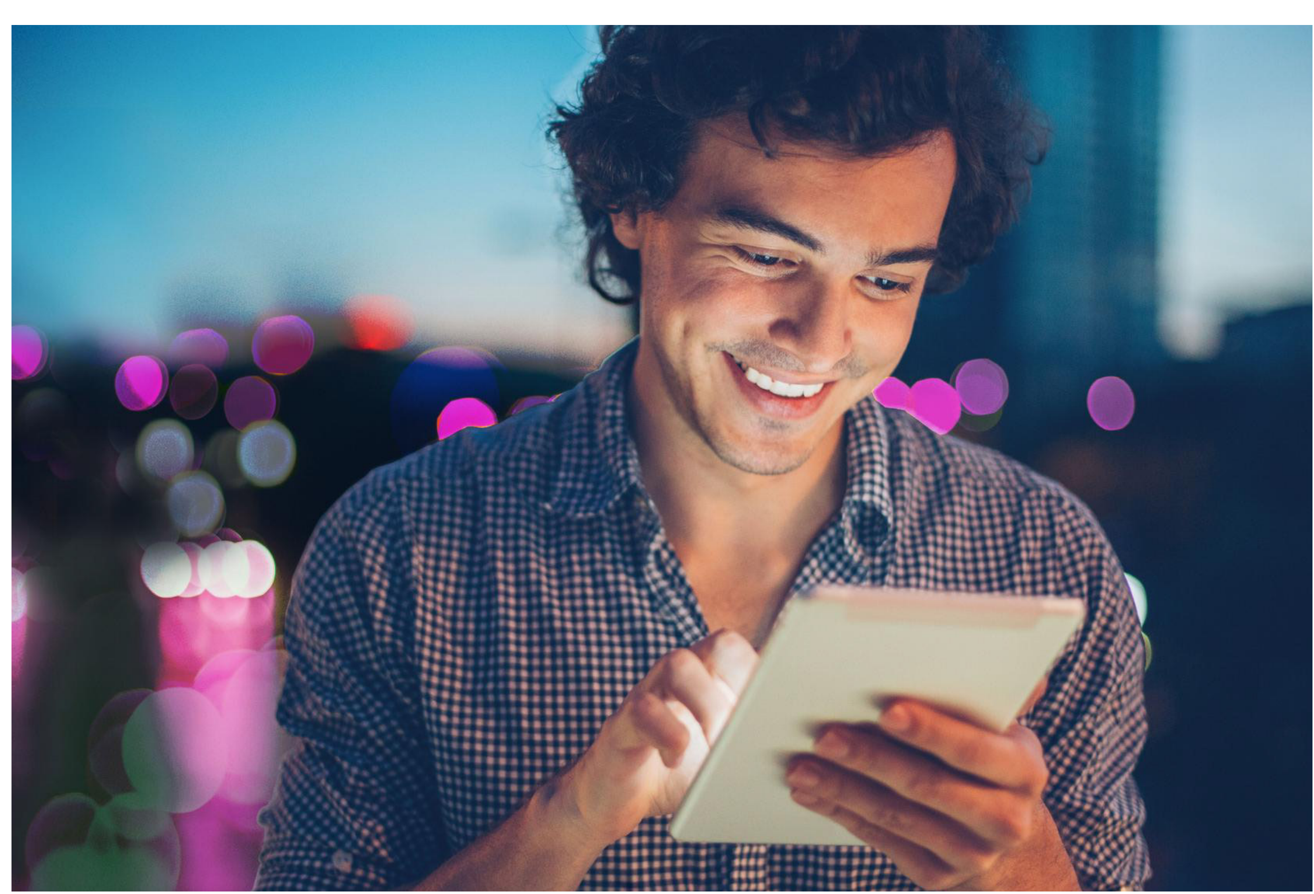
Recommended global best practices:

- Bringing greater ease in document submission.
- Improve transparency and prompt communication throughout the claims settlement process. A regular communication from the insurer and surveyor including the prompt sharing of interim and final survey reports with the insured would significantly improve their overall claims experience.
- Interest on delayed claims: Policyholders should be compensated through a notional interest commensurate to the delay in claims settlement beyond 30 days from the time of document submission.
- Removal of restrictions on claims consultancy: Policyholders should have the freedom to engage qualified experts of their choice to advise them on the resolution of claims irrespective of the claim amount.

