CHAPTER IX: MINISTRY OF FINANCE (DEPARTMENT OF FINANCIAL SERVICES-INSURANCE DIVISION)

National Insurance Company Limited

9.1.1 Loss due to breach of tariff in a petrochemical risk

National Insurance Company Limited committed a breach of tariff in a petrochemical fire risk policy by undercharging premium of Rs.5.33 crore. As a result, the Company paid penalty for an equivalent amount of Rs.5.33 to Tariff Advisory Committee. In addition, it failed to recover Rs.5.93 crore (under re-insurance arrangement) from The New India Assurance Company Limited against the policy towards fire loss due to breach of such tariff.

The Baroda Divisional Office (DO) of National Insurance Company Limited (Company) issued fire policies for the period from 1 August 2004 to 31 July 2005 to Indian Oil Corporation (IOCL), covering material damage risk of IOCL's Vadodara Petroleum Refinery for total premium of Rs.11.46 crore. The Company was the lead insurer sharing 70 *per cent* risk while The Oriental Insurance Company Limited (OICL) and United India Insurance Company Limited (UIICL) were the co- insurers for 12 and 18 *per cent* of the risk respectively.

Re-insurance was statutory under this category as it was a mega risk (sum insured Rs.5,735.92 crore). In re-insurance, a part of the risk along with proportionate premium is distributed to other insurance companies by the insurers. In the instant case, The New India Assurance Company Limited (NIACL) was the reinsurer for 14.41 *per cent* of loss. However the PSU companies have decided that such re-insurance cannot be automatic especially where there may have been underquoting of tariff etc.

Audit noticed (May 2006) that on 29 October 2004, IOCL intimated a fire claim in Fluid Catalytic Cracking (FCC) unit of Vadodara Petroleum Refinery. The claim was approved (June 2007) for Rs.62.88 crore in which the Company's share of loss was Rs.44.01 crore (70 *per cent*) and NIACL's share of loss was Rs.6.34 crore.

The Company committed a breach of tariff by undercharge of premium while underwriting the risk and had to pay (May 2005) a penalty of Rs.5.33 crore equivalent to shortfall in premium to Tariff Advisory Committee (TAC). NIACL did not agree for the re-insurance (March 2005) quoting breach of tariff. The Company also had to absorb NIACL's net share of loss of Rs.5.93 crore in the instant fire claim. Despite the fact of breach of tariff in December 2004, the Company did not prefer any supplementary bill for Rs.5.33 crore to the insured till May 2007 or adjust the same during the payment of claim.

The Company mainly contended (July 2009) the following:

- Representation was made (May 2005) to TAC and the risk was assessed by Loss Prevention Agency (LPA).
- The risk was inspected by a qualified engineer before quoting the rates who opined that TAC and LPA rates were not correct.
- The Company accepted NIACL's refusal to accept statutory cession for this policy for their share of claim.

The contention of the Company is not convincing for the following reasons:

- The Company was fully aware that the rates quoted by them at the time of bidding were not in consonance with TAC rates.
- The Company had also paid a fine for breach of tariff for the same risk in the earlier period (2003-04) as a co-insurer with UIICL.
- The Company itself calculated (January 2005) the difference of Rs.three crore approximately between their rates and that of TAC.

Thus, violation of tariff regulation caused the Company to suffer a total loss of Rs.16.59 crore[1].

The matter was reported to the Ministry in August 2009; their reply was awaited (November 2009).

The New India Assurance Company Limited

9.2.1 Irregular settlement of claim

Acceptance of an inadmissible claim towards car shells damaged during transportation resulted in loss of Rs.1.24 crore.

Divisional Office 121400 under Mumbai Regional Office of The New India Assurance Company Limited (Company) issued a Mega Risk Policy to Tata Motors Limited (TML) for a premium of Rs.11.85 crore for the period 01 April 2006 to 31 March 2007 to cover losses upto Rs.15300 crore[2] by way of Property Damage (PD) and Business Interruption (BI). The policy was co-insured with the United India Insurance Company Limited and Tata AIG General Insurance Company Limited to the extent of 40 *per cent* and 10 *per cent* respectively.

