Insurance-A Booming Professional Opportunity

N.D. Gupta

< EXECUTIVE SUMMARY >

◆Insurance is the pooling of fortuitous losses by transfer of such risks to insurers, who agree to provide other pecuniary benefits on their occurence, or to render services connected with the risk. It is the transfer of financial responsibility for the risk at the point of occurrence, and conventionally involves the insurer in a commitment to pay. The inured is thus exchanging the uncertain cost of losses for certain and known cost of the premium. The insurance services lead to efficient and productive allocation of capital resources, facilitate growth of trade and commerce, substitute for governments social security programs, and assist individuals and firms in efficient management of risks. The insurance market may tremedously improve as India represents huge untapped market. However, globalization will certainly increase insurance penetration and all professionals shall equip themselves to exploit the opportunities offered by this sector.

INTRODUCTION

Somebody named "Murphy" has once stated something called "law" which dictates that if something wrong can happen, it will.

The probability of something happening which is not going to have favourable effect on its environment can be termed as risk. More the probability higher the risk. Since the risk itself depends upon the happening of a future event, you cannot assure yourself that risk can be eliminated in entirety. That is why to reduce the impact of that unfavourable event, every enterprise tries to manage the risk so that its impact may be minimised in case of happening of that event.

Risk Management today has become a very complex and demanding profession. Risk managers have greater responsibilities than ever before. Increasingly they are being asked to manage both risks and opportunities with an eye on improving shareholder value.

Risk is a burden not only to the individual but to the society as well. There exist several techniques for meeting the problem of risk, of which insurance is the most practical method for handling major risks.

The Commission on Insurance Terminology of the American Risk and Insurance Association has defined insurance as follows:

"Insurance is the pooling of fortuitous losses by transfer of such risks to insurers, who agree to indemnify insured for such losses, to provide other pecuniary benefits on their occurrence, or to render services connected with the risk."

Insurance is based on the principle of risk pooling. It is the transfer of financial responsibility for the risk at the point of occurrence, and conventionally involves the insurer in a commitment to pay. Provided the terms and conditions of the policy are met, payment of the premium secures a source of funds in the event of loss. The insured is thus exchanging the uncertain cost of losses for the certain and known cost of the premium. The cost arising from pure losses during the period of cover are then fixed for the insured. The stabilisation of loss costs means that earnings are less susceptible to the effects of pure loss than when these are retained.

Insurance however does not always fully compensate the insured for losses suffered. This may be the result of limitation of the liability accepted by the insurer, poor management of instance by the insured leading to gaps in cover or uninsurable losses.

The author is Chairman, Professional Development Committee of ICAI

HISTORY OF INSURANCE

The roots of insurance might be traced to Babylonia, where traders were encouraged to assume the risks of the caravan trade through loans that were repaid (with interest) only after the goods had arrived safely-a practice resembling bottomry and given legal force in the Code of Hammurabi (c.2100 B. C.).

With the growth of towns and trade in Europe, the medieval guilds undertook to protect their members from loss by fire and shipwreck, and to provide decent burial and support in sickness and poverty. By the middle of the 14th century, as evidenced by the earliest known insurance contract (Genoa, 1347), marine insurance was practically universal among the maritime nations of Europe. In London, Lloyd's Coffee House (1688) was a place where merchants, shipowners, and underwriters met to transact business. By the end of the 18th Century. Lloyd's had progressed into one of the first modern insurance companies. In 1693, the astronomer Edmond Halley constructed the first mortality table, based on the statistical laws of mortality and compound interest. The table corrected in the year 1756 by Joseph Dodson, made it possible to scale the premium rate to age; previously the rate had been the same for all ages.

Insurance developed rapidly with the growth of British commerce in the 17th and 18th Century. Prior to the formation of corporations devoted solely to the business of writing insurance, policies were signed by a number of individuals, each of whom wrote his name and the amount of risk he was assuming underneath the insurance proposal, hence the term underwriter. The first stock companies to engage in insurance were chartered in England in 1720, and in 1735, the first insurance company in the American colonies was founded at Charleston, S.C. Fire insurance corporations were formed in New York City (1787) and in Philadelphia (1794). The Presbyterian Synod of Philadelphia sponsored (1759) the first life insurance corporation in America, for the benefit of Presbyterian ministers and their dependents. After 1840, with the decline of religious prejudice against the practice, life insurance entered a boom period. In the 1830s the practice of classifying risks began.

The New York fire of 1835 called attention to the need for adequate reserves to meet unexpectedly large losses; Massachusetts was the first state to require companies by law (1837) to maintain such reserves. The great Chicago fire (1871) emphasized the costly nature of fires in structurally dense modern cities. Reinsurance, whereby losses are distributed among many companies, was devised to meet such situations and is now common in other lines of insurance. The Workmen's Compensation Act of 1897 in Britain required employers to insure their employees against industrial accidents. Public liability insurance, fostered by legislation, made its appearance in the 1880s; it attained major importance with the advent of the automobile.