3.6 Policyholders need financial solution, not just an insurance product

Pure insurance products can only support customers in the event of a loss. Individuals have different financial needs. If the insurance market participants are allowed to sell holistic financial solutions along with insurance products, it will be far more beneficial to policyholders and future customers.

- Currently, in India financial intermediaries including Agents , IMF & Banks are allowed to sell the entire gamut of Financial products including insurance products However Brokers are allowed to sell only insurance products.
- Allowing market participant to sell various (financial) services for benefit of customers and also making distribution more viable to increase insurance penetration. This would also enhance the professional knowledge of the intermediaries as their exposure become much wider.



Global trends:

In countries like Australia, UK and France insurance brokers are allowed to sell non-insurance products. In US, it is not allowed without holding other relevant licenses. However, closer to home, in Asian countries like Singapore, China, Hong Kong and UAE, insurance brokers are not allowed to sell other financial products.

Recommended global best practices:

- Allow market participants to offer range of financial products. Currently in India roadside assistance could be bundled with motor insurance to support customers after an accident. Similarly like in other markets, this can be replicated for other lines of business like.
- Health insurance providers should be allowed to offer full range of Health risk management services to help policyholders and insurers reduce claims by bringing diagnostic, wellness and other services. Their remuneration is allowed from client, health vendors or insurers.
- Home Insurance: Bundling home insurance with ancillary services such as plumbing, electrical or carpentry would be a big help for homeowners, especially in the event of a loss.
- Cyber Insurance: Offering subscription to an anti-virus application with cyber insurance would help retail customers who are increasingly using digital mediums for managing their work as well as their household needs.

3.7 Allowing captives

- Captives are entities that help commercial policyholders lower their cost of risk and insurance through specialized legal entities which reside within the policyholder's organization. The current regulatory landscape in India in unclear on whether organizations can set up their own captives. Captives has its own benefits: A captive can expand its book of business by offering insurance to related third parties, such as franchisees, vendors or customers thereby increasing insurance penetration.
- Additionally, it would also expand the gamut of coverages available to commercial policyholders.
- Helps in reducing the overall insurance cost for policyholders, protecting their cashflow and providing access to insurance coverages which are not available in the commercial market.

Global trends:

Captives are used extensively throughout the world including the developed insurance markers like the United States, the United Kingdom, Australia, Singapore etc. Recently, considerable interest has been evident in Latin America, and in Asia Pacific, particularly from Japan and China.

Recommended global best practices:

Explicitly allowing captives and setting up a framework which will enable commercial policyholders to set up captives.

- Ideally Captives are established to take care of the low and moderate level risk exposures (insurance needs) of the large corporates, and they can also reach out to the reinsurers for XL protection for large risks exposures. This would enable developing additional risk capacity in the market and also help the corporates understand their risk behaviours and loss experiences which would also enable them to develop appropriate risk mitigation measures. This would eventually enable to build resilient corporates and community.

3.8 Premium financing

Post COVID-19, the insurance premiums, particularly for property lines of business have gone up considerably. In addition to this, most organizations have a significant outlay for managing employee benefits programs, spend on insurance for a mid-size to large corporate can be significant and may impact cash flow if not managed properly. Considering this, Premium Financing can be highly beneficial:

- Will benefit borrowers because this will allow them to retain their assets to invest in a productive business which generates higher returns.
- Gives lenders a secure long-term loan.
- For insurers, this arrangement guarantees timely renewal and assured premium payments.

Global trends:

Globally, most of the countries like US, Australia, France, and Singapore allows premium financing. In the UK the premium financing activity is regulated and in Hong Kong, though there is no specific regulation prohibiting this arrangement, insurers or intermediaries would need to obtain a license as a financier from the Hong Kong Monetary Authority. In China, premium Financing activity is not allowed.

