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

General Insurance Corporation of India

9.1 IT Audit on SAP-Reinsurance Module

Introduction

General Insurance Corporation of India (Company) has been catering to the reinsurance[♣] needs of Indian General Insurance Industry. The Company was designated as 'Indian Reinsurer' in November 2000, assumes reinsurance business from foreign insurance companies and leads the reinsurance programmes of several insurance companies in neighboring South Asian Association for Regional Cooperation (SAARC) Countries, South East Asia, Middle East and African continent. The Company has its registered and corporate office in Mumbai and overseas offices viz. representative office at Moscow and branch offices in London and Dubai.

IT systems were managed by IT Management Group (ITMG) housed in their Head office in Mumbai. General Manager heads the ITMG who report to the Chairman-cum-Managing Director of the Company.

Objectives of introducing ERP system

The Company implemented (August 2006) a comprehensive, integrated Enterprise Resource Planning (ERP) system using SAP R/3 covering all major functions such as reinsurance, investment operations, treasury operations, human resources and accounting with the objective of redesigning the Company's computerized framework in line with global standards.

Benefits of introducing SAP-Reinsurance

Some of the significant anticipated benefits were:

- Integrated system
- Detailed data capturing
- Automatic calculations of Commission etc.
- Loss Module with automatic generation of Statement of Accounts
- Check on Annual Aggregate Limit/Annual Aggregate Deductibles/claim payment with differential shares through the policy period
- Statistics for 100 *per cent* of premium and liability of original insurer and GIC share thereon

---

[♣] ***Contract made between an insurance company and a third party to protect the insurance company from losses.***

Objectives of Audit

The main objectives of audit were to:

- Assess whether benefits envisaged and planned by the Company were truly achieved
- Evaluate the security system, business continuity and disaster recovery procedure.
- Evaluate and comment upon the weakness in controls relating to SAP FS-RI Module so as to enable the Company to eliminate inaccurate, unauthentic and unreliable information for improved decision making
- Ascertain the existence of audit trail between underwriting, claims, accounting and actual collections/disbursements.

Scope of Audit

This IT Audit includes review of business process re-engineering, hardware and software procurement, customization and implementation of SAP R/3 with the prime focus on SAP Financial services-Reinsurance (FS-RI) Module viz. Basic System and Risk Manager and its link with accounting activities, security features in an ERP environment and training. The review covers the period from 2006-07 to 2009-10.

Audit Criteria

The criteria used for audit were:

- Companies Underwriting Manual and Claims Manual
- Business Process Document and Business Blueprint accepted by the Company

Audit Methodology

IT Audit methodology included correspondence, discussions with ITMG and data extraction using SAP query, SAP reports and analyzing the same using Computer Assisted Audit Techniques.

SAP Financial Services – Reinsurance System

SAP system was procured (December 2004), customized and implemented in August 2006 by engaging the services of WIPRO. SAP project implementation was carried out in a planned manner. The system implemented consisted of five modules viz. SAP-Financial Services-Reinsurance (FS-RI), SAP Financial Services – Collection and Disbursement (FS-CD), SAP Investment Management & Investment Control (IM-IC), SAP Financials & General Ledger Accounts (FICO-FIGL), SAP Human Relations including Payroll Administration and Payroll and SAP Net Weaver (including Business Intelligence and Business Warehouse). The Company spent ₹ 6.59 crore for implementation of this project and further incurred ₹ 7.46 crore towards data migration, maintenance and support and additional development as on 31 May 2010.

FS-RI consists of two sub modules viz. Basic System and Risk Manager. Basic system deals with treaty[1] reinsurance contracts and Risk Manager deals with policy administration of facultative[2] reinsurance contracts. Loss Management and reinsurance

[1] Treaty is a reinsurance contract which covers all the insurance policies coming within the scope of that contract, usually for a period of one year or more.

[2] Facultative Reinsurance is specific reinsurance covering a single risk.

programme functions were included in Basic sub-module.

Audit findings

The findings of Audit were as under:

9.1.1 General IT Controls

General IT controls encompassing project planning, business process re-engineering, involvement of senior level Management and structured steps in implementation were adopted by the Company. The acquisition and maintenance of hardware and software was carried out keeping in line with CVC guidelines. An inventory of IT Assets and physical access security to IT assets was in place.

9.1.2 IT Security Controls

The Company has framed IT security policies and procedures (December 2006) and the updated (December 2009) Policy was also communicated to all the officers and staff. An Information Security (IS) Audit comprising review of physical security, vulnerability assessment and penetration testing and review of information security management system in place was conducted (November 2009) by M/s. Appin Security Group. Recommendations of M/s. Appin Security Group were accepted and corrective actions were taken by the Management. However, audit has observed the following:

- At the time of installation of SAP certain standard users were automatically created with default passwords, which are commonly known or can be known from a search through internet. Such default passwords for Users viz. 'SAP*' and 'Early Watch' were not changed exposing the system to unauthorized access and high risk. On being pointed out by the Audit, the Company changed the default passwords, which was also verified by Audit.
- Eight user identifications were not deactivated despite their having been unused from the date of creation. The Audit point was accepted by the Company and users were locked at the instance of Audit. The Ministry while concurring with the Company's reply stated (December 2010) that a system has been introduced for review of unused identifications regularly.
- The passwords of the users were not changed after every 60 days as per the IT security policy of the Company. Necessary rectification actions were taken by the Company at the instance of audit. The reply of the Company was endorsed (December 2010) by the Ministry.
- The Company initiated steps in respect of off-site storage, Business Continuity Plan and Disaster Recovery. However, Business Continuity Plan and Disaster Recovery Procedure were yet to be communicated to all users and awareness enhanced. The Ministry replied (December 2010) that the availability of disaster Recovery System as well as the Business Continuity Plan had since been communicated to all.

9.1.3 System design

9.1.3.1 Non-linking of financial authority

In order to accept the business offer as well as for claim settlement, Company has defined financial standing authority. However, Company did not ensure to capture the financial

standing authority in the SAP system and link the same to underwriting/claims authorization through the system. The claim settlement process was kept out of the system and SAP system implemented does not reflect the actual business process.

The Company while accepting (September 2010) the audit observation stated that they would address the issues in the proposed functional upgrade of SAP system to derive maximum benefits from SAP. The Ministry concurred (December 2010) with the Company's reply.

9.1.3.2 Automatic calculations by system

Under proportional type of facultative arrangements, once the 100 *per cent* premium and liability was entered into the system along with coinsurance share of the cedent and Company's share of participation, the system ought to have calculated Company's share of premium and liability. However, in three cases, it was observed that premium was not calculated automatically resulting in differential (undercharged) premium amounting to ₹ 1008.01 (one case), AED 39,608 (one case) and Bahraini Dinar (BHD) 8905.68 (one case).

The Company in its reply (September 2010) accepted audit points and stated that the same would be considered. The Ministry endorsed (December 2010) the views of the Company.

9.1.3.3 Non-Mapping of Business Rules

Treaty status (such as create, declined, business not materialised, business materialised, business not taken up, cancelled by cedent etc.) in customized SAP system allow tracking of entry of offers and the progress of offers/proposals/quotations in various stages. Accounting of the business transactions ought to take place in accordance with the treaty status. However, the following instances of inconsistency of data were noticed due to non- updating of treaty status and due to improper validation.

