Policy Brief

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Conceiving Prudent Outcomes Driven Regulatory Frameworks: Drawing Lessons from the Indian Insurance Sector

Background

From the 1990s onwards, moving beyond traditional regulatory domains like the RBI and SEBI, many new regulatory arrangements came up in India across sectors like power, telecom, insurance, airports, ports, pensions etc. These arrangements were envisaged to be at arms-length from the Government and were implemented through formal 'independent' regulatory bodies. The underlying aim was to ensure role separation between policymaking and regulation through an arrangement assigning enactment of policies and laws to the Government and their day-to-day implementation and operationalization to these regulatory bodies. The objective was to create a credible and investor-friendly environment for the entry and operation of businesses through transparent, non-intrusive, outcomes-focused, and (relatively) de-politicized regulatory oversight by independent bodies operating at arms-length from government.

he cross-sectoral Indian experience with these regulatory bodies has been mixed. Useful lessons can be drawn from the success stories and beneficially mainstreamed across sectors with suitable adaptation. In this context, especially with the heightened growth and investment imperatives the country faces today, regulatory achievements from the insurance sector can usefully inform practices in other areas, and enable further consolidation of the achievements of the sector with regard to risk mitigation and long-term capital provisioning. The objective of potentially leveraging this learning merits a comprehensive assessment of both – key

insurance sector successes and persisting shortcomings.

Insurance Sector Achievements

India witnessed a sector, comprising 6 state-owned insurance companies, with INR 46,000 Crore premiums in the year 2000, transform into a sector with 57, mostly private insurers, with INR 9 lakh crore in premiums through the adoption of a policy framework that promoted private participation, offshore investment, and independent regulation through a regulator empowered by an enabling statutory framework, which did away with limiting hardwired provisions.

While this framework prioritized ease of entry, it retained undiluted stress on key safeguards like fit and proper qualification and essential capital adequacy. Regulations framed through an open and inclusive process progressively favoured outcomes over prescriptiveness, and enabled innovative business practises and product design within a broad framework stressing financial prudence and propriety, corporate integrity, and consumer protection. Product introduction moved from a process of prior approvals to one involving use-and-file with the regulator. This enabled quick introduction, innovation, and customization. The distribution environment progressively evolved into an open architecture set-up with increasing digital and e-insurance emphasis. This gave insurers greater reach, crucial especially for new entrants while enhancing access and lowering costs for the customer. Such non-intrusive regulation will be further strengthened by the recently introduced overall expense of management approach to regulating expenses, as opposed to having narrow limits across various expenditure areas.

Some other far-reaching measures that were introduced include the de-tariffing of premiums, the regulatory sandbox for controlled experimentation with innovations, and enhanced actuary availability through flexible requirements while ensuring greater actuary responsibility towards solvency maintenance. Another key feature has been an emphasis on technology, with regulations in place for the use of digital approaches and e-insurance, along with comprehensive cybersecurity guidelines. This emphasis proved invaluable during the pandemic and has led to an enduring shift in business practices. Steps such as insurance repository accounts and dematerialization of policies are also underway.

New and potentially far-reaching initiatives are on the anvil. These include Bima Sugam (a universal insurance services hosting and access portal), Bima Vahak (conceived as a ‘bare-foot’ last mile insurance distributor), and Bima Vistar (an all-in-one affordable insurance product offering basic life, health, accident, and property cover as an essential social safety net). Envisaged legislation will further ease entry requirements and empower the regulator to permit the entry of new insurance intermediaries/intermediary categories that enable innovative services and delivery approaches. The proposed amendments will also enable composite insurance licences for life insurers to undertake general or health insurance business (and vice-versa) and allow insurance companies to undertake services incidental to insurance and distribute other financial products to improve their financial viability and capacity (akin to banking and digital payment entities doing insurance intermediary work).

Prevailing Gaps

However, notwithstanding the significant achievements, some key gaps remain in the sector. Insurance penetration and density – at 4.2 percent of GDP and USD 91 respectively in

2021-22 – remain low compared to global numbers – 7 percent and USD 874 – with limited spread to rural areas and smaller cities. Certain risks remain un-insurable or are insurable only at prohibitive premiums. While significant steps have been initiated, including the coverage of medical teleconsultation, standard demystified health and travel policies, and coverage of pre-existing diseases like diabetes, cardiovascular disease, and hypertension, gaps remain in the coverage for treatments for pre-existing/ chronic conditions, conditions requiring specialised care and, mental disorders. Government schemes like Pradhan Mantri Suraksha Bima Yojana (PMSBY), Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY) etc. have brought weaker sections into the insurance fold and greatly increased citizens' awareness, but much remains to be done to enhance awareness regarding essential insurance covers and customer rights, and regarding the importance of safeguarding against risks that are not insurable. Attention also needs to be paid to promoting a larger re-insurance sector in India, given the large and growing size of the industry. Risks associated with cyber-attacks and data breaches, which are important to manage in the digital age, also need to be adequately addressed.