As a result of a fire at the Tata Motors Car Plant Paint Shop, Pune on 21 September 2006, TML lodged (September 2006) a PD claim of Rs.50.56 crore and a BI claim of Rs.136

[1] (Rs.5.33 crore shortfall i.e. under recovery in premium plus Rs.5.33 crore penalty to TAC plus RS.5.93 crore NIACL's net share of loss)

[2] Property Damage for Rs.12300 crore and Business Interruption for Rs.3000 crore

crore with the Company. While the PD claim was settled (September 2009) for Rs.47.05 crore, the BI loss was assessed at Rs.70.07 crore and settled (June 2008)[1].

The BI claim assessed at Rs.70.07 crore included Rs.2.48 crore towards loss on account of 789 passenger car shells damaged during transportation for painting from the TML plant at Pune to Kurla (in Mumbai) and back during the BI period, i.e., from 21 September 2006 to 31 January 2007. The Company should have disallowed this loss as clause 6.5 of the policy[2] expressly provided that insured would not be covered for any loss or damage that ought to have been covered by a *marine*[3] policy. The Company, however, overlooking this fact accepted the loss of Rs.2.48 crore as a legitimate claim within the terms of the Mega Insurance Policy. This resulted in a loss of Rs.1.24 crore[4] to the Company on account of the inadmissible payout to TML.

The Management (May 2009) / Ministry (July 2009) contended the following:

- The surveyors had allowed the cost of the damaged body shells as increased cost of working and not as transit damage. Had the insured taken separate marine policy only for the transportation of body in white, they would have claimed the premium for such policy as increased cost of working. The Company would have ended up reimbursing the premium as part of the BI claim and also the transit losses under the marine policy. The marine policy, if any, would have been availed from Company, as they are the major insurers for Tata Motors and also for the reason that the policy was to be taken arising out of the claim with the Company.

- Shifting of body in white to Kurla Plant from the affected plant, i.e., Paint shop at Pune, was necessary to prevent the escalation of the BI loss. Hence, expenses incurred were considered as loss prevention measures or increased cost of working. By admitting the liability, the Company had not been placed in any additional or avoidable financial burden.

The contention of the Management/Ministry is not convincing for the following reasons:

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[1] ***Interim payments of Rs.10 crore, Rs.20 crore and Rs.10 crore in September 2006, February 2007 and February 2008 with final payment of Rs.30.07 crore in June 2008. In a situation where there is a lead insurer and co-insurer(s) as in this case, the leader shall decide admissibility of claim and the same shall be binding on the coinsurers. The leader shall comply with the law and practice governing ascertainment of extent of loss, liability under the policy and ensure payment of claim strictly as per terms and conditions of the policy.***

[2] ***Clause 6.5 of the policy: "This insurance does not cover any loss or damage to property which, at the time of happening of such loss or damage, is insured by or would, but for the existence of this policy, be insured by any marine policy or policies except in respect of any excess beyond the amount which would have been payable under the marine policy or policies had this insurance not been effected".***

[3] ***Marine insurance "is concerned with the insurance of goods in transit from one place to another by sea, by inland waterways, by rail, road and air…." - extract from Chapter 1 of Marine Insurance (First Edition- Reprinted in 2008) published by the Insurance Institute of India.***

[4] ***NIA's share at 50 per cent of Rs.2.48 crore. The payout was Rs.0.99 crore (40 per cent) by the United India Insurance Company Limited and Rs.0.25 crore (10 per cent) by Tata AIG General Insurance Company Limited, the other two co-insurers.***

- Clause 6.5 of the policy applies to both Section I-PD and Section II- BI it specifically excludes any claim on account of loss or damage, which should normally have been covered by a marine policy.