No. of cases	Observations
153	The status of Treaties were displayed as 'create or copy' (signing of treaty slip and finalization of treaty were pending) mode as on 25 February 2010 although treaty period had expired.
02	Though the status of the treaty no. 35328 was shown as "create mode" for the period from 1.7.2008 to 30.6.2009 accounting transactions were made against and in respect of treaty no. 42020, the status was " create mode" for the period from 1.1.2007 to 31.12.2007, premium, commission and losses paid amounted to USD 139435.71 were accounted. The accounting transactions in respect of such un-materialized treaties were incorrect.
01	In respect of a retrocession treaty (33626), starting year and ending year was indicated as 5 May 5002 and 4 May 5003 while the status of treaty was indicated as 'business materialized'.
149	Although treaty period had expired in these cases, modifications to the treaty (such as date effective from, first account date, date of cancellation of treaty etc.) were allowed to be carried out. The system ought to have restricted any modifications after the treaty period had expired.
30	Brokerage amounting to ₹ 27.04 lakh was paid even though the business was

	directly assumed without involving broker. In seven treaties the broker code was blank and in 23 treaties dummy broker codes were allotted. This indicated improper customization and absence of linking between the broker-master to Treaty details.

The Ministry while agreeing with the above observations stated (December 2010) that it was not unusual for multinational companies to have breaking alliances and that based on the specific request from the subject Cedants, brokerage had been paid to them. They however added that the instances pointed out were due to erroneous feeding of data and would be corrected.

9.1.4 Input Controls

Input Controls are vital to the integrity of any application system. Input controls were reviewed with a view to ensure that the procedures and controls reasonably guarantee that (i) the data received for processing were genuine, complete, accurate and properly authorised and (ii) data entered were accurate and free from duplication.

The Company generally cannot underwrite any risk, unless it communicates to cedent[1] its response to proposal received from cedent about the risk. The willingness to underwrite risk is conveyed to cedent by way of communicating 'Written[2] (share) Line'. Once the treaty/policy terms and conditions are finalized the actual *per cent*age of share or specific amount is agreed between the cedent and the reinsurer[3], a treaty slip is signed by both the parties to agreement. This share is considered as Signed[4] (share) Line. Subsequently, a formal agreement is inked by both the parties to the contract. Keeping this business procedure, input controls and validations were subjected to check and following deficiencies were noticed.

9.1.4.1 Absence of validation in Written Line and Signed Line input

The following instances indicated absence of proper validation checks in the system:

- In 25 cases, Signed share was captured and business was shown as 'materialised' in the system though the Written Line was captured as zero.
- In respect of four facultative proportional[5] policies shown as 'materialised' in the year 2007-08, it was noticed that both the written line and signed line were not captured. System also indicated Company's liability to the extent of ₹ 19.08 crore in three cases and in another case involving USD 15,00,000.
- In five cases, though the status of policy was shown as "Business not materialized", the details regarding Signed Line was captured with Company's liability to the extent of ₹ 26.22 crore, 18.62 crore Taiwan Dollar and of 60 lakh USD.

---

[1] ***Cedent means the original or primary insurer; the insurance company which purchases reinsurance***

[2] ***Written share generally mean a per centage of original share or a specific amount of risk which the reinsurance company is ready to underwrite***

[3] ***Reinsurer is the insurer which assumes all or a part of the insurance or reinsurance risk written by another insurer.***

[4] ***Share signed in the Treaty slip***

[5] ***Proportional means a form of pro rata reinsurance indemnifying the ceding company for an established per cent or per centage of loss on each risk covered in the contract in consideration of the same per centage of the premium paid to the reinsurance company.***

- In two cases (Loss number 18358 and 4209) relating to loss accounting through the participation of Company was indicated as nil, payment of claim as well as outstanding amount have been indicated against those losses.
- Actual liability accounted by the Company cannot exceed the signed share liability. However, in 49 cases involving various currencies the system allowed accounting of liability more than the signed share of liability.
- In 20 cases the premium accounted differed from the signed share premium.
- Although, Annual Aggregate Limit (AAL)[♣] of ₹ 12.50 crore was defined in Treaty No. 43023, the loss amounting to ₹ 125 crore was entered in to the system erroneously. This error was rectified later.
- No liability can accrue to the Company without receipt of premium under facultative business. In 10 cases, Company's Facultative liability was indicated to the extent of ₹ 1707.31 crore (five cases), Taiwan Dollar 1.14 crore (three cases) and Arab Emirates Dirham 42 crore (two cases) although premium was indicated as zero.
- The loss mode was required to be defined in underwriting sub-module as either 'Accounting year basis' or 'underwriting year basis'. Upon selecting accounting year basis, system ought to have restricted claims occurring after the treaty period. It was noticed that in six cases amounting to ₹ 5.68 lakh although the loss mode was selected as accounting period, system did not restrict claims which had occurred after the treaty period.

The Company clarified (March 2010) that due to human error the loss mode was wrongly selected as 'accounting year basis' instead of 'underwriting year basis' under which the claims were payable.

- It was also noticed that in one case, the treaty was created on 9 October 2009 (Treaty No. 46769) whereas the accounting for the treaty was done prior to the date of creation of treaty i.e. on 1 July 2009.
- In one obligatory treaty no. 40815, system allowed booking and cancellation of brokerage to the tune of ₹ 9.03 crore on two different occasions although such treaty did not contain details of broker and brokerage.

9.1.4.2 Absence of maker-checker system

Data entry is done in off-line mode chiefly after processing of papers manually. The system did not indicate that data so fed in the system was subject to check by another official than the maker before saving. This is corroborated from the following illustrative cases:

- In the case of treaty no. 32139 the period was erroneously stated from 01.04. 0200 to 31.03.0201 at the time of creation of treaty. Instead of modifying or cancelling this entry, a fresh entry with correct dates was made. This indicates that data entered in the system was not subject to any date validation and that a maker-

---

[♣] ***Annual Aggregate Limit means cumulative of losses in a year that is agreed to be paid as maximum limit under that particular treaty.***

checker method was absent before saving data. Similar error was also noticed in treaty no. 35014.

- Para 4.2.6 of Business Blueprint provides that 'Profit Commission is calculated year-wise, company-wise as per the terms agreed in the treaty slip and that the profit commission is paid to cedent after the treaty books are finally closed'. It may be deduced from the above, that profit commission invariably was a 'Result Dependent Condition'. However, in treaty No. 47218 for 2009-10, the profit commission was included under the tab 'Result Independent Condition' due to incorrect data entry and absence of further supervisory checks.

The Company in its reply (September 2010) accepted the audit points and stated that these would taken up in the proposed functional upgrade of SAP system to derive maximum benefit from SAP**.** The Ministry concurred (December 2010) with the Company's reply and stated that the Company had initiated action to get the data entry corrected in the system.

9.1.5 Migration issues

9.1.5.1 The status of treaty no. 31952 was indicated as "Copy" from 1977-78 to 1984-85 and not as materialised. The status was not updated as on date.

