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Measures of Good Corporate Governance in Insurance Sector in India by IRDAI

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Abstract

Corporate governance is often looked upon as a means to measure how well the companies are run. Investors use corporate governance as an indicator to judge the quality of a company's management and the effectiveness of its boards. Corporate governance relates to moral principles, values, and practices that facilitate the balance between economic and social goals. It aims to coordinate the interests of individuals, businesses, and society as a governance structure emphasizing the common interest as much as possible. The present paper describes the efforts taken and guidelines issued by IRDAI for a much efficient performance of the sector in India and will be based on ethical principles.

Keywords: *Good Governance, Governance, Good Corporate, Governance, IRDAI, Insurance*
JEL Code: *G0, G2, G3*

1. Introduction

The terms 'governance' and 'good governance' are being increasingly used in development literature in present times all over the world. Governance is a concept of recent exposure to designate the efficiency, quality, and good guidance of the intervention of the state while good governance is the process of measuring how public institutions conduct public affairs manage public resources, and guarantee the realization of human rights in a manner essentially free of abuse and corruption and with due regard for the rule of law. Governance can be used in several contexts such as international governance, national governance, local governance, and corporate governance.

Corporate governance relates to moral principles, values, and practices that facilitate the balance between economic and social goals. It aims to coordinate the interests of individuals, businesses, and society as a governance structure emphasizing the common interest as much as possible.

There is no unique structure of 'corporate governance' in the developed world. Thus no one can design a code of corporate governance for Indian companies by mechanically importing one form or another. Indian companies, banks, and financial institutions can no longer afford to ignore better corporate practices. As India is continuously entering into globalization, Indian as well as international investors will demand greater disclosure, more transparent explanations for major decisions, and better shareholder value. There are many aims and objectives of corporate governance. For example,

- To provide a regulatory framework and an environment conducive to effective economic activities,
- To ensure that businesses are in citizen’s human rights, social responsibility, and environmental protection,
- Promote the adoption of codes of ethics in business to achieve the objectives of enterprises,
- Ensure that corporations treat all their stakeholders that is shareholders, employees, suppliers, and customers fairly and transparently, and
- To provide for the responsibility of management and directors

2. Objective of the Paper

The objective of the study is to bring forth the effort of IRDAI in the quest of bringing good corporate governance in the insurance sector in India and establishing a more secure environment for customers.

3. Corporate Governance by IRDAI

The Insurance Regulatory and Development Authority of India (IRDAI) has established a comprehensive corporate governance framework to safeguard the long-term interests of policyholders within the Indian insurance sector (Insurance Regulatory and Development Authority [IRDAI], 2016). This framework emphasizes key practices that promote:

- Financial Stability: Ensuring solvency through sound risk management and investment policies (IRDAI, 2016).
- Effective Oversight: Establishing clear roles and responsibilities for the Board of Directors, CEO, and key management personnel (IRDAI, 2016, Section 1.1).
- Transparency and Accountability: Encouraging robust disclosures, fostering positive stakeholder relationships, and maintaining open communication with IRDAI (IRDAI, 2016, Section 1.1).
- Core Elements of the IRDAI Framework (IRDAI, 2016, Section 1.1):
- Governance Structure: Defines a well-defined organizational structure with clear delegation of authority and accountability.
- Board Composition and Responsibilities: Establishes a competent Board of Directors responsible for strategic direction, risk oversight, and ensuring adherence to applicable regulations.

- CEO and Key Management Functions: Identifies critical management roles and outlines their responsibilities for effective day-to-day operations.
- Appointed Actuaries: Mandates the appointment of qualified actuaries to ensure sound financial and risk management practices.
- External Audit: Requires independent audits of financial statements for enhanced transparency and accountability.
- Disclosure Requirements: Promotes openness by mandating the disclosure of relevant financial and operational information to stakeholders.
- Significant Owners and Controlling Shareholders
- Promoter Lock-in: IRDAI mandates a minimum 5-year lock-in period for promoters' shares to ensure long-term commitment (Insurance Regulatory and Development Authority [IRDAI], 2016).
- Foreign Investment Cap: Foreign investment in Indian insurance companies is limited to 49%, and the company must remain Indian-owned and controlled (Insurance Act, 1938, Section 2(7A)).
- Control Definition: Control is defined as the right to appoint a majority of directors (Insurance Act, 1938, Section 2(7A)).
- Governance Structure
- Board Composition: While most insurers are yet to go public, their Boards are typically composed of a mix of executive and non-executive directors, with the role of the Chairman varying.
- Group and Conglomerate Influence: Insurers within financial groups or conglomerates may be subject to additional governance requirements and practices established at the group level.
- Stakeholder Management: Emphasizes the importance of building and maintaining positive relationships with policyholders, investors, and other stakeholders.
- Interaction with IRDAI: Ensures compliance with IRDAI regulations and facilitates constructive dialogue with the regulatory body.
- Whistleblower Policy: Provides a mechanism for reporting unethical practices within the organization.

