To Our Readers

No one doubts that the liberalization of the insurance sector has been good for the Indian economy. Coverage has increased, available funds for investment have taken a jump and more foreign investment is expected in this sector. Although a few good years have passed since the first entry, and although a few good men have worked very hard to see that entry pains are minimized and that the injection itself is safe and secure, nevertheless, the vagaries of the economy raise issues that must be tackled fair and square.

The first and the foremost of these issues is the continuing declining trend in returns or investments by the insurance companies. What is generally good for the economy need not necessarily be good for the insurance companies, or at least that is what most of surveys tell. Faced with lower returns, insurance companies have been trying various ways and means to cut operating costs. Approaches have varied from downsizing to comprehensive outsourcing. Of these, outsourcing appears to be the more beneficial since downsizing has its own not-so-likeable and not-so-politically-correct side effects. Of course, this means the growth of opportunities in the BPO sector. And many people are eyeing new options in this area.

But the more important issue is that of managing risks. The initial hype about the growth of the insurance sector may lose its luster in a few years. And it is then that the regulators will again start taking a very hard look at whether adequate risk-based capital is available to cover potential losses. Some companies abroad have of course, taken a proactive stance and have introduced extensive risk management practices. But this is far from a general trend. Few, if any, are willing to look at sensitive areas like the extent of capitalization. Under-capitalisation in a turbulent economic environment is of course, a dangerous path to walk on, if some of the significant risks to which the company is exposed, become a reality. At the same time, finding capital is lot more difficult than finding debt. And people do run shy of investments whose risks they themselves are unable to comprehend.

Faced with such choices, what really can a company do? Some of them shrug off these negative scenarios by saying that they comply with the requirements of the regulators. However, the regulators only define the capital that is required for risks as are seen by the regulator. The company itself must focus on the whole process of assessment of risk. And this requires the specific attention of the Board and senior management as well.

What is important to note is that risk assessment and risk management are not strategies that can be dealt with in the usual way that decisions are taken, i.e. by applying nothing better than normal common sense. In a complex world, risk management and risk assessment both will require the application of very advance and sophisticated techniques.

The crucial question is are we ready for it? And since as professional accountants we have a very large interface with the insurance sector, how best can we advise the companies to adopt best practices. The ICAI has obviously a role to play. Not only in terms of the development of the required techniques but also in seeing that its members are provided with the necessary inputs. This is the objective to which the Institute's Insurance Committee is working and we hope that not only the members but the insurance sector in general will benefit from these efforts.

June, 2004

Editor
The Institute of Chartered Accountants of India