9.1.5.2 It was seen that the cancellation date was indicated as '01-01-1900' in respect of 11286 migrated materialized treaties. It was further noticed that in some of the treaties migrated the details relating to premium, commission, loss paid, incurred claims, net balance and accounts booking were not available. In view of the above, accuracy and completeness of data migrated from the erstwhile system to SAP system was not being ensured.

The Company in its reply (September 2010) accepted the audit points. The Ministry endorsed (December 2010) the Company's reply.

9.1.6 Output Controls

In order to ensure that the accounting of premium is accurate, MIS reports on estimated premium income vis-à-vis actual premium booked by the Company was called for. However, it was noticed that that the Company could not utilize some of the MIS reports since many important fields were blank as the same were not made mandatory. During the course of certification of accounts for the year 2009-10, it was brought to the notice of the Company that due to this deficiency Company failed to account premium to the extent of ₹ 165.47 crore which was accepted by the Management.

The Company in its reply (September 2010) stated that they would revisit their requirement during SAP functional upgrade. The Ministry concurred (December 2010) with the Company's reply.

9.1.7 Training

Data input errors pointed above amply indicate that the training imparted was ineffective and had defeated the purpose of introduction of SAP system. Further, a system of obtaining feedback from the officers/employees immediately after the in-house training was not available and hence effectiveness of training could not be commented.

The Company replied (September 2010) that audit point is noted and a system of

obtaining feed-back from the participants would be made compulsory in future. The Ministry endorsed (December 2010) the Company's reply.

9.1.8 Post Implementation Review

The Company had not carried out a post implementation review (functional audit) of SAP although the system was stated to have been stabilized in 2008-09.

The Company replied (September 2010) that they were contemplating a functional upgrade of SAP in the beginning of next fiscal year and as a pre-requisite for the said exercise, they would be undertaking a full-fledged functional audit. The Ministry concurred (December 2010) with the Company's reply.

Conclusion

Re-designing the Company's computerization framework in-line with global standards cannot be considered as fully accomplished in the absence of (i) a real-time environment in implementing SAP system and (ii) configuring the approval of proposals, claim processing and settlement online by linking it to Financial Standing Order (FSO), despite incurring expenditure of ₹ 15.19 crore as on date. The input controls, validation checks were inadequate resulting in incomplete and incorrect data capturing in the system apart from manual intervention. Level of user awareness was inadequate to minimize errors during input stage of data. Further, awareness about Disaster Recovery Procedure was yet to be communicated to all the employees.

The Company replied (September2010) that efforts would be taken up for initiating Real-time environment including online approval of proposals, claim processing and settlement; adequate validations, input controls and automatic calculations as suggested would be incorporated during the functional upgrade of their system. The Company also stated that a comprehensive training encompassing majority of employees was being carried out and Disaster Recovery Procedure was being finalized and documented.

Recommendations

The Company need to:

- ***Introduce real-time SAP environment while upgrading the system***
- ***Strengthen input controls and process controls to ensure accurate, reliable and completeness of data.***
- ***Raise the level of user awareness and minimize errors of input data.***

The Company accepted (September 2010) the recommendations and assured to take up the same in order to reap the benefits from the ERP system of SAP in future and particularly during the proposed functional upgrade of the system.

The matter was reported to the Ministry in December 2010; reply was awaited (February 2011).

National Insurance Company Limited

9.2 Excess settlement of claim due to violation of Standard Policy Conditions

National Insurance Company Limited settled a claim in excess by ₹ 236.68 crore in violation of standard policy conditions of Industrial All Risk Policy.

As per Industrial All Risks Insurance Required (IAR) Policy, the cover in its widest form will include (a) Fire and all Special Perils, (b) Burglary, (c) Machinery Breakdown/Boiler Explosion/Electronic Equipment Insurance and (d) Business Interruption (Fire and all Special Perils). The Machinery Loss of Profit (MLOP) cover is optional and can be included by deleting Special Exclusions 1.4,1.5,1.6, and 1.7 to Section II of IAR Policy.

A Delhi based Divisional Office of National Insurance Company Limited (Company) issued an Industrial All Risk Policy to Satluj Jal Vidyut Nigam Limited (SJVN) for the period 28 March 2005 to 27 March 2006 for the sum insured Fire- ₹ 5029 crore, Machinery Breakdown- ₹ 1791 crore and Business Interruption (FLOP) ₹ 1420 crore covering its 1500 MW Nathpa Jhakri Hydro Electric Project (Project) consisting of six turbine generators of 250 MW each in Himachal Pradesh including common auxiliaries, accessories and civil works.

An incidence of water leakage occurred in unit No. 4 of the Project of SJVN on the night of 4 September 2005 and the Management found that labyrinth pipe and checkered plates were blown away. Subsequently, the Project was submerged with water and as a result of flooding, all the generators, accessories, unit control system and instrumentation suffered extensive damage.

Audit observed, that the Company settled the claim for Material Damage at ₹ 71.19 crore and Business Interruption at ₹ 236.68 crore under Fire Section instead of ₹ 71.19 crore only under Machinery Break Down Section, as the proximate cause of the loss was detachment/failure of the blind flange at the T junction of the pressure equalizing pipe (labyrinth leakage pipe), which was "Machinery Breakdown". Thus, no claim was payable for Business Interruption since the same was caused due to machinery breakdown and MLOP was not covered in the Policy as the insured had not opted for such cover.

The Management stated (August 2010) that in the initial stage of survey and during approval of 'on account' payment the joint surveyors relied upon circumstantial evidence and the reports of 'High Power Committee' and 'Internal Investigation Report' on the cause of loss.

The Ministry stated (January 2011) that technical expert was appointed to ascertain the proximate cause of the loss since the claim was highly technical in nature. Technical expert opined that the proximate cause of the loss was flood since failure of the flange would not and could not have resulted in flooding and the insurer cannot avoid liability under "Business Interruption section". The claim was settled on the basis of the Joint surveyor's final report and technical expert's finding which mentioned that detachment/failure of Blind flange at 'T' junction was the cause, was successive but not concurrent in their operation and 'Flood' was not the first or the last or the sole cause of the loss, and it was the dominant or effective operative cause.

The Management/Ministry's reply is not acceptable as the entry of water was caused by detachment/failure of Blind Flange at the T Junction pressure as reported by the Joint Surveyors in their report dated 19 November 2005. Further, as per findings (October 2005) of the High Power Committee appointed by Government of India and Internal Investigation, the cause of flooding of Power House was failure of blind flange at the T junction of the pressure equalizing pipe and dislodging of flange due to poor quality of welding as well as improper design. The above reports were based on laboratory tests. The Management disregarding all these three reports appointed another surveyor/technical expert one and a half years after the Joint Interim Loss Adjustment Report of the joint surveyors. Technical expert's report (January 2007) led the joint surveyors to change their initial report of November 2005 wherein they had clearly stated that water entry into the power house had been proximately caused by detachment of the blind flange, which was machinery breakdown and instead came up with a final report in April, 2008 wherein loss was then shown as caused by water which came under "Fire section" of the policy. Proximate Cause was Machinery Breakdown and water entered subsequently as admitted by the Ministry also that flood was not the first or the last or the sole cause of loss. Rather flooding was caused by dislodging of flange and so Machinery breakdown would remain as the proximate cause of loss.