Recommended global best practices:

- The regulator should consider allowing premium financing. Encouraging premium financing business to grow will help policyholders and insurers to get more business. It would not be a dilution of Section 64 VB rather; it would help comply the same.
- In India some of the retail term product allows for premium payments in installments, but this option should be extended to corporate clients for all lines of business including property lines where the market has seen considerable rise in premiums over the last 2-3 years.
- Further, it would reduce the financial burden of the state/central governments, and also help in bringing a greater number of economically poor and lower middle-income customers under social insurance protection net.

4

Creating resilience in Indian insurance markets

4.1 Risk based solvency for enhanced risk management

As per the current solvency requirement in India, required capital is a factor-based set of solvency requirements that move in line with business volume which is relatively insensitive to risk. The control level of solvency is set at 150 percent of the required solvency margin to the available solvency margin. This is too simplistic a definition of adequate solvency and does not promote enhanced risk management from insurance companies. Secondly, it does not account for every risk that insurers exposed to, particularly, climate risk, pandemic risk, cyber or data risks, regulatory risks, etc. it does not incentivize the insurer's risk mitigation measures.(Emerging Risks)In the financial sector assessment in 2017 of Indian insurance sector regulation and supervision by the International Monetary Fund Financial Sector Assessment Program, one of the key recommendations was for the Indian insurance regulator to "formulate a strategy, plan, and timetable for modernization of the solvency framework as soon as possible."

Global trends:

In most of the countries risk-based solvency has been introduced as can be seen from the countries benchmarking provided earlier wherein in some countries like Australia, UK and European countries the risk based solvency has been implemented since early 2000s, clearly highlighting that India is an outlier in terms of the capital regime in place currently.

Recommended global best practices:

The implementation of Risk based solvency regime will enhance the financial soundness of insurers in India. Under this regime the capital requirements imposed on insurers will be more sensitive to their assets and liability matching, risk appetite and mixed products. Further, capital resources of insurers will be categorized as per the quality and ability of resources to absorb losses while helping insurance companies to keep check and strengthen their risk management culture. The new regime will ensure that insurers with solid risk management and good underwriting measures as well as better asset & liability management will need lower capital requirements, however insurers exposed to high risks will have to possess more capital to protect policyholders. This will instill stability in the market as insurers will be encouraged to better manage the potential risks associated with the products.

4.2 Policyholder needs insurance market stability: Adequate protection of Insurer through defining minimum Cat XL purchase limits

Insurance companies depend on their reinsurance arrangements to cover them against large catastrophe losses. The bases of determining the adequate reinsurance limit against the pan country exposures across various lines of business of insurance companies is through a Catastrophe Modelling output -. The Catastrophe Modelling Report provides the estimated losses that insurance companies can get from various natural perils like Earthquake, Cyclone, Flood, etc, based on various levels of severity of the event, also known as Return Period (RP). Insurance companies then decide on which return period estimated losses their Catastrophe purchase should be. This approach is recognized by IRDAI as well in the Reinsurance Regulations; however, the regulations are silent on the minimum return period to be considered by insurance companies to have adequate reinsurance protection. Higher the risk severity, greater should be the protection for the insurers.

Global trends:

Globally insurers and reinsurers get financial strength rating from international rating agencies like S&P and A.M.Best and this rating becomes one of the key criteria for the end customer to decide which insurer or reinsurer to use. This is a standard global practice used to place insurance or reinsurance business as it helps the users to validate the financial position of the (re)insurer as per common global standard. A significant weightage in these rating methodologies is given to the amount of Catastrophe Risk protection the (re)insurer have to withstand large losses and the market standard considered for adequate catastrophe protection is 1 in 250 Return Period for Earthquake peril and 1 in 100 Return Period for Windstorm. These return periods are also factored in the rating provided by the international agencies which incentivizes the (re)insurer to maintain their protection limits at these levels.

