Pool of uncertainty: motor insurance industry faces fraud allegation

6 March 2012

Introduction

The start of 2012 has seen further developments in the troubled motor insurance industry, with worrying reports that the insurance market regulator - the Insurance Regulatory and Development Authority (IRDA) - is formally investigating seven general insurers in relation to suspected fraud committed by faking claims and siphoning off funds from the third-party motor pool.

When the market was de-tariffed on January 1 2007, the IRDA decided that it would continue to regulate the premium for third-party motor insurance. Following complaints that insurers were not writing such business, the IRDA set up a third-party motor insurance pool for commercial vehicles, effective from April 1 2007.

Third-party insurance pool

All general insurers (with the exception of specialist insurers, such as the Export Credit Guarantee Corporation of India Ltd, the Agriculture Insurance Company of India Ltd and stand alone health insurers) were obliged to participate in the pool, which was administered by the national reinsurer, GIC Re, under the guidance of the General Insurance Council. The council in turn established various committees to advise GIC Re on all issues relating to the pool (eg, administration, underwriting, claims, accounts, investment and statistical).

Under the pool terms, no insurer could refuse to grant third-party insurance cover for commercial motor vehicles. All premiums were remitted to the pool and losses were shared in proportion to each insurer's total gross direct premium in India for all classes of general insurance business in relation to the total market gross direct premium income for all classes of general insurance business. GIC Re participated in the pool at the level of the statutorily mandated cessions that must be made to it.

The pool was the subject of dissatisfaction from the early days. Private insurers complained that they were being burdened with the results of inadequate due diligence undertaken by the government-owned insurers, and that they were being forced to share losses based on their market share, irrespective of the size of their motor insurance portfolio. Government-owned insurers complained that they had to write such business throughout the country, whereas private insurers had the luxury of cherry-picking their risks. There were also shared concerns about the

overall efficiency of the pool and the absence of a real incentive to manage claims so as to reduce payouts and associated costs. As a significant indicator of the problems experienced, in 2009 to 2010 the pool made an underwriting loss of approximately Rs6.74 billion ($140 million).
The IRDA responded in December 2010 by appointing a committee to review the operation of the pool. It subsequently commissioned a peer review of the pool by the Government Actuary Department in England. The reports received by the IRDA highlighted:

- problems with under-reserving and data inadequacies;
- issues with claims administration; and
- an alarming increase in the liabilities of the pool.

Declined risk pool

The IRDA consequently issued two circulars on December 23 2011 - one to dismantle the pool and the other to replace it with a declined risk pool. The existing pool is set to close by March 31 2012, with insurers remaining responsible for servicing the policies that they have issued and for settling claims under those policies.

As with the earlier pool, the declined risk pool is relevant only to commercial vehicles and is to be administered by GIC Re. The stated purpose of the declined risk pool includes the equitable and fair sharing of risks by all insurers and claims management efficiency. The declined risk pool will operate as follows:

- No insurer can refuse a third-party commercial vehicle risk, but an insurer can either underwrite the risk to its own account if the risk falls within an insurer's underwriting criteria, or cede the risk to the declined risk pool.
- Each insurer's underwriting criteria must be filed with the IRDA. At this stage, the specified underwriting reference points are limited to the age of a vehicle, geographical parameters and the type of vehicle.
- Any business that falls outside the filed underwriting criteria can be ceded to the declined risk pool, with the ceding insurer retaining 20% of each risk to its net account.

Every insurer is obliged to achieve a minimum target of third-party motor insurance business, which is calculated on the basis of an insurer's total gross premium and the industry's total motor premium. The insurers who achieve this target will have no share in the business ceded to the declined risk pool, whereas the share of the others will be in proportion to their respective shortfall in meeting the target. The declined risk pool is to be extinguished at the end of every

underwriting year on a clean-cut basis by transferring the risks at par to the insurers in line with their share.

The appointed actuary of the declined risk pool is required to analyse and submit to the IRDA the claims frequency, claims costs, expense inflation and investments, among other things, and classify the rates for each classification (eg, standard risks or sub-standard risks) at least on an annual basis. Based on this, the premium for third-party motor liability cover will be reviewed annually based on the formula notified by the IRDA. The premium will be the same for both risks underwritten by an insurer to its own account and those ceded to the declined risk pool.

Under-reserving

In January 2012 the IRDA directed insurers to revise their reserves with retrospective effect:

- from 153% to 159% for 2007 by 2012;
- to 188% for 2008 by 2013;
- to 200% for 2009 by 2014; and
- to 213% for 2010 by 2015.

The total impact on insurers is said to be around Rs82 billion ($1.7 billion).

Comment

It is hoped that the participation of each insurer in claims handling, the equitable sharing of risk and the annual revisions of premiums on rational criteria will go a long way in benefiting the sector. As with everything in insurance, the success or failure of the declined risk pool can only be judged only with the passage of time.

Worryingly, in January 2012 media reports suggested that the IRDA is investigating seven insurers in relation to making fake claims, overstating claims and settling claims for much higher amounts than needed. The identities of the seven insurers being investigated remain unknown.

The IRDA has not officially confirmed whether an investigation is underway, but the reports have gone as far as detailing the committee members who are looking into the matter, which appears to comprise three IRDA officials and the chief executives of the Oriental Insurance Co Ltd, United India Insurance Co Ltd, HDFC Ergo General Insurance Co Ltd and Bajaj Allianz General Insurance Co Ltd. The IRDA is also reportedly appointing an auditor to study the books of accounts of the seven insurers under investigation.

The investigations will encompass evaluation of the accounts for the last four to five years and will broadly investigate:

- insurers booking claims that were not third-party claims to the pool and siphoning off the money;
- insurers settling claims outside the Motor Accident Claims Tribunal for much larger amounts than needed and taking the pool;
- fraud being perpetrated by people who are not part of the management of the insurers by colluding with police officials, lawyers and customers for an unjustifiably high claim amount; and
- how the insurers routed monies out of the pool and how they booked and managed the claims.

It appears that the insurers under investigation made claim payouts averaging more than Rs300,000 a case (the industry average is Rs190,000).

This investigation, assuming it is actually underway, is perhaps the first of its kind in the sector in India. It is said that insurers today face the challenge of a deficit of public trust. Any truth in the allegations of fraud will only make this worse and will increase the risk of over-regulation of other aspects of the industry.

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