4. Board of Directors

4.1 Composition

The Insurance Act stipulates that the insurance companies in India would be public companies and hence, would require a properly constituted Board.

- Insurance companies should ensure that the Board comprises competent and qualified Directors to drive the strategies in a manner that would sustain growth and protect the interests of the stakeholders in general and policyholders in particular.

As required under Section 149 of the Companies Act, 2013, there shall be at least one-Woman Director on the Board of every insurance company.

4.2 The Role and Responsibility of the Board

The specific areas of responsibilities of the Board of Insurers are detailed in Annexure 1. The Board would primarily concentrate on the direction, control, and governance of the insurer and in particular should articulate and commit to a corporate philosophy and governance that will shape the level of risk adoption, standards of business conduct, and ethical behaviour of the company at the macro level. The Board should also set a clear and transparent policy framework for the translation of the corporate objectives.

4.3 Fit and Proper Criteria

In line with the international and domestic norms, the Directors of insurers have to meet the "fit and proper" criteria. The criteria to be satisfied, at a minimum, would relate to integrity demonstrated in personal behaviour and business conduct, soundness of judgment, and financial soundness. The Insurance Act prohibits (i) an insurance intermediary/ agent to be the Director of an insurance company (except with prior approval of the Authority); and (ii) the common directorship among life insurance companies.

4.4 Disclosures about Meetings of the Board and its Committees

Insurers shall ensure compliance with the provisions of the Companies Act, 2013, and the Secretarial Standards issued by the ICSI from time to time as regards the conduct of the meetings of the Board of Directors and their committees.

5. Control Functions

Given the risks that an insurer takes in carrying out its operations and the potential impact it has on its business, the board must lay down the policy framework to put in place. For example,

- robust and efficient mechanisms for the identification, assessment, quantification, control, mitigation and monitoring of the risks;
- appropriate processes for ensuring compliance with the Board approved policy, and applicable laws and regulations.

6. Delegation of Functions- Committees of the Board

To provide adequate Board time for discharge of the significant corporate responsibilities, the Board can consider setting up of various Committees of Directors by delegating the overall monitoring responsibilities after laying down the roles and responsibilities of these Committees to the Board.

The roles and responsibilities of the Committees would generally be as detailed below:-

6.1 Audit Committee (mandatory)

- Every Insurer shall constitute an Audit Committee as per Section 177 of the Companies Act, 2013.
- The Audit Committee shall oversee the financial statements, financial reporting, statement of cash flow, and disclosure processes both on an annual and quarterly basis. It shall set up procedures and processes to address all concerns relating to the adequacy of checks and control mechanisms.

6.2 Investment Committee (mandatory)

The Board of every Insurer shall set up an Investment Committee comprising of at least two Non-Executive Directors, the Chief Executive Officer, the Chief of Finance, the Chief of Investment, the Chief Risk Officer, and, the Appointed Actuary.

6.3 Risk Management Committee (mandatory)

It is now well recognized that the sound management of an insurance company, as in the case of other financial sector entities, is dependent on how well the various risks are managed across the organization. In pursuit of the development of a strong risk management system and mitigation strategies, insurers shall set up a separate Risk Management Committee to implement the company’s Risk Management Strategy. The risk management function should be under the overall guidance and supervision of the Chief Risk Officer (CRO) with a clearly defined role.