Thus, the Company settled the claim in excess by ₹ 236.68 crore in violation of standard policy conditions of Industrial All Risk Policy.

9.3 Loss of rent

Failure to incorporate term on mutual evaluation of prevalent market rent in the agreement led to loss of rent of ₹ 7.85 crore

National Insurance Company Limited (licensor) owns the Royal Insurance Building at Churchgate, Mumbai. The total built up area is 57680 sq.ft [8240 sq.ft x 7 (ground + six)]. The licensor's own occupancy is 21604 sq.ft and remaining 36076 sq.ft is let out to either Government or private parties or lying vacant (July 2010).

In respect of an area admeasuring 11027 sq.ft (first floor 2787 sq.ft + third floor 8240 sq.ft) which was in the possession of M/s. Syngenta Group of Companies (the licensee), the following offer was made (August 2003) by the licensee to the licensor:

- Monthly rent at the rate of ₹ 60 per sq.ft with effect from 1 April 2003.
- Lease for a period of ten years.
- Provision of increase of rent at the rate of 25 *per cent* on completion of every five years, subject to mutual evaluation of the then prevalent market rent.

The licensor's Regional Office at Mumbai, in spite of independent valuation at the rate of ₹ 78/- per sq ft of the said premises in December 2002, proposed (September 2003) monthly rent of ₹ 60 per sq. ft. and the lease period as 10 years subject to approval of its Head Office. However, in respect of enhancement of rent while proposing 25 *per cent* increase after 5 years, failed to incorporate the term on mutual evaluation of the prevalent

market rent. The Head Office approved (March 2004) the proposal with the period of leave and licence agreement (LLA) divided into 4 terms of 30 months each.

Based on the above, the licensor and licensee signed (April 2004) the *LLA* for the initial term of 30 months (April 2003-September 2005). But for the second term of 30 months (October 2005 to March 2008) no *LLA* was executed due to some area dispute, which was later, settled (December 2007). Subsequently, the licensee was allotted (February 2006) further area admeasuring 8240 sq.ft on the second floor of Royal Insurance Building at the same rate of ₹ 60 per sq. ft. per month.

The *LLA* for the third term was executed with the licensee for all the three floors (December 2008) covering the period April 2008 to March 2011 (leave and licence period enhanced from 30 months to 36 months). The rent was fixed at ₹ 75 per sq.ft per month, 25 *per cent* more than the original rate of ₹ 60 per sq.ft per month.

Audit observed that though the *licensor* had got the market rent of the building (fourth floor) assessed (May 2008) by a Govt. Registered valuer at ₹ 257.77 per sq.ft. could not enforce the same while going in for the lease after 5 years in December 2008 due to failure to incorporate the term on mutual evaluation of prevalent market rent in the first *LLA* signed in April 2004. Thus, there was short realisation of rental income amounting to ₹ 7.85 crore during the period April 2008 to July 2010.

In the December 2008 *LLA*, however, the licensor included the term saying that 'the parties hereto may mutually agree upon the renewal of the arrangement herein granted, on such terms and conditions as may then be agreed to between the parties'. The inclusion as above clearly revealed the lapse on the part of licensor in inclusion of the term on mutual evaluation of market rent in the LLA of April 2004 though the licensee had offered the same.

Ministry replied (November 2010) that the rate agreed to was realised and added that the provision regarding market rent was omitted as it was an extension of item relating to increase in rent by 25 *per cent* after completion of 5 years.

The reply was not convincing as the Company failed to incorporate the offer of the licensee on increase in rent subject to mutual evaluation of market rent due to which it could not enforce the market rent of ₹ 258 per sq.ft in the renewal after 5 years for the period April 2008 to March 2011.

Thus, lack of due diligence resulted in failure to incorporate the relevant term in the offer and in subsequent LLA leading to loss of rent of ₹ 7.85 crore to the Company.

Recommendation

The Company may strengthen the internal control mechanism to ensure that due diligence exercise is comprehensive while entering into LLAs.

The New India Assurance Company Limited

9.4 Excess settlement of claim

Settlement of a claim ignoring the policy conditions resulted in excess settlement of ₹ 10.65 crore.

Divisional Office 510700 under Kolkata Regional Office of the New India Assurance Company Limited (NIA) (insurer) issued a Standard Fire and Special Perils Policy covering building and stocks to Hotel Trident (unit of EIH Limited-insured) for the period from 01 April 2008 to 31 March 2009 for a sum insured of ₹ 780.92 crore. Another policy was also issued for the same period covering Consequential Loss with an indemnity period of 12 months, for a sum insured of ₹ 232.85 crore. The relevant fire policy had a terrorism extension coverage, subject to an excess of 0.5 *per cent* (i.e. ₹ 5.07 crore) of the combined Sum Insured in respect of both 'Material Damage' and 'Loss of Profit' for each and every loss.

There was an act of terrorism in the Hotel on 26 November 2008 causing damage to the building and contents. It took 25 days to repair the damage. The hotel became fully operational and was reopened on 21 December 2008. Tentative loss assessed by the surveyors for Material Damage and Business Interruption for 25 days was ₹ 16.50 crore (₹ 50 lakh for material damage and ₹ 16 crore[♣] for consequential loss). The net admissible amount worked to ₹ 11.43 crore after adjusting policy excess of ₹ 5.07 crore. The insured reported (April 2009) a business interruption of 12 months after the occurrence and a claim for ₹ 91.17 crore on the plea that their working results could not be normalised within the insured indemnity period of 12 months. So, the surveyors revised their estimated loss to ₹ 55 crore and then to ₹ 66 crore. Final report of the surveyors was yet to be finalised (December 2010). On the recommendation of the surveyors in December 2008 and in April 2009, ₹ 3 crore and ₹ 15 crore respectively were released to the insured as 'on account' payment.

It was observed in Audit that:

- The preamble of the Consequential Loss (Fire) policy had clearly laid down that the benefits under the policy would be available only to the extent the business was interrupted in consequence of the damage or destruction to the insured property arising from the occurrence of the perils covered under the fire policy.

- The properties insured were building and its contents. The damage to the said properties was completely repaired and the hotel became fully operational in 25 days. Once the earning capacity of the insured properties damaged by the insured peril was restored, the damage ceased to interrupt the business. The insurer was not liable for the revenue shortfall on account of other factors such as loss of goodwill, global economic slowdown etc; as they were either non-insurable interests or uninsured perils.

- The maximum indemnity available under the policy was only ₹ 7.35 crore. However, ₹ 18 crore was paid to the insured by way of 'on account' payment resulting in excess payment of ₹ 10.65 crore.

The company in their reply (July 2010) admitted that the interruption period would end for all practical purposes on restoring the property damage. It however added that till the time the results of business had been affected in consequence of this damage and there was achievement of normalcy of business results, the insured would be indemnifiable. In the instant case, according to the Company, even after the re-opening of the hotel on 21

[♣] ***₹232.85 crore x 25/365 =₹15.95 crore***

December 2008, it took several more days for the normalcy in business results to return due to factors such as lingering fears in the minds of the clientele, global economic slowdown, cancellation of confirmed booking by Corporates etc. Thus, the Company viewed the 'on account' payment of ₹ 18 crore made in line with the policy coverage.