- If the insured availed such a cover of marine insurance in the normal course, he would be required to pay the premium and as the claim did not fall under BI loss, the Company was under no obligation to reimburse the premium under BI loss.

- As per clause 6.5 of the policy, conditions (which is an exception clause), damages to body shells while in transport to Kurla and to Pune from Kurla for Rs.2.48 crore was not an item of admissible expenditure under increased cost of working. The damages are to be covered by a separate marine policy, which covers the insurance of goods in transit from one place to another.

Thus, the Company incurred an avoidable loss of Rs.1.24 crore on account of payment of an inadmissible claim.

The Oriental Insurance Company Limited

9.3.1 Short collection of premium in violation of IRDA instructions

In violation of Insurance Regulatory and Development Authority's instructions' the Company allowed a discount of 22 *per cent* over and above the maximum permissible limit of 51.25 *per cent* resulting in under recovery of insurance premium by Rs.1.50 crore.

Tariff Advisory Committee (TAC) had prescribed rate of premium to be charged on various classes of business. From January 2007, TAC withdrew the prescribed tariff rates. Consequently rates, terms and conditions and regulations applicable were regulated by The Insurance Regulatory and Development Authority (IRDA). IRDA asked (March 2007) all General Insurers to ensure that the discount over and above erstwhile tariff rate[1], even after introduction of de-tariff regime, should not exceed 51.25 *per cent* for individual rated risks.

A Delhi based branch of the Company issued an Erection All Risk Policy to Gujrat State Electricity Corporation Limited, Alstom (Switzerland) Limited, Alstom Projects India Limited and all affiliated companies (Insured) for the period 8 November 2007 to 7 January 2010 for the sum insured of Rs.1097.75 crore covering Material Damage, Third Party Liability and other add on covers.

Audit observed (September 2008) that the Company allowed an additional discount of 22 *per cent* over and above the maximum limit (51.25 *per cent*) permitted by the IRDA resulting in short collection of premium amounting to Rs.1.50 crore[2].

[1] ***Tariff rates that were applicable before withdrawal of the same by TAC in January 2007***
[2] ***plus service tax at applicable rates***

In response, the Management accepted (June 2009) the audit observation and asked the Insured to pay the differential amount. However, recovery of the amount was awaited (October 2009). Thus, allowing excess discount in violation of IRDA instructions resulted in under recovery of premium of Rs.1.50 crore.

The matter was reported to the Ministry in June 2009; reply was awaited (November 2009).

United India Insurance Company Limited

9.4.1 Avoidable loss due to incorrect classification of policy

Incorrect classification of a policy as "non-risk booked" led to omission of re-insurance arrangement and consequential loss of Rs.12.75 crore.

Each insurance company cedes a part of the risk underwritten to other insurance companies so that in the event of loss, the loss could be apportioned among them on an agreed basis. General Insurance Corporation of India Limited (GIC) frames such re-insurance policy for each year in consultation with public sector general insurance companies. Accordingly, United India Insurance Company Limited (Company) framed a re-insurance programme for 2007-08 for its field offices with directions to follow it without any deviation. The programme prescribed that all marine policies with sum insured exceeding Rs.five crore should be classified as risk booked (RB) and re-insurance arrangements made accordingly.

Kolkata Divisional office of the Company issued a marine cargo annual policy to ITC Limited (Insured) for the period from 1 April 2007 to 31 March 2008 for Rs.226 crore as sum insured. The policy covered all transit risks with a per bottom limit of Rs.2.50 crore and storage for 12 weeks *whilst in store* after reaching warehouse against the seven days normally allowed. The Company incorrectly classified the policy as Non-Risk Booked (NRB) on the basis of per bottom limit. Hence, no re-insurance arrangement was made.