6.4 Policyholder Protection Committee (mandatory)

The Authority is mandated by statute to protect policyholders' interests and therefore adoption of sound and healthy market practices in terms of sales, marketing, advertisements, promotion, publicity, redressal of customer grievances, consumer awareness, and education is essential. Some of the important Regulations/Guidelines/Circulars are as follows:

- Protection of Policyholders’ Interests Regulations, 2002;

- Insurance Advertisements and Disclosure Regulations, 2002;
- Master Circular on Insurance Advertisements in August 2015
- Guidelines on Public Disclosure for insurance companies
- Guidelines on Advertisements, Promotion & Publicity of Insurance Companies and Insurance Intermediaries in May 2007.

6.5 Nomination and Remuneration Committee (mandatory)

The Nomination and Remuneration Committee shall be constituted in line with the provisions of Section 178 of the Companies Act, 2013. Indian Insurance Companies which have constituted two independent committees for Nomination and Remuneration separately may merge these two Committees after seeking the Board approval, under intimation to the Authority, within 180 days from the date of issue of these guidelines.

6.6 Corporate Social Responsibility Committee ('CSR Committee') (mandatory)

Section 135 of the Companies Act, 2013 requires the constitution of a CSR Committee if certain conditions as mentioned in the said Section are fulfilled. For Indian Insurance Companies, a CSR Committee is required to be set up if the insurance company earns a Net Profit of Rs. 5 Crores or more during the preceding financial year. Further, the 'Net Profit' for this purpose shall be as under: -

"Net profit" means the "profit/(loss) before tax" as per its financial statements prepared following the applicable provisions of the Insurance Act, 1938 and the Regulations framed thereunder, but shall not include the following, namely

i. Any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and
ii. any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Companies Act.

6.7 With Profits Committee

The Authority has issued IRDA (Non-Linked Insurance Products) Regulations 2013, which lay down the framework for Profit Fund Management and Asset sharing, among other things. In terms of these Regulations, every Insurer transacting life insurance business shall constitute a With Profits Committee comprising of an Independent Director, the CEO, The Appointed Actuary, and an independent Actuary.

6.8 Other Committees

The other Committees which can be set up by the Board, include the Ethics Committee and ALM Committee (other than life insurers). In cases where the Board decides not to constitute such Committees, their functions and responsibilities can be addressed in such manner as the Board may deem fit. However, once these Optional Committees are in place, the insurer is required to comply with the requirements on the "Role and Responsibilities" of such Committees as laid down under these Guidelines.

6.8.1 Ethics Committee (not mandatory)

Functions and Responsibilities of the Ethics Committee include monitoring the compliance function and the insurance company's risk profile for compliance with external laws and regulations and internal policies, including its code of ethics or conduct, receiving reports on the above and on proactive compliance activities aimed at increasing the insurance company's ability to meet its legal and ethical obligations, on identified weaknesses, lapses, breaches or violations and the controls and other measures in place to help detect and address the same, supervising and monitoring matters reported using the insurer's whistleblowing or other confidential mechanisms for employees and others to report ethical and compliance concerns or potential breaches or violations.

6.8.2 Asset Liability Management (ALM) Committee

ALM is an ongoing process of formulating, implementing, monitoring, and revising strategies related to assets and liabilities to achieve an organization's financial objectives, given the organization's risk appetite, risk tolerances, and business profile. The need for ALM cannot be over-emphasized as it lays down the framework to ensure that the insurer invests in a manner that would enable it to meet its cash flow needs and capital requirements at a future date to mitigate liquidity risk and solvency stipulations.

6.9 The mandatory committees, except the Nomination and Remuneration Committee, the Corporate Social Responsibility Committee, and the With Profits Committee shall meet at least four times in a year and not more than four months shall elapse between two successive meetings of such Committees. The quorum shall be two members or one-third of the members of the Committee, whichever is greater, however in case-independent director(s) is/ are mandated to be in any of the Committees, at least one such independent director or his alternate director, should necessarily be present to form the quorum.

7. Key Management Persons

7.1 CEO/ Managing Director/ Whole-Time Director

IRDAI requires prior approval for the appointment, re-appointment, or termination of the CEO and WTD. The CEO is responsible for ensuring the company's operations align with the Board's policies and are not detrimental to policyholders' interests.

7.2 Role of Appointed Actuaries

IRDAI mandates prior approval for the appointment of an Appointed Actuary, who must meet rigorous qualifications and eligibility criteria outlined in the IRDA (Appointed Actuary) Regulations, 2000. These regulations detail the procedure for appointment, powers, duties, and obligations of Appointed Actuaries.