Ministry concurred (October 2010) with the Company's views and stated that (i) policy given to the insured was an Industrial All Risk policy under which terms & conditions were quite different from standard fire and special peril policy (ii) interruption would continue till the normalcy of the business results were attained as per the provisions of the policy under BI (Business Interruption) and (iii) the loss assessment was done on provisional basis for releasing on account payments.

The reply of the Management/Ministry was not convincing as:

- The policies in question were (i) a standard fire and special perils policy with terrorism extension and (ii) a consequential loss (Fire) policy relevant to the standard fire and special perils policy. Hence the terms and conditions were in no way different.
- The claim for business interruption beyond the date of restoration of property damage would be admissible only if the business results would not have been affected had there been no property damage. In other words, the insured need to establish that the interruption (revenue shortfall) beyond the date of restoration of the property damage was solely attributable to property damage. In the instant case, the insured themselves anticipated and clarified that the normalcy in room occupancy would not be achieved during the indemnity period because of the impact of terrorism. Thus, the business interruption after the date of reopening of the hotel was not in consequence of property damage but on account of the impact of terrorism and global slowdown which were extraneous causes as far as the scope of the consequential loss policy was concerned. This point was made clear to the Company by the surveyors themselves in their letter dated 29 September 2009, wherein they stated that a distinction would have to be drawn between 'in consequence of the damage' and 'in consequence of the incident i.e terrorism' and that the interruption in consequence of fear of terrorism would not be covered.

Thus, the settlement of the claim beyond the scope of the policy not only entailed loss of ₹ 10.65 crore but also the Company would be obliged to settle similar claims in future for 'Loss of Profit' in consequence of the incident quoting this case as a precedent.

The Oriental Insurance Company Limited

9.5 Claims Management and settlement in Northern Zone

Introduction

Insurance is a contract in which an individual or entity receives financial protection or reimbursement (indemnity) against losses from an insurance Company. Thus, an insurer settles claims against policies issued by him. The efficiency of the claims management and settlement process has a direct impact on a Company's ability to retain customers.

Audit objectives

The theme audit was conducted to assess:

- the system of processing and disposal of claims;
- the system of appointment and efficiency of service of surveyors in settlement of claims; and
- monitoring mechanism to ensure timely recovery from co-insurers.

Scope of Audit

The Northern Zone has seven Regional Offices, of which it was decided to cover two Regional Offices[1] and Seven Divisional Offices[2]. Audit test checked 2702 claims (out of 13508) settled during 2008-09 to 2009-10 during May 2010 to August 2010. Since, 'Health Service Insurance' was examined during 2009-10 and its audit findings stand included in Report No. 10 of the Comptroller and Auditor General of India (CAG) for the year 2010-11, these claims were not covered.

Audit methodology

Audit reviewed the records maintained for appointment of surveyors, surveyors' reports, settlement of claims at operating offices & service centres and various reports generated under management information system besides discussions with the unit heads and other officers of the Company.

Audit criteria

The following criteria were used:

- Insurance Act, 1938;
- IRDA's regulations;
- guidelines issued by the Company for processing, and settlement of the claims;
- various reports and returns prepared under MIS;
- records relating to appointment of surveyors, surveyors' reports;
- functioning of service centres set up exclusively for centralized settlement of claims; and
- review of money due to/from other persons or bodies carrying on insurance business.

Audit findings

The details of the policies issued, premium collected, number of claims settled (including claims reported and outstanding) by Oriental Insurance Company Limited (Company) and its Northern Zone for the period from 2007-08 to 2009-10 is given in *(**Annexure-IV**)*.

An analysis of the details given in above Annexure revealed that there was a considerable increase in number of claims settled during the year 2009-10 indicating the Company's resolve to settle claims faster, there was no significant progress in settling claims

---

[1] ***Delhi Regional Office – I (DRO-I) and Delhi Regional Office –II (DRO-II)***

[2] ***Divisional Office (DO) – I, II, VI, XVIII & XX under DRO-I and DO – XIII & XXII under DRO -II***

outstanding for more than six months during the period. Total claims outstanding for more than six months constituted 73.67 *per cent* and 51.78 *per cent* of total claims outstanding as on 31 March 2010 in respect of the Company and Northern Zone respectively. As against this, the percentage of claims outstanding for more than six months was 54.16 *per cent* of total claims outstanding in respect of DOs reviewed in audit. Audit observed that performance of the Company could further improve by strengthening its system and ensuring compliance thereof as discussed below.

The Management stated (September 2010) that in view of high percentage of pendency in various offices, a claim review committee was constituted in DRO I & II and within a period of three months there would be sizeable reduction in number of claims outstanding.

9.5.1 System deficiencies

9.5.1.1 Appointment of surveyors: The IRDA[1] Regulations require insurers to appoint surveyors to assess the loss within 72 hours of receipt of the claims. It was noticed that there were delays in appointment of surveyors in 151 out of 2702 claims reviewed.

The Management stated (September 2010) that efforts would be made to follow the guidelines of IRDA and Regional Offices (DRO I & II) were issuing fresh directives to all the controlling offices.

9.5.1.2 Delay in receipt of survey reports from surveyors: Surveyors are required to submit their reports within 30 days of appointment. It was noticed that this timeframe was not adhered to in 987 cases out of 2702 claims reviewed.

The Management stated (September 2010) that the Regional Offices (DRO I & II) were instructing all surveyors that in case of delay in submission of reports, an interim report should be submitted as per IRDA guidelines.

9.5.1.3 Delay in settlement of claims: IRDA Regulations require that the claimant be offered a settlement within 30 days of receipt of the survey reports. However, there were delays beyond this period in 684 cases out of 2702 claims reviewed.

The Management stated (September 2010) that they were making strenuous efforts to make up the delay by drawing the attention of the operating offices and reiterating the provisions of IRDA regulations applicable to the settlement of claims and both the Regional Offices (DRO I & II) were instructing their DO in-charges accordingly.

9.5.1.4 Non-settlement of claims through in-house surveyors: In line with IRDA's regulations as well as Insurance Act, 1938, the Company's guidelines stipulate that 'In case of claims of less than ₹ 20,000, survey by a licensed surveyor is not mandatory. Such losses may be surveyed by the Company's officials (in-house survey) if survey is required'. Following this some of the DOs have incorporated a clause in tender document (DO-I customer IOCL[2]), risk Management programme (DO-VI customer Bharti Airtel) and in policy terms (DO-II customer Bennett & Coleman Ltd) waiving the survey in case of losses upto ₹ 20,000. However, review of records of the selected divisional offices revealed that the licensed surveyors were appointed even in cases where the services of

---

[1] ***IRDA: Insurance Regulatory and Development Authority***
[2] ***IOCL: Indian Oil Corporation Limited***

in-house surveyors should have been utilised. This resulted in avoidable payment of survey fee of ₹ 10.45 lakh in 638 claims settled for ₹ 31.86 lakh.

The Management stated (September 2010) that in most of the cases where the surveyor was deputed, the estimated loss was more than ₹ 20000 but the final assessment was less than ₹ 20,000 and the services of in house surveyors will be utilised where the estimated loss would be less than ₹ 20000. The reply is not tenable as the audit considered the cases where the reported loss was less than ₹ 20000 and claim settled was also less than ₹ 20,000.