Investment regulations could allow wider, capital-provisioning-backed, risk-return choices, as is the approach in many overseas jurisdictions. This can deepen capital, especially long-term debt markets, and enable Indian insurers to adequately perform their role as providers of long-term capital for infrastructure, etc.

Notwithstanding these gaps, comfort can be derived from the prevailing momentum, which sets the stage for building on the successes of the sector and bridging the gaps through a renewed emphasis on prudent practices adopted by IRDAI, which reveal an understanding of the challenges the industry faces and the intent of the regulator to address them. This opportunity is further strengthened by heightened digital thrust and enhanced consumer awareness and demand – especially in the life and health space, provided by the pandemic.

The Way Forward

Going forward, we need to keep in mind certain important qualitative principles learnt from experience and ensure that they are not diluted as we target rapid growth in the sector. A key regulatory priority in this context must include the continued promotion of competition, which, in most aspects, is the most effective, hands-off, and efficient regulator. Towards this end, it would be crucial to recognize and uphold the right to do business as an underlying principle and enable the entry of disruptive service providers offering innovative new services and business models. This can be achieved through an open approach that avoids straitjacketed entry gateways. This will also encourage further digitization and enable insure-tech firms to come in and achieve the full potential afforded by technology. Hybrid business models using brick-and-mortar hubs with digitally enabled spokes (agents) and a wide reach can also possibly emerge.

The regulatory approach must remain comprehensively outcomes-focused and, hence, be at arm's length, non-intrusive, and non-prescriptive. Core regulatory concerns and priorities like solvency, sustainability, financial propriety at the corporate and product level, consumer welfare and protection, product and business innovation, fair competition, and sector growth must be consciously identified and promoted within broad operating norms and frameworks with balance across stakeholder interests, as opposed to micro-prescriptive provisions. All

existing and proposed regulations and regulatory practices must be reviewed to identify a clear nexus with these core objectives and be suitably modified or abandoned if they fail the test. If a clear justification exists, the identified regulatory objective must be achieved through a minimalist and least onerous approach that avoids prescribing processes and modalities but lays down goals to be achieved through the insurer's initiative and choices.

Regulation must also be consciously re-oriented towards promoting the classical insurance principles based on the viability of large, diverse insurance pools at low premiums, to ensure universal inclusion and affordability. The emphasis must not be on perfectly segmenting the population to weed out those at higher risk. Insurers must distinguish between self-acquired, controllable, and natural uncontrollable risks in individuals and penalise the former instead of the latter. This must go hand in hand with a more refined actuarial basis for pricing insurance products, which could factor in the observed performance of insurance pools for iterative re-calibration and wider use of post-facto mechanisms to pass on excessive surpluses to consumers.

An essential aspect of promoting competition is the creation of a level playing field across service providers and delivery modes. Barring exceptions like incentives for rural services, recognition of the greater cost of doing business in certain lines of business/regions or the special circumstances of small new insurers, etc., regulatory norms should not favour particular business models or product mixes. They must enable competition based on service quality and efficiencies inherent in the adopted products, business practices and distribution modes. This can allow a superior USP to enter, disrupt, and succeed, and elevate the insurance ecosystem.

In this context, while conceiving interventions like Bima Sugam, we may need to ensure that the state and the regulator remain infrastructure providers as opposed to being service providers or sponsors of certain services. A good example is that of digital public infrastructure like UPI created by the state as an opportunity multiplier for private service providers. The state as a provider or sponsor of services, risks upsetting the level playing field through the potential creation of state-favoured entities, and runs the well-known risk of public sector failures in running customer-focused commercial ventures. To this extent, Bima Sugam should be a neutral platform with uniform access to all service providers and customers without any exclusivity vis-à-vis other marketing channels.

Primacy of the Distribution Challenge

We need to recognise that insurance is a distribution-led business. Experiments with direct-to-customer services have had very limited success. It is also apparent that deficiencies in distribution infrastructure capacity have been the major bottleneck preventing the translation of huge institutional capacity on the underwriting side into significantly higher growth in the insurance business in India. Thus, transforming the distribution landscape and giving an adequate institutionalized voice to distribution intermediaries in industry consultations, holds the key to achieving the ambitious growth objectives for the sector.

Recent distribution changes have evoked mixed responses. Allowing corporate agents multi-company work, followed by permitting individual agents to work as intermediary point-of-sale persons or as stand-alone health and motor insurer agents, have diluted the traditional distinction between multi-company brokers with extensive service obligations towards customers and single-company

agents with service obligations largely on the company. While aiding distribution and competition, these moves have raised concerns about free-riding and obscuring boundaries without converging responsibilities. They have adversely impacted life insurers and general insurers and pushed them towards brokerage options.