7A. External Audit - Appointment of Statutory Auditors

The IRDAI (Preparation of Financial Statements and Auditors' Report of Insurance Companies) Regulations, 2002 empower the authority to issue directions/guidelines on the appointment, continuance, or removal of auditors of an insurer. These guidelines/directions may include prescriptions on the qualifications and experience of auditors, their rotation, period of appointment, etc. as may be deemed necessary by the Authority.

7A.1 Access to Board and Audit Committee

The Audit Committee should have discussions with the statutory auditors periodically about internal control systems, the scope of the audit including the observations of the auditors (where applicable), and review the quarterly/half-yearly and annual financial statements as the case may be before submitting to the Board of Directors and also ensure compliance with the internal control systems. The statutory auditors should also have access to the Board of Directors through the Audit Committee.

8. Disclosure Requirements

The IRDAI (Preparation of Financial Statements and Auditors' Report of Insurance Companies) Regulations, 2002, have prescribed certain disclosures in the financial statements and the Authority is in the process of finalizing additional disclosures to be made by insurers at periodical intervals.

9. Outsourcing Arrangements

All outsourcing arrangements of an Insurer shall have the approval of a Committee of Key Management Persons and should meet the terms of the board-approved outsourcing policy. The Board or the Risk Management Committee should be periodically apprised about the outsourcing arrangements entered into by the insurer and also confirm to the effect that they comply with the stipulations of the Authority as well as the internal policy placed before them. An insurer shall not outsource any of the company's core functions other than those that have been specifically permitted by the Authority.

10. Interaction with the Regulator

IRDAI conducts regular oversight to ensure insurance companies adhere to sound corporate governance practices. This includes assessing board members' qualifications, evaluating internal functions, and analysing the impact of group structures on governance. IRDAI will also communicate any concerns identified through supervisory activities to the Board and senior management.

10.1 Reporting to IRDAI

The annual Report of insurers shall have a separate certification from the Compliance Officer in the format attached to Annexure 8. All insurers are required to file a report on the status of compliance with the Corporate Governance guidelines on an annual basis. This report shall be filed within 3 months from the end of the financial year, i.e., before 30 June. The report shall be filed as per the format in Annexure 9.

11. Whistle Blower Policy

11.1 Insurers are well advised to put in place a "whistle-blower" policy, where mechanisms exist for employees to raise concerns internally about possible irregularities, governance weaknesses, financial reporting issues, or other such matters. These could include employee reporting in confidence directly to the Chairman of the Board or of a Committee of the Board or to the Statutory Auditor.

12. Independent Directors

As required under Schedule IV of the Companies Act, 2013, the independent directors shall meet at least once a year to evaluate the performance of other than independent Directors. Similarly, there shall be an evaluation of the Independent Directors by the other members of the Board of Directors as required in the Schedule.

13. Applicability

These guidelines shall apply to all insurers granted registration by the Authority except that:

i. Reinsurance companies may not be required to have the Policyholders' Protection Committee; and
ii. Branches of foreign reinsurers in India may not be required to constitute the Board and its mandatory committees as indicated herein.

There are many more guidelines issued by IRDAI for good corporate governance in the insurance sector in India.

Corporate governance structure of LIC

Life Insurance Corporation has been a dominant player in the life insurance sector. So, here is an example of the corporate governance structure of the LIC of India:

- Board Composition-
- Key Managerial Persons
- Board Committees
- Secretarial Compliance report
- Grievance Redressal Summary
- Share capital Reconciliation Audit Report
- Independent Directors:

1. Terms and conditions of appointment of Independent Directors
2. Familiarisation Programme of Independent Directors

- Training for Directors
- Meetings
- Board
- Shareholders
- Compliance Report on Corporate Governance
- Compliance
- RPT Disclosures
- Details of agreements entered into with the media companies and/or their associates

Conclusion

The IRDAI, Companies Act, 2013, and the respected governing bodies of different insurance players have played immense roles in improving the service and establishing ethics and lawful attainment of the business of the insurance sector. Their efforts have ensured the consumer's welfare and the long-term growth of the sector. With these guidelines, the number of frauds and inefficient practices of the insurance players has decreased considerably. Consumers can have greater faith in the companies and can have trust in the different products and corporate agents. This environment is good for the twin growth of policyholders and the long-term development prospects of the insurers, policyholders, and ultimately the country.

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