

Cracking Down on Payments for Insurance Distribution

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The Indian insurance statutory and regulatory framework restricts payments that can be made for the solicitation and procurement of insurance products. The root of this restriction is the Insurance Act 1938, which states that only licensed insurance agents or intermediaries can be paid for the solicitation and procurement of insurance products. Therefore, any payment related to or based on sales can be made only to a licensed insurance agent or intermediary. Through its regulations, guidelines and circulars, the Insurance Regulatory and Development Authority (IRDA) has placed restrictions on the quantum of payments made to agents and intermediaries, as well as on the use of introducers, finders and lead generators in the distribution of insurance products.

Under the previous regulatory framework, unlicensed third parties played a limited role in the advertising and distribution of insurance products. For example, the second proviso to R10(1) of the IRDA (Insurance Advertisement and Disclosure) Regulations 2000 allowed an insurer to purchase a database from an unlicensed third party and to pay "compensation based on sales" for the information in the database.

This provision initially led to arrangements between banks and insurers, under which substantial payments were made and, in some cases, even more money was exchanged, which was usually payable as commission to intermediaries. Clamping down on this trend, in February 2003 the IRDA issued a circular setting down limits on the amounts that could be paid based on sales as a referral fee to a bank whose database the insurer had purchased.

No similar guidance was issued simultaneously for non-banks, which led to an increased usage of the provision in the regulations. Apart from database fees, in some cases several other payments were being made to non-banks, including for infrastructure, foreign programmes, conferences and manpower.

This position has now drastically changed with the introduction of the IRDA (Sharing of Database for Distribution of Insurance Products) Regulations 2010, the deletion of the second proviso to R10(1) of the Insurance Advertisement and Disclosure Regulations and the withdrawal of the IRDA referral circular. Aimed at streamlining referral activities and the fees payable by insurers, the new database regulations require the insurer to register the 'referral company' with the IRDA. A referral company must, among other things, have a net worth of at least Rs5 million and a business that is (i) not related to the transaction of insurance business, and (ii) not involved in any business of extending loans or advances, accepting deposits or trading in securities on its own account or on the accounts of its customers. The second condition is particularly relevant as it means that banks and non-bank financial companies (often seen as ideal database providers) are precluded from sharing their databases with insurers. Similarly, individuals, associations, trusts and societies are prevented from entering into database arrangements with insurers.

Apart from registration and eligibility criteria, the new regulations contain several conditions with which the insurer and referral company must comply, including:

- Customers' details can be provided only with prior consent;
- Remuneration to the referral company for the acquisition of its database must be within the limits of commission payments as prescribed under the Insurance Act. More specifically, referral payments must not exceed 25% of commission; and
- All 'advance payments' for any type of referral arrangement, database or lead are prohibited. Similarly, no other payments as remuneration or otherwise towards incidental costs, including database maintenance, infrastructure, training, entertainment, development, communication, advertisements or sales promotions, can be made to the referral company.

All existing arrangements that do not comply with the regulations must be terminated immediately or otherwise brought into conformity with the regulations by the end of 2010. The penalties for non-compliance with the regulations are severe, including suspension or cancellation of the insurer's licence.

These regulations are the latest in a series of measures that the IRDA has adopted to restrict payments being made to insurance intermediaries and unlicensed third parties. For instance, following the IRDA's circular of March 13 2009, all payments made by insurers to intermediaries and parties related to them under the heads of 'commission' or 'other payments' must be reported periodically to the IRDA and certified by the insurer's chief executive officer, chief financial officer and compliance officer.

The exclusion of banks and non-bank financial companies has been a significant blow to the distribution models of several insurers (especially life insurers), which relied heavily on banks and non-bank financial companies as referral providers. In the aftermath of these new regulations, while life insurers are competitively looking for options to rebuild their distribution systems, banks and non-bank financial companies are contemplating corporate agency and insurance broking models in order to remain involved in insurance distribution.

For further information on this topic please contact Neeraj Tuli at Tuli & Co by telephone +91 11 2464 0906, fax +91 2464 0904 or email n.tuli@tuli.biz

www.tuli.biz