Recommended global best practices:

As a prudent risk management practice and for the stability of Insurance market, the regulations could be amended to include the minimum Return Period as per global market standards to be considered by Indian insurance companies for their Catastrophe Risk Protection especially for main Natural perils in India like Earthquake and Flood. The experience of insurance companies from catastrophe losses so far might suggest that lower return period to be adequate for their Catastrophe protection, but this is largely due to the low insurance penetration which lead to lower insured losses. However, the Indian market is witnessing an increase in frequency of Catastrophe Events in line with the other regions around the globe due to climate change and it is expected that the natural perils events are going to be more severe going forward. Accordingly, the insurers can be advised to review their Nat-Cat risk retentions keeping in mind the climate change implications. This would help them in designing their reinsurance programming appropriately.

4.3 Strengthening Reinsurance

4.3.1 Restriction on cession limits to avoid:

The current regulations in India does address concentration of risks with overseas reinsurers by capping the maximum cession by insurance companies per Cross Border Reinsurer to 20% of the total reinsurance premium ceded out-side India with cession reducing based on the rating of reinsurers. The above restrictions are applicable to even group companies of the overseas Joint Venture partners of Insurance companies in India who have made substantial investments in their Indian arm.

The restriction on cession limits further reduces the Cross-border reinsurer capacity available to insurers in India which is leading to increased risk of shortfall in placement of insurance company's reinsurance protection in case reinsurers based in India do not support their reinsurance arrangement. This could severely impact the balance sheet and solvency of insurance companies in case of large losses while at the same time reinsurance cost would be driven up directly contributing to the low insurance penetration in India.

Global trends:

As per the country wise benchmarking restrictions on cession limits with a single reinsurer is not a common practice globally and while China has a restriction of 80% placement with a single reinsurer for one policy, this is largely a risk management practice rather than a restriction on placement.

A common risk management practice followed in many countries where risk based solvency is implemented is an asset risk capital charge on reinsurance recoverable based on the rating of the reinsurer wherein for a lower rated reinsurer there will be higher capital charge on the reinsurance recoverable as compared to a higher rated reinsurer. This approach promotes reinsurance placement with better rated reinsurers while providing insurance company the flexibility to obtain reinsurance capacity from the reinsurers across the globe without any restriction on cession limits.

Recommended global best practices:

Regulations introducing risk based solvency along with asset risk capital charge on reinsurance recoverable based on the rating of the reinsurer as an alternate to the Restriction on Cession Limits and Order of Preference would be more in line with the objectives of IRDAI as per the Reinsurance Regulations particularly in ensuring the best possible Re-insurance coverage available to protect the interest of the policyholders at a reasonable cost and adequate diversification of risks as more highly rated reinsurers around the globe would be promoted to provide capacity in India.

4.4 Promoting alternative risk transfer solutions to increase insurance penetration & narrowing protection gaps against NAT CAT disasters

Alternate Risk Transfer (ART) essentially means using nontraditional insurance and reinsurance to transfer risk. Some of the most common alternate risk transfer mechanisms are insurance pools, CAT Bonds, Public-Private partnership & parametric solutions. Such solutions are particularly important to provide disaster risk financing which reduces the protection gap in large catastrophe events.

India has largely been depended on State and Centre relief to support the vulnerable sections of the society post large catastrophe losses and as per the Working Group report provided by NIDM along with Insurance Institute of India, the assistance provided by the Government for rescue, relief, rehabilitation and reconstruction needs may not be sufficient to mitigate massive losses on account of disasters and there is an urgent need to bring risk financing, insurance, re-insurance and risk transfer mechanism for building resilience. The large events like Kerala Flood, Chennai Flood or Cyclone Fani clearly show that one cannot depend on raising funds ex-post; and that ex-ante solutions that allow the government to access funds and act swiftly in the region impacted are need, to save precious lives and livelihoods.

The current regulations in India allow insurance companies to source an ART solution post approval by the regulator on a case to case basis, however there are limited solutions currently in place. In June 2020, State of Nagaland which is one of the smallest state in India purchased a parametric coverage for excess rainfall in a first such solution in the India market but there is a clear need for more such solutions to be in place.