The business of life insurance in India in its existing form started in the year 1818 with the establishment of the Oriental Life Insurance Company in Calcutta.

HISTORY OF INSURANCE IN INDIA

1818	Europeans started the Oriental Life Insurance Co. in Calcutta
1870	The first Indian Insurance Company-Bombay Mutual life Insurance
1870	The British Govt. enacted The Insurance Act
1912	First Indian Insurance Act was passed with an enactment again in 1938

Some of the important milestones in the life insurance business in India are:

1912	The Indian Life Assurance Companies Act enacted as the first statute to regulate the life insurance business.
1928	The Indian Insurance Companies Act enacted to enable the government to collect statistical information about both life and non-life insurance businesses.
1938	Earlier legislation consolidated and amended to by the Insurance Act with the objective of protecting the interests of the insuring public.
1956	245 Indian and foreign insurers and provident societies taken over by the central government and nationalised. LIC formed by an Act of Parliament, viz. LIC Act, 1956, with a capital contribution of Rs. 5 crore from the Government of India.

The General insurance business in India, on the other hand, can trace its roots to the Triton Insurance Company Ltd., the first general insurance company established in the year 1850 in Calcutta by the British.

1907	The Indian Mercantile Insurance Ltd. set up, the first company to transact all classes of general insurance business.
1957	General Insurance Council, a wing of the Insurance Association of India, frames a code of conduct for ensuring fair conduct and sound business practices.
1968	The Insurance Act amended to regulate investments and set minimum solvency margins and the Tariff Advisory Committee set up.
1972	The General Insurance Business (Nationalisation) Act, 1972 nationalised the general insurance business in India with effect from 1st January 1973. 107 insurers amalgamated and grouped into four companies viz., the National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd. and the United India Insurance Company Ltd. GIC incorporated as a company.

EVOLUTION OF PRESENT INDIAN INSURANCE INDUSTRY

In April, 1993 Govt. set up a high power committee headed by Mr. R. N. Malhotra to suggest reforms in the insurance sector and make it more efficient and competitive. The committee recommended the establishment of a strong and effective insurance regulatory authority in the form of a statutory autonomous board on the lines of SEBI.

In December 1999, the insurance sector was thrown open to private sector, followed by the establishment of IRDA (Insurance Regulatory and Development Authority) in April 2000. Realising the vast potential in Indian market, companies all over the globe rushed to find a foothold in the lucrative Indian market. Evolution of technology and convergence of services witnessed the insurance products being offered by banks also.

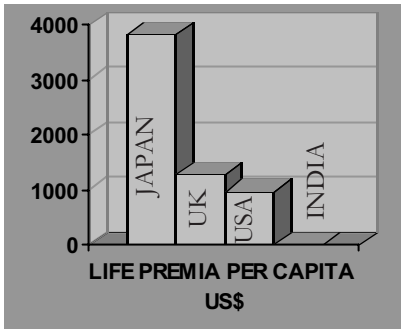
The potential for growth of the Indian Insurance Industry can be gauged by the fact that the Indian Insurance market registered the highest growth in the Asian region even though India's share of global insurance premium is less than 0.5% (1998) compared with the US - 24.2% and Japan - 21%. The private players are well aware that only 25% of the insurable population have been extended cover which means that market penetration is low and the potential to exploit is high.

LIFE INSURANCE STATISTICS	
Indian Population	1Billion
GDP as in 2000	(Rs.)20000 Billion
Gross Domestic Savings as % of GDP	23%
Estimate of insurable population	(Rs) 240 Million
Estimated market by 2005	(Rs) 650 Million

Some of the other factors which make the Indian Insurance Industry highly lucrative are that the Insurance Permia per capita is very low (US$4) and there is presence of huge middle class of approx. 300 million. Also the lack of a comprehensive social security system / state benefits and welfare means that demand for pension products is high.

The Confederation of Indian Industry (CII) has projected growth of life insurance premium from Rs. 350 billion at present to Rs. 1400 billion by 2009 and pension funds from Rs. 10 billion to Rs. 140 billion. The growth in non-life premiums is expected to increase from Rs. 75 billion to Rs. 375 billion.

The Chart shown alongside shows that considerable scope exists to raise the per capita premium.



PROFESSIONAL OPPORTUNITIES IN INSURANCE

Insurance sector has a positive correlation with economic development in an economy. As an economy develops over the years, the insurance sector starts making inroads into the interiors of the economy. During the past several years, the sector of insurance has flourished so much that the insurance business is being considered to be one of the most rapidly developing areas in the financial sector. With this transition in the insurance sector, the horizons for the contribution by Chartered Accountants have broadened. There has emerged a king-size pool of opportunities that the Chartered Accountants can explore and apply their professional wisdom and experience to.