Audit scrutiny revealed that:

- While the stocks were under 12 weeks storage in a warehouse at Bhiwandi a fire occurred on 15 July 2007 which destroyed the stock of cigarettes, tobacco and personal care products valuing Rs.18.36 crore.
- The Company settled the claim at Rs.16.53 crore as assessed by the surveyor.
- The Company could recover Rs.2.48 crore only from GIC being the 15 *per cent* obligatory cession and absorbed the balance loss of Rs.12.75 crore♠ due to incorrect classification of policy as NRB.

The Management stated (June 2009) as below:

♠ ***Total claim Rs.16.53 crore-(obligatory cession to GIC Rs.2.48 crore+retention by the company Rs.0.36 crore +excess retention of premium due to non-cession Rs.0.94 crore) =12.75 crore.***

- The risk was classified as NRB on the basis of per bottom limit of Rs.2.50 crore and that the claims in respect of storage extension under marine policies were very rare.
- While noting the audit observation, they also added that necessary instructions to operating offices were being issued for classifying the policies as RB or NRB.

The Ministry stated (November 2009) that these types of losses during storage on completion of transit were not common and as such reinsurance was arranged on per bottom limit.

The contentions are not acceptable as the underwriting office not only misclassified the policy but also deviated from the ban by the Company on storage extension for stock kept at final destination. Thus, absence of counter checking mechanism for deviations in underwriting and non-compliance with the storage ban led to an avoidable loss of Rs.12.75 crore.

9.4.2 Avoidable loss due to delay in re-insurance arrangement

Non-finalisation of facultative arrangement in time resulted in loss of Rs.1.43 crore to Public Sector General Insurers.

Divisional Office XI, New Delhi of United India Insurance Company Limited (Company) renewed (July 2002) a Group Personal Accident Policy for Indian Railways for the period from 01 August 2002 to 31 July 2003 with lead insurance of 34 *per cent* and co-insurance of 22 *per cent* each with National Insurance Company Limited, The New India Assurance Company Limited and The Oriental Insurance Company Limited. The Company arranged an excess of loss (XL) cover, to protect its net account from claims, through a broker on 07 September 2002 with deductible of Rs.two crore which covered only 20 *per cent* of the sum insured. The Company did not take balance XL cover, as terms and conditions with brokers were not finalised by then.

Rajdhani Express met with an accident on 9 September 2002 in which 117 (approximately) persons were killed and 207 were injured. The aggrieved persons preferred claims with the Railway Claims Tribunal.

Audit scrutiny revealed that:

- The Company had paid Rs.4.74 crore up to March 2009 towards various claims for the said accident.
- If the Company had finalised the XL cover in full on or before 31 July 2002, i.e., prior to commencement of risk, it would have recovered Rs.1.79 crore after adjusting obligatory recovery and deductible under XL cover, but it could recover only Rs.36 lakh for the 20 *per cent* cover taken. Hence, the Company along with co-insurers had to bear balance claims of Rs.1.43 crore.
- Additional claims of Rs.1.80 crore were yet (June 2009) to be decided by the Railway Tribunal.

While accepting loss the Management stated (June 2009) that: In spite of their best efforts, full placements could not be ensured before the accident resulting in avoidable loss of Rs.48.62 lakh to the Company and Rs.94.38 lakh to the other three public sector general insurers.

The Ministry stated (November 2009) that considering the competitive scenario and the rate quoted re-insurance support on proportional basis could not be completed. It further added that the loss was well within the net retention of Rs.two crore.

The replies are not acceptable in view of the following facts:

- The process for renewal had started (May 2002) well before commencement of risk (July 2002).
- The Company had enough time to make arrangements for appropriate re-insurance cover and failure to do so resulted in absorption of loss by Public Sector General Insurers to the extent of Rs.1.43 crore (June 2009).
- The Ministry's contention that the loss was within the retention level of Rs.two crore is not correct as the retention is to be reckoned with reference to the sum insured and not against the claim paid.

Thus, non-finalisation of re-insurance arrangement prior to inception of the risk resulted in loss of Rs.1.43 crore.