Global trends:

ART is one of the key financial tools for funding disasters and it is being used across the globe as a viable risk transfer instrument. Many countries have already utilized ART as an ex-ante tool for post-disaster recovery which has helped government's endeavor to bridge the protection gap. The most effective solution are seen from public and private sector partnerships, in order to finance the capital requirement to provide disaster relief.

Such partnerships are not only seen in advanced economies but there are various solutions seen in South East Asia which have been very effective. Some examples of such partnerships are:

- Southeast Asia Disaster Risk Insurance Facility (SEADRIF): In December 2018, Cambodia, Indonesia, Lao PDR, Myanmar, Singapore, and Japan agreed to establish SEADRIF as a trust to own a general insurance company in Singapore. It provides rapid and predictable relief funding, reducing reliance on disruptive budget reallocations or dependence on uncertain humanitarian aid. The first financial product offered by SEADRIF Insurance Company, a licensed direct general insurer in Singapore, is a catastrophe risk pool for Lao People's Democratic Republic and Myanmar. Working together allows for a significant cost reduction in insurance coverage.
- Philippines Catastrophe Bond for Earthquake and Typhoon: The WB-PH CAT Bonds provide financial protection of up to USD 225 million (PHP 11.4 billion) insurance for losses due to earthquakes and typhoons. Under this arrangement, the Philippines pays the risk premium portion of the total coupon payment to Cat Bond investors. This instrument was structured to provide protection for up to US$75 million for earthquakes and US$150 million for typhoons from November 2019 to November 2022. The successful issuance marked several firsts for the government and the Asian capital market—the first Cat Bond for the Philippines; first Cat Bond for any Asian sovereign; first Cat Bond to be listed in the Singapore Exchange (SGX); first Cat Bond to be listed in any Asian exchange; and the first WB-issued Cat Bond listed in the SGX.

Recommended global best practices:

In order to bridge the protection gap in India, there needs to be more involvement and partnership among the governments, regulator and (re)insurance industry to provide quick and transparent disaster financing solutions. Catastrophe Bonds and Parametric solutions are such solutions which have been very effective in other regions to narrow down the protection gaps. These products can be designed to suit the specific needs of state or central government based on their requirements and as the trigger is based on pre agreed specific criteria like magnitude of an Earthquake or amount of rainfall, the payouts are not disputed and can be arranged immediately upon occurrence of the events unlike traditional insurance wherein the loss quantification takes a lot of time. Hence, it is recommended that suitable cat-bonds with parametric based insurance cover for natural catastrophic risks like earthquake, floods, cyclones can be developed at regional level. This would attract investors to finance in such disasters as part their green climate initiatives and provide additional risk capacity to mitigate climate risks in the country.

Most of the south-east countries, western Africa and Caribbean countries have developed the catastrophic risk pool which finances the alternative risk transfer mechanism like cat-bonds and parametric insurance covers. Similarly, we also need to develop a regional level disaster risk fund established at state level to finance for such hybrid ART covers with parametric insurance solutions to mitigate the disaster risk insurance. Such fund would enable the state government to get financial support from various corporates, NGO's and government departments. Such risk pool can take the CAT XL protection from the global reinsurance market.

Annexure – Insurance penetration data for selected countries

Country[9]	Insurance Penetration (Premiums as % of GDP)	Insurance Density (premiums per capita in USD in 2021)	Global Market Share (2021)
Australia	4.4	2817	1.10%
UK	11.1	5273	5.80%
France	9.4	4140	4.30%
Singapore	9.3	6742	0.30%
US	11.7	8193	39.60%
China	3.9	482	10.10%
Hong Kong	19.6	9556	1.10%
UAE	2.9	1305	0.30%
South Africa	12.2	852	0.70%
Spain	5.1	1551	1.10%
Germany	6.5	3313	4%
India	4.2	91	1.9%

[9]Source: Swiss Re Sigma Report 04/22 - World insurance: inflation risks front and centre