The opportunities available for Chartered Accountants in the Insurance Sector have been summarised in the following paragraphs.

❖ Statutory Audit

Section 12 of the Insurance Act, 1938 provides that the financial statements of every insurer are required to be audited annually by an auditor unless they are subject to audit under the Indian Companies Act.

Among the public sector insurance companies, Section 25 of the Life Insurance Corporation Act, 1956, dealing with 'Audit' is specific about appointment of auditors by the Corporation with the previous approval of the Central Government. The General Insurance Business (Nationalisation) Act has no specific mention and hence Section 619 of the Companies Act, 1956 which prescribes appointment of statutory auditors by CAG becomes applicable.

In the current scenario, with the private insurance companies operating in the market, the appointment of statutory auditors has come within the ambit of the functions of IRDA. Accordingly the IRDA has compiled a panel of Chartered Accountants and has prescribed certain parameters for this purpose.

❖ Internal Audit

Currently, the internal audits of public sector insurance companies are done in-house. Such audits are not done concurrently and hence are not effective. In the changing scenario, private sector insurance companies will be outsourcing these internal audit requirements. Public sector companies also may follow suit to improve upon the quality of such audits.

Needless to mention that the members of the profession have engaged themselves in the internal audit for long. It has been an area in which Chartered Accountants possess an expertise and can apply it fruitfully.

❖ Tax Audit

The insurance companies are liable to tax audit under section 44AB of the Income Tax Act, 1961. Chartered Accountants being experts in the areas of auditing and with an in-depth knowledge of the provisions of the Income Tax Act, 1961 have ample opportunities in this area.

❖ Surveyor or Loss Assessor

The surveyor is a person whom the insurance company appoints to examine the claims put up by the insured, and to assess and adjust the actual loss suffered, in accordance with the terms and conditions of the policy held by the insured, and submit a report thereon for the consideration of the insurance company.

Section 64UM(2) of the Insurance Act provides that "No claim in respect of a loss which has occurred in India and requiring to be paid or settled in India equal to or exceeding twenty thousand rupees in value on any policy of insurance, arising or intimated to an insurer at any time after the expiry of a period of one year from the commencement of the Insurance (Amendment) Act, 1968, shall, unless otherwise directed by the Authority, be admitted for payment or settled by the insurer unless he has obtained a report, on the loss that has occurred, from a person who holds a licence issued under this section to act as a surveyor or loss assessor". Section 64UM(1) (D) of the Insurance Act, 1938, provides the qualifications which an individual should possess to act as a Surveyor or Loss Assessor. Clause (c) of the said Section includes a fellow or associate member of the Institute of Chartered Accountants of India under its purview. A person intending to act as a Surveyor or Loss Assessor has to apply to the Insurance Regulatory and Development Authority in the appropriate form and with the prescribed fee.

Chartered Accountants can act as qualified surveyors in ascertainment of loss in the following cases:

- Industrial all risk policy

- Marine transit claims
- Fire losses involving loss/damage to stocks of inventories
- Loss of profit insurance claims
- Miscellaneous insurance

❖ Insurance Agent

An insurance agent is a person who takes up agency from the insurance company to sell its policies on a commission basis. He acts as an intermediary between the insurance company and the policyholder.

An insurance agent should be an excellent communicator and must possess a repository of knowledge about insurance policies to market existing policies to individuals, families, businesses, and corporates. They help policyholders choose appropriate policies suitable to their need and assist in the settlement of claims.

The Chartered Accountants can engage themselves in the process by entering into agreement with the insurance companies to function as the Direct Sellers of their products and charge commission in lieu of the services so rendered from them. The area promises attractive scope for the constituents of the profession.

❖ Risk Management and Consultancy

Insurance has traditionally been perceived as the tool for managing risks. With the increasing complexities in business operations and financing structures, the resource exposure of enterprises has been heightened to a large extent.

Risk management thus emerges as a dynamic activity characterized by greater knowledge and technology application in product development and pricing in tandem with emerging requirements. Chartered Accountants can engage themselves in:

- Reserving and pricing studies
- Full audits of the efficiency and adequacy of risk management programs
- Risk Management / Administration reviews
- Insurance marketing assistance-renewals
- Actuarial audits of self insured of captive retention
- Captive Insurance Company reviews

The risk-evaluation, segment-wise or client-wise, often requires industry-specific knowledge. The Chartered Accountants possess the knowledge about the operations of the industries or the units with which they deal in their normal course of profession. If the insurers intend to avail out-sourced services for such risk perception and evaluation, the Chartered Accountants may render their services. Chartered Accountants can also take up assignments in managing the risks of their clientele by advising them the right risk management techniques as well as to give them consultancy in areas where they will be needing insurance and such related matters.