The above four issues were brought out earlier also in CAG's Report No.15 (para 4.6) of 2008. Effective internal controls were yet to be implemented in all operational offices of the Company with periodical monitoring at highest level to reduce delays in settlement of claims at different stages.

9.5.1.5 Evaluation of survey work: Though, the Company prescribed evaluation of surveyors' performance through average qualitative ratio based on time taken for submission of report, assessed and settled amounts, it was observed that the service centers both at DRO-I and DRO-II rated all the existing surveyors as 'Excellent' for the period under review. The rating was not justified in view of the fact that there were many delays in submission of reports and variations in assessed and settled amounts.

The Management stated (September 2010) that both the Regional Offices (DRO I & II) had constituted a Committee to review performance of the surveyors and would submit their report on quarterly basis to their DGMs. Steps need to be taken to review the performance of surveyors at all operational offices in the Company.

9.5.1.6 Establishment of Service Centers: To improve upon client satisfaction, the Company took a pioneering initiative during the year 2008-09 in establishing 'Service Centers (SVC)' in Regional Offices for centralised settlement of claims excluding health. The service centre, being a specialised office is expected to settle claims faster for the offices attached to it. The position of establishment of SVCs at DRO-I & II is given below.

Name of Office and date of starting SVC	Total DOs functioning	DOs attached to SVC	Type of claims attached as on 31 March 2010
DRO-I SVC March 2008	15	12	Motor OD claims of all 12 DOs and all types of other claims relating to five DOs
DRO-II SVC February 2009	13	11	Only Motor OD claims

Audit observed that in the 21 SVCs which were running across the country the average turnaround time of settlement of claims was 30 days and 29 days during the years 2008-09 and 2009-10 respectively in respect of motor own damage (OD) claims. As against this, the average time taken by SVCs at DRO-I and DRO-II was 43 and 44 days respectively during the year 2009-10. Though the Management created different types of MIS for Management analysis of functioning of SVC, it was observed in audit that only the position relating to outstanding claims was monitored by the Management.

The Management stated (September 2010) that corrective measures had been taken and the position would improve in 2010-11.

The purpose of establishment of service centers was that the operating offices would be freed from non-marketing activities and devote more time for sales. However, as the job of settlement of claims was being done both at service centre and at operating offices concerned the purpose of utilising the resources efficiently was not achieved. All the claims were not attached to the SVCs for settlement along with existing manpower of operating offices. This resulted in lower share of SVC i.e. only 28.18 *per cent* in settlement of claims in the selected DOs during the year 2009-10 even after two years of conceptualisation of establishment of SVCs.

The Management stated (September 2010) that the reason for low share of SVC was that, two DOs were not attached to SVC, one DO for all claims and others for motor claims. Initially motor claims would be attached to SVC and after stabilisation other claims would be attached. Accordingly in the 21 SVCs running across the country other claims would also be attached. Reply is not acceptable as Audit did not consider data of DOs that were not connected to SVCs. The percentage of settlement was with reference to total claims settled by DOs including SVC indicating that the job of settlement of claims was being done both at SVC and at operating offices without utilising the resources efficiently.

Recommendation

The Company may expedite attaching all the departments to the service centres for expeditious settlement of claims.

9.5.1.7 Outstanding share recoverable from Co-insurers on settlement of claims: As per Company's guidelines the principal insurance company will process the claim on behalf of all the coinsurers. The coinsurers shall settle their share of the claim within 15 days from the date of receipt of such intimation from the leader without any delay.

A review of records revealed that in 105 out of 276 cases settled during October 2007 to March 2010 relating to DO I & DOVI of Delhi RO I an amount of ₹ 1.13 crore recoverable from co-insurers was not settled within the prescribed period. The co-insurers share was outstanding for a period ranging from 4 months to 33 months (July 2010). In DO II & DO XX Delhi RO I an amount of ₹ 18.96 lakh (number of cases not made available) was outstanding from co-insurers for a period ranging from 4 months to 16 months (July 2010). Whereas, there was nothing outstanding against claims payable on outgoing co-insurance basis in case of the DOs selected for audit except in DO-VI for ₹ 0.51 lakh. It was observed that the details of settled claims were not intimated to the co-insurers in 68 cases (July 2010) amounting to ₹ 73.19 lakh which remained unrecovered (September 2010).

There was no system of reconciliation of the amounts due to / from other persons or bodies carrying on insurance business in the Company. The amount of huge cash outflow on account of settlement of claims on behalf of other insurers without reconciliation/ early settlement was detrimental to the interest of the Company.

The Management stated (September 2010) that recommendations of audit were noted and suitable instructions were issued to operating offices to intensify efforts for recovery of co-insurers' share of premium and claims settled.

Recommendation

The Company may introduce a system of periodic reconciliation for collection of the

amount paid on behalf of other co-insurers and ensure the compliance thereof.

9.5.2 Compliance deficiencies

Terms and conditions of the policy are the guiding principles for settlement of the claims and are binding. During test audit of seven selected Divisional Offices of the Company, instances were noticed from among the selected sample of 2702 claims settled (20 percent of total claims settled) in different operational offices wherein, the Company settled the claims ignoring the stipulated policy conditions which resulted in *avoidable expenditure of ₹18.14 crore* as discussed below:

Claims settled on compromise basis

9.5.2.1 In DRO-I a loss of theft/robbery of goods occurred on 01 June 08 under special contingency (Exhibition of Jewellery in USA) policy issued in favour of M/s GM Products Pvt. Ltd. for the period 22 May 2008 to 22 July 2008. As per the policy the plain/studded gold jewellery (goods) was to be kept in one tin box and the Company was not liable if the goods were left unattended. The surveyor in the report stated that the goods were kept in two bags and the insured lost attention due to distraction which resulted in the loss. Though the loss took place due to chain of events yet there was negligence on the part of the insured in taking proper care of goods as opined by BO/DO also. However, the claim was settled on compromise basis for ₹ 1.02 crore which was not payable as per terms and conditions of the policy, as the goods remained unattended to at the time of robbery.

The Management stated (September 2010) that attending to the insured goods was a matter of interpretation as per the circumstances at the time of loss. In the instant case, the insured had placed the bags on the floor closed to their body and were very much attended to by them. The reply was not acceptable as the form of carriage was changed to two packages instead of one tin box which was in violation of policy conditions. The claim should not have been settled based on interpretation of circumstances which was subjective. In absence of the Company's norms to settle claims on non-standard basis in such special contingency (Exhibition of Jewellary) policies, the claim should have been repudiated.

9.5.2.2 DRO-I settled a claim in August 2009 for ₹ 73.81 lakh on compromise basis under all risk policy (Jewellers' policy) issued in favour of M/s K.K. Jewels Impex. The Company was not liable in case of a theft occurred from a car other than the one which was not fully enclosed type having at the time all doors and windows and other openings securely locked and properly fastened. Audit observed that car doors were open leaving the keys inside and the goods were in suitcases instead of stored in tinned boxes hence the claim was not payable as per exclusion clause of the policy.