9.4.3 Avoidable loss on re-insurance arrangement

Under estimation of third party premium and non adherence to re-insurance programme resulted in avoidable loss of Rs.one crore.

Insurance Companies enter into re-insurance agreement with re-insurers to protect their interest from large claims. The re-insurance programme is drawn up by the Company in the beginning of each year to ensure appropriate re-insurance arrangements when policies are issued. The re-insurance arrangement is normally done in the form of proportional treaty or non-proportional treaty. For proportional treaties the premium is paid in proportion to the share of risk accepted by the re-insurer. In respect of non-proportional treaty like Excess of Loss (XL) cover, a Minimum Deposit Premium (MDP) is paid to the re-insurers based on the estimated gross net premium income (GNPI). At the end of the financial year, the actual premium income is assessed and shortage of MDP, if any, would be paid to the re-insurer. However, excess premium, if any, would not be refunded.

Instances of defective estimation of premium for arriving at MDP and inadequate placement of risk with re-insurers resulting in avoidable loss noticed in the re-insurance department of United India Insurance Company Limited (Company) are discussed below:

A. Excess payment of minimum deposit premium

The re-insurance department of the Company took an XL cover for the year 2007-08 to protect its net account from the claims of motor third party and workmen compensation. The Company budgeted its premium at Rs.1,460 crore, assessed the estimated GNPI at Rs.1,115 crore and paid Rs.8.27 crore as MDP.

Audit observed (June 2009) as under:

- The Company underestimated the outgo of Motor Thirty Party premium consequent upon introduction of Motor TP pool arrangement w.e.f., 1 April 2007.

- Enhancement in the EGNPI over budgeted premium from 71.42 *per cent* in 2006-07 to 76.37 *per cent* in 2007-08 was not justified in view of introduction of Motor TP pool. The estimates for EGNPI for the purpose of MDP should have considered the actual GNPI for previous year and in doing so it would have saved Rs.0.75 crore.

The Ministry stated (November 2009) that: Actual TP pool premium (Rs.404 crore) was higher than the estimate (Rs.149 crore) for GNPI working and added that the actual premium earning would vary sometimes as was in the present case.

The reply is not acceptable as underestimation of Motor TP premium (Rs.149 crore) and adoption of higher estimated NGPI for the year 2007-08 was not justified. This resulted in excess payment of Rs.0.75 crore[1] as MDP.

B. Avoidable loss due to delay in re-insurance arrangement

The Mumbai Division of the Company issued a special contingency policy to NEO Sports Broadcast (P) Limited covering seven 50 over international cricket matches between India and Australia starting from 29 September to 20 October 2007. The sum insured was Rs.16.07 crore for each one-day match.

Audit scrutiny revealed that:

- The Company retained more risk (16.55 *per cent* as against 12.44 *per cent*) contrary to the re-insurance programme for 2007-08.

- The first match was cancelled and the claim was settled for Rs.6.46 crore by absorbing Rs.1.07 crore to their net account. Due to retention of additional risk, the Company had to bear an additional loss of Rs.0.25 crore.[2]

The Management stated (June 2009) that this was due to delay in obtaining General Insurance Corporation's approval for re-insurance support. The Ministry, while endorsing the Management reply stated (November 2009) that considering the business quantum which was likely to emanate from such event, the Company decided to retain a small uncovered portion of the additional net.

The reply is not convincing as retention of more risk was contrary to the approved re-insurance programme and resulted from the Company's failure to make timely arrangement up to the prescribed level immediately on underwriting the policy.

Thus, the under estimation of Motor TP premium and non adherence to re-insurance programme resulted in avoidable loss of Rs.one crore in the above cases.

[1] ***Rs.1115 crore – Rs.1016 crore = Rs.99 crore X 0.758 per cent=Rs.75 lakh***
[2] ***Additional absorption Rs.26.55 lakh – additional premium retained Rs.82,000***