❖ Designing of the Insurance Product

Operating department of an Insurance Company is involved in developing products to cover the stipulated risks on the basis of risks perceived. While designing an insurance product, an insurer decides its cost to be charged from the insured in the form of premium, reduction thereof in certain cases like not lodging any claim during the previous covered period(s), suggesting the implementation of risk-mitigating measures, etc.

The Chartered Accountants can play a valuable role in developing the features of an insurance product. They possess adequate knowledge of the financial and technical aspects pertaining to the industry and can apply their skills to yield well-tailored products incorporating the desired features. The Chartered Accountant firms can formulate a model insurance product grounded on the study of an industry and apprise the insurance companies about the development of the same to make them aware of the quality of services, which can be rendered by them to the insurers.

❖ Management of Portfolio

The insurer possesses huge amount of funds, which need proper management. The management of the portfolio of an insurance company requires the identification of investment avenues, evaluation thereof and the selection of the most appropriate mix of alternatives where the funds of the company can be invested. The selection requires the knowledge of finance-related functions and techniques apart from in-depth knowledge of the patterns of requirement of funds in the company, as well as in the industry as a whole, and the regulations of the IRDA in this behalf.

The Chartered Accountants are well versed with the methods and techniques pertaining to the finance related decision-making including the application of scientific and statistical techniques for the same. There is invariably a large scope for the utilisation of the services of Chartered Accountants in this field.

❖ Insurance Litigation

The Chartered Accountants can render their professional expertise in the quantification of claims, both personal injury and business interruption claims. They may also render their services in determining the consideration of liability involving accountants' negligence and for other professional negligence cases. They may also provide their knowledge in rendering assistance of fidelity insurance disputes and insurance accounting disputes.

❖ Forensic Auditing / Investigative Assignments

The insurance industry is susceptible for fraudulent / inflated claims. The examples of fraudulent claims include auto accidents faked or staged to claim benefits, phony burglaries, thefts, or acts of vandalism reported to insurers. To understand the enormity of these claims on the economy, we consider the following quote from the Fact Book 2001, Insurance Information Institute (New York, NY: Insurance Information Institute, 2001 p.127) " The Coalition Against Insurance Fraud estimates that insurance fraud is the equivalent of a hidden tax of about $900 per family on the cost of goods and services in the United States".

Chartered Accountants with their inherent inquisitive abilities sharpened by their training can provide a lot of value addition to the claim settling techniques. The investigative skills aided by their probing minds and technical assistance can be effectively utilised by insurers by offering investigative assignments to the CAs.

❖ Others

◆ Insurance Brokers

Chartered Accountants can act as Direct, Re-insurance and Composite Insurance Brokers. Here the functions would involve:

- Maintaining proper records
- Negotiating with insurers/re- insurers
- Rendering advice based on technical data of the coverage

◆ Third Party Administrator Services

Chartered Accountants can render their services in the following areas:

- Negotiation of rates between TPA & Hospitals/ Medical Practitioners
- Verification / audit of pending settlements
- Certification for submission of statements to Insurer etc.

◆ Audit of Claims

The Chartered Accountants can provide services in the following areas:

- A full review of existing arrangements
- Detailed consultation
- Recommendations on process improvement
- Benchmarking reviews
- Audit of outsource claims service providers
- Negotiations with suppliers
- Cost containment in relation to the overall claims
- Specialist risk management etc.

Initiatives of the Instiute of Chartered Accountants of India

Our Institute has realised that the Insurance Industry is the most happening industry and has set up an Insurance Committee to leverage the professional skills of Chartered Accountants. The Committee has specially designed a Post Qualification Course on Insurance & Risk Management, which was formally launched on the 19th of April 2003, in Chennai. It is also proposed to introduce a modular training course for surveyors and loss assessors, exclusive to the members of our profession. The ICAI has initiated dialogues with Department of Banking and Insurance and IRDA for getting audits of risk management practices by insurance companies done by Chartered Accountants.

CONCLUSION

The insurance sector plays a very vital role in the process of economic development of any country. It acts as mobiliser of savings, as financial intermediary, as promoter of investment activities, as stabilizer of financial markets and as a risk manager. Insurance services lead to efficient and productive allocation of capital resources, facilitate growth of trade and commerce, substitute for governments social security programmes, and assist individuals and firms in efficient management of risks. Post 9/11 the CEO's of major companies world over have realised the need for adequate insurance in all perceptible areas affecting their firms. We may safely observe that the insurance market may tremendously improve as India represents huge untapped market. Globalization will certainly increase insurance penetration and all professionals should equip themselves to exploit the opportunities offered by this sector. ■