New mode distributors like aggregators have their own misgivings regarding the lack of a level playing field in recognizing legitimate costs and obtaining KYC etc. for customer onboarding. Certain other related issues also need to be addressed. These include adequate access to centralized e-KYC, insurance information bureau, Vaahan vehicle registration database, and repositories for improved underwriting, curtailment of fraud and more efficient service delivery. It should also be ensured that insurance intermediaries, including non-conventional distributors like aggregator portals, obtain and carry out e-KYC authentication using the e-KYC Setu system for onboarding customers. Limitations of policy size and type imposed on point-of-sale persons in health and life businesses need to be re-looked.

A level playing field in rights, obligations, and commercial terms across distribution channels is essential for undistorted insurer choices based on cost-effectiveness and service quality. The recently introduced expense of management regulation – with management discretion in expense allocation within broad overall limits – would support this goal. Concerns, especially on the life side, regarding expense norms remaining partly segmented and contingent on product mix could be addressed.

Sub-broking, successful in stock trading, could be encouraged, including for aggregator platforms. Rich distributor understanding of customers and risks merits its use in underwriting, claims settlement, and product development. Managing General Agents with such mandates, prevalent overseas, could be considered.

Shaping distribution to include full disclosure and third-party checks could reduce product mis-selling caused by accountability gaps and conflicted situations like sales to vulnerable bank customers. Rationalized incentives over the term of life policies could improve their persistence beyond the initial subscription. Suitable redressal mechanisms could address claim delays and wrongful denials, especially with respect to general insurance. This would go well with a concerted effort to address fraud and misrepresentation by taking forward IRDAI efforts to introduce stricter guidelines on fraud prevention.

Summarizing Broad Cross-Sectoral Lessons

Indisputably, the Indian insurance sector has had a phase of significant achievement over the last two decades and is poised for an even brighter future through continued prudent policies on proven lines. The following lessons drawn from this journey can provide a model for useful emulation across sectors:

- Policy and regulatory arrangements in key sectors must envisage role separation across policy-making, regulation, and commercial service provision to consumers. This would obviate conflicts of interest and consequent risks of lack of fairness and accountability associated with monolithic structures where the policy maker may also be the regulator operationalizing the policy, and sometimes even the service provider, as in the case of the State Electricity Boards and Department of Telecom in the pre-reformed power and telecom sectors. Such lack of separation fails to inspire credibility

in the arrangements amongst private investors with regard to transparent and consistent implementation of policies, and a de-politicised and level playing field across private and publicly owned service providers.

- Regulatory capture by the government (policy maker) or private entities, which could potentially undermine the targeted role separation, must be avoided. This should be done by protecting the independence and autonomy of the regulatory body through measures like arms-length and independent regulatory appointment processes including sound, well-specified qualifications, security of tenure, restrictions on tenure extensions, subsequent appointment to other public positions, budgetary autonomy for the regulator etc. Ideally, an eminent and completely independent entity must suggest several potentially well-suited names for regulatory appointments and the Government must be required to choose from among them.

- The statutory policy framework, while laying down key broad principles and objectives must not hardwire aspects requiring flexibility in a dynamic and changing world that are best left to regulatory or corporate discretion.

- The regulatory body must conduct its affairs through consultatively-adopted, prudent regulations. It should lay down a business-friendly, transparent, minimally onerous, low transactions cost, largely contact-less, and digitally implemented processes to give effect to policies laid down by the policymaker. This would include areas like granting licenses, giving mandated approvals, exercising operational grievances and complaints, and achieving other desired outcomes.

- The regulatory approach must be arm's length, non-intrusive, and non-prescriptive, with minimal micro-management of day-to-day operational and management decisions of the regulated entities. Towards this end, it must be outcomes-focused through broad, prudent frameworks centred around key broad regulatory goals, while leaving the minutiae of operational details to the initiative and ingenuity of the company management. Regulatory sandboxes could be usefully adopted.

- Competition – the most impartial, hands-off, effective, efficient, and yet minimalist, regulator with the capacity to quickly elevate the entire sectoral eco-system to new heights of innovation and technological excellence – must be promoted. The introduction of competition by the regulator can enable the de-regulation of certain areas like tariff setting etc. and greatly simplify the regulator's work.

- All existing and proposed regulations and regulatory practises must be subjected to an essentiality and regulatory burden audit to identify a clear nexus with the core regulatory goals mentioned above and their attainment in the least burdensome manner. These prescriptions should be suitably modified or abandoned if they fail the test. If a clear public interest justification is found for particular provisions, the underlying regulatory objective must be achieved through the minimalist approach stressed above.

(Views are personal. Suggestions/information received from various sources is gratefully acknowledged)

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