The Management stated (September 2010) that the case met all the requirements provided in the policy and the stand that car was left unattended to and that there was failure to take reasonable steps to safeguard the jewellery or lack of efforts to retrieve the same from the robbers would be untenable. The reply was not acceptable as the theft took place from a car which was unlocked and not properly secured establishing the facts that reasonable care was not taken. Hence, the claim was not payable as per exclusion of the policy and also general principles of insurance.

Claims on Machinery

9.5.2.3 DRO-II settled a claim in August 2007 against a Mega Risk Policy issued (July 2005) in favour of NTPC Limited for ₹ 4.98 crore. In contravention of policy condition that the actual value of machinery damaged shall be payable after deducting depreciation at five *per cent* per year on reducing method subject to maximum of 50 *per cent*, the Company settled the claim without deducting ₹ 1.51 crore towards depreciation.

The Management stated (September 2010) that this clause was amended from the policy period 1 July 2006 onwards and endorsement in this regard was issued in June 2007. The reply is not acceptable as the clause revised from the policy period 1 July 2006 onward was not applicable in the instant case as the subject claim settled by the Company was based on the policy for the period 1 July 2005 to 30 June 06 i.e, before issue of the endorsement.

9.5.2.4 In another case, under the policy issued (July 2007) in favour of NTPC Limited the Company settled a claim in April 2009 for ₹ 6.78 crore in respect of damage of a 23 year old Generating Transformer without applying the exception clause as per the policy terms which stipulates that the insurer shall not be liable for damage due to continued operation. The high power enquiry committee and the surveyor report also specifically stated that the loss was due to gradual deterioration for being used for more than 23 years. Ignoring these reports, the Company settled the claim for ₹ 6.78 crore.

The Management stated (September 2010) that these transformers were operating for the past 35 years at various places and such transformer can also be used for a period of 40 years. Reply is not acceptable as the loss took place due to gradual deterioration of insulation because of accelerated aging of transformer which was also confirmed by the surveyor and high power committee appointed in this case.

Claims not reported within the prescribed time

9.5.2.5 In case of an all risk policy (Jewellers) the insured (M/s Crystal gold Pvt. Ltd.) was required to give immediate notice and furnish a statement of loss within 14 days of the date on which the event occurred. A claim reported on 14 July 2008 for the loss occurred on 19 June 2008 was settled on non-standard basis for ₹ 37.37 lakh instead of repudiating it as recommended in survey report.

The Management stated (September 2010) that reporting of the claim after gap in no way adversely affected the quantum of loss. Reply is not acceptable. The Company had lost the opportunity of first hand investigation of the incident and there was no justification for delay in reporting the claim in view of the fact that the insured Company had its office at Delhi and also got confirmation from the police that the goods were not recoverable and traceable.

9.5.2.6 As per the transit insurance policy issued to Food Corporation of India by DO-VI, the insured was to submit insurance claims with supporting documents for any transit loss of grains to the Company through authorised broker on fortnightly basis. Scrutiny of data revealed that the DO settled 757 claims during the period 2008-09 to 2009-10 for an amount of ₹ 6.48 crore where the delay in lodging the claims ranged from 17 to 1200 days beyond the stipulated period.

The Management while accepting the observations of the audit stated (September 2010) that it is issuing instructions to offices suitably and the delays were inevitable considering the size and span of operations. The reply is not acceptable in view of the fact as the volume, size and span of operations of FCI was known to the Company before entering into the agreement.

9.5.2.7 Terms and conditions of the special contingency policy (default in payment by insured's distributors) issued to M/s. Metro Ortem Ltd in DO- XX required:

- a periodical declaration by insured about unpaid invoices of more than 120 days;
- quarterly declaration of the list of debtors who delayed their payment beyond 30 days; and
- that the insured should not agree to any rescheduling of payment of an insured debt without prior written approval of the Company.

Even though the insured did not adhere to any of these conditions, the Company settled a claim for ₹ 3.85 lakh on non-standard basis.

The Management stated (September 2010) that on the basis of the legal opinion and keeping in view the commercial relations with this client it was decided by the competent authority to settle the claim on compromise basis. The reply is not acceptable as lower claim ratio of the insured was not a valid ground to settle an inadmissible claim.

9.5.2.8 As per the Marine policy (M/s. Maharashtra Seamless Ltd.), the insured was required to lodge claim for loss on the port authorities, sea/road carriers within a stipulated period of seven days and one year respectively from the date of discharge at port failing which the claim should be settled on non-standard basis being recovery rights not protected. In this case no claim was lodged on port authorities and road carriers rejected the claim. However, the Company (DO-XIII) settled the claim fully for ₹ 95.72 lakh instead of settling on non-standard basis by deducting ₹ 23.59 lakh.

The Management stated (September 2010) that claim on sea carriers was lodged within one year and rights of recovery was protected. Further, a recovery suit was initiated. However, the fact remained that no claim was lodged on the port authorities and the road carriers while refusing the claim stated that the damage could have occurred at handling point at port. Further, as per the records made available to audit no recovery suit was initiated on the sea carriers.

Inadmissible payment of duties

9.5.2.9 In terms of CENVAT Credit rules♣ a manufacturer or producer of final products or a provider of taxable service shall be allowed to take credit for duties paid such as Excise duty, Counter Vailing Duty (CVD), education cess on CVD and additional duty on inputs. Scrutiny of the claim files in selected offices revealed that though the offices concerned were deducting the amount incurred by the insured towards the duties for which the insured is entitled for availing CENVAT credit, there were instances in which the Company made payments to the extent of ₹ 52.74 lakh on this account. This was mainly due to absence of clear instructions from the Company in this regard and based on recommendations of the surveyors' concerned.

♣ ***CENVAT Credit Rules, 2004 issued by Government of India***

The Management issued (October 2010) a detailed circular to make the issue more clear and understandable for all the dealing officials.

Recommendation

The Company may introduce effective internal control system in operating offices and ensure compliance thereof.

Miscellaneous Issues

9.5.2.10 DO VI allowed claim expenses towards architects, surveyors & consulting engineers charges in excess of three *per cent* i.e. ₹ 43.41 lakh permissible as per the terms of the policy in respect of a fire claim relating to M/s. Jindal Steel & Power Ltd in July 2009 . The Management stated (September 2010) that these expenses were part of repair charges directly related to the repair costs and hence part of assessment made by the surveyors. The reply is not acceptable as charges paid were part of the payments made to consultant engineers/ service engineers for stay, travel etc, towards inspection.

9.5.2.11 Insuring the vehicle at higher Insured Declared Value (IDV) in two cases (one each in DO-XIII and DO-XXII under DRO-II) resulted in excess settlement of claims (₹ 27491 + ₹ 40900) by ₹ 0.68 lakh.

The Management stated that to educate and clarify the interpretation of GR 8 of Motor Tariff a circular from HO was being issued to all Regional Offices.

Conclusion

There was significant achievement in reducing the turnaround time of settlement of claims to 30 days and 29 days during 2008-09 and 2009-10 in respect of Motor OD through attachment of a few operating offices with service centers. However, adherence to time schedule in appointment of surveyors, receipt of survey reports, utilization of services of in-house surveyors, settlement of claims and recovery from co-insurers required further improvement as discussed in preceding paragraphs.

There were deficiencies in compliance with the terms and conditions of policies leading to payment of inadmissible claims amounting to ₹ 18.14 crore. Compliance deficiencies related to settlement of claims, on compromise basis, without deducting depreciation or damage, belated reporting of claims and settlement on other than on non-standard basis etc. Thus, the Company needs to improve its internal controls, system of processing and disposal of claims and enforce strict observance of the terms and conditions of the policies.

The Management while noting the issues stated that by the end of 2010-11 they expected to fully centralise the claim processing at the service centers; issue strict instructions duly providing for controls in all offices for appointment of surveyors and getting reports within prescribed time limits. Further, strict action would be taken against defaulters and instructions on statutory matters were being given from time to time by way of circulars, letters, workshops and training sessions.

The matter was reported to Ministry in September 2010; reply was awaited (February 2011).

United India Insurance Company Limited

9.6 Internal controls on Underwriting

Introduction

Insurance Regulatory and Development Authority (IRDA) was constituted (April, 2000) to regulate, promote and ensure orderly growth of the insurance and re-insurance business in India. As a result of opening up of insurance sector and de-tariffing 'Marine Cargo' and 'Fire and Engineering insurance', insurance companies were permitted to fix the tariff for underwriting after independent risk analysis, subject to limit on maximum discount on tariff rates earlier fixed by Tariff Advisory Committee (TAC). In the de-tariff scenario, United India Insurance Company Limited (UIIC), instead of doing fresh risk assessment and fixing premium rates on their own, reduced the basic rates fixed by TAC by a fixed percentage and adopted this as their guideline rates. Further, discounts were also permitted on the guideline rates to market insurance products. UIIC delegated powers to its operating offices (Regional, Divisional and Branch Offices) for underwriting business and allowing discounts. The underwriting procedure for Fire and Engineering and Marine procedures were manualised and additional instructions as necessary were being issued as circulars.

Scope of Audit

Audit undertook (August 2010) a study on compliance with guidelines on underwriting by operating offices in respect of selected Fire, Engineering and Marine Cargo portfolios. These constituted 24 *per cent* of the total premium for all portfolios of ₹ 9,517 crore during 2008-09 and 2009-10 by selecting 688 policies for underwriting limits and 215 policies for discount from 10 Divisional offices (DOs) under two Regional offices (ROs).

Audit Objectives and criteria

Audit was conducted with the objectives to review the adherence to:

- manuals, procedures and instructions on underwriting as part of internal control mechanism; and
- IRDA guidelines on discounts.

Audit examined these with reference to the following criteria:

- IRDA's regulations regarding discount
- Manuals, guidelines and circulars issued for policy underwriting
- Delegation of powers by the UIIC

Audit Findings

9.6.1 Manual of procedures for underwriting and claims settlement

The manuals for Fire and Engineering and Marine were updated in 1987 and 2001 respectively. However, in the de-tariffed regime, where the companies had been permitted to fix their own tariff based on proper risk assessment, these manuals have become outdated and irrelevant.

Recommendation

UIIC may expedite preparation of Manuals for the de-tariff scenario.

9.6.2 Issue and receipt of circulars/Instructions issued by Head office

- The circulars issued by the Head Office of the UIIC were neither subject-wise nor serially numbered to enable the receiver to ensure receipt of all circulars. The circulars / instructions were also put on the intranet of UIIC. However, no archive of all circulars was available. In spite of the dual system existing, the operating offices could not keep themselves updated of the latest circulars.
- No system existed at the Head Office to obtain acknowledgement for the receipt of circulars from the field offices.
- None of the sampled offices had all the circulars as per the HO list.

Audit selected five circulars at random issued (not through intranet) during the years 2007-09 by the Fire Tech Division of Head Office and test checked its receipt by the operating offices. It was observed that in six of the 10 DO test checked, one or more of the five circulars could not be produced on request.

9.6.3 Non-Compliance to circulars/instructions

Audit checked compliance to two important requirements, viz, risk acceptance limits and allowance of discounts by DOs and observed the following:

(a) Non-adherence to prescribed risk acceptance limits

All the policies under Fire, Engineering and Marine Cargo falling beyond the underwriting limits (688 policies) of the 10 selected DOs which required approval of the competent authority did not have the approvals of the RO/HO and there was 100 *per cent* deviation.

The offices agreed that no prior approvals in writing had been taken. For oral approvals stated to have been obtained, there was no corroborative evidence available. Certain other offices claimed that policies written in excess of their powers had been duly reported in their Management Information System (MIS) reports. One of the offices (Chennai RO), which was the designated authority for 240 policies out of total 688 policies, stated (October 2010) that all the policies were underwritten in a highly competitive scenario and within a short span of time and hence oral approvals were given in all the cases without ratification in writing. However, they were not able to provide any evidence like file noting or record of discussion in support of consideration of individual proposals.

The reply of the Management was an after-thought as no system of seeking or providing approvals was in place.

Recommendation

UIIC may ensure compliance to underwriting limits and in case oral approvals were inevitable in the business scenario, necessary procedures may be evolved for authenticating such approvals.

(b) Allowance of discounts by DOs on policies falling beyond the underwriting limits of DOs

UIIC prescribed that in respect of policies falling beyond the underwriting limits of the DOs, they were not empowered to grant any discount. Audit test checked 31 *per cent* (out of 688) of such policies, and it was observed that discounts were allowed on 88 *per cent* of these policies under the three portfolios. Also discounts had been granted by the DOs without bringing on record the justification such as favourable claim experience, details of competition faced, etc.

The IRDA had directed (March 2007) all the general insurers that the net rates of premium for individual rated risks, after considering all the discounts and loadings, should not be below 48.75 *per cent* of the basic/tariff rates. UIIC had fixed 70 *per cent* of the basic/tariff rates as their guideline rate. As such, UIIC was not empowered to grant discounts beyond 30.36 *per cent* of their guideline rates. However, it was observed by Audit that in 92 *per cent* of the cases where discounts were allowed, the discount was in excess of the IRDA permitted limits.

(c) Non-revision of guideline rates to realistic levels

In the competitive business scenario, it is imperative to do proper risk assessment of portfolios periodically based on past data, to revise/adjust the basic rates of premium to realistic levels sustainable in the market and to delegate powers for granting discounts to the operating/regional offices to such an extent necessary to retain the existing business and to attract new business. However, UIIC did not initiate measures in this regard. Test checks as above revealed that discounts in excess of 50 *per cent* were granted in 80 *per cent* of the policies and in 54 *per cent* of the policies the discount allowed was more than 75 *per cent*. The operating offices stated that the business scenario warranted such discounts. Thus, the base rates fixed by UIIC needed revision.

Recommendation

UIIC may undertake portfolio wise risk assessment, revise the basic premium rates to the levels sustainable in the market and revisit the delegation of powers for granting discounts and lay down procedure for grant of discounts.

Conclusion

The guidelines and relevant data for effective underwriting in line with present business scenario need to be updated. Operating offices had been underwriting business and allowing discounts beyond delegated powers and also beyond the limits prescribed by IRDA without recording justification.

The matter was reported to Ministry in December 2010; reply was awaited (February 2011).