Mergers & Acquisitions Norms for General Insurance

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Abstract

Insurance may be described as a social device to reduce or eliminate risk of life and property. Under the plan of insurance, a large number of people associate themselves by sharing risk, attached to individual. The risk, which can be insured against include fire, the peril of sea, death, incident, & burglary. Any risk contingent upon these may be insured against at a premium commensurate with the risk involved.

Insurance is actually a contract between two parties whereby one party called **insurer** undertakes in exchange for a fixed sum called **premium** to pay the other party on happening of a certain event.

Insurance is a contract whereby, in return for the payment of premium by the insured, the insurers pay the financial losses suffered by the insured as a result of the occurrence of unforeseen events.

Introduction of Insurance:

Insurance law is the name given to practices of law surrounding insurance, including insurance policies and claims. Insurance regulation that governs the business of insurance is typically aimed at assuring the solvency of insurance companies. Thus, this type of regulation governs capitalization, reserve policies, rates and various other "back office" processes.

With the help of Insurance, large number of people exposed to similar risks makes contributions to a common fund out of which the losses suffered by the unfortunate few, due to accidental events, are made good.

An **insurer** is a company selling the insurance; an **insured or policyholder** is the person or entity buying the insurance. The insurance rate is a factor used to determine the amount to be charged for a certain amount of insurance coverage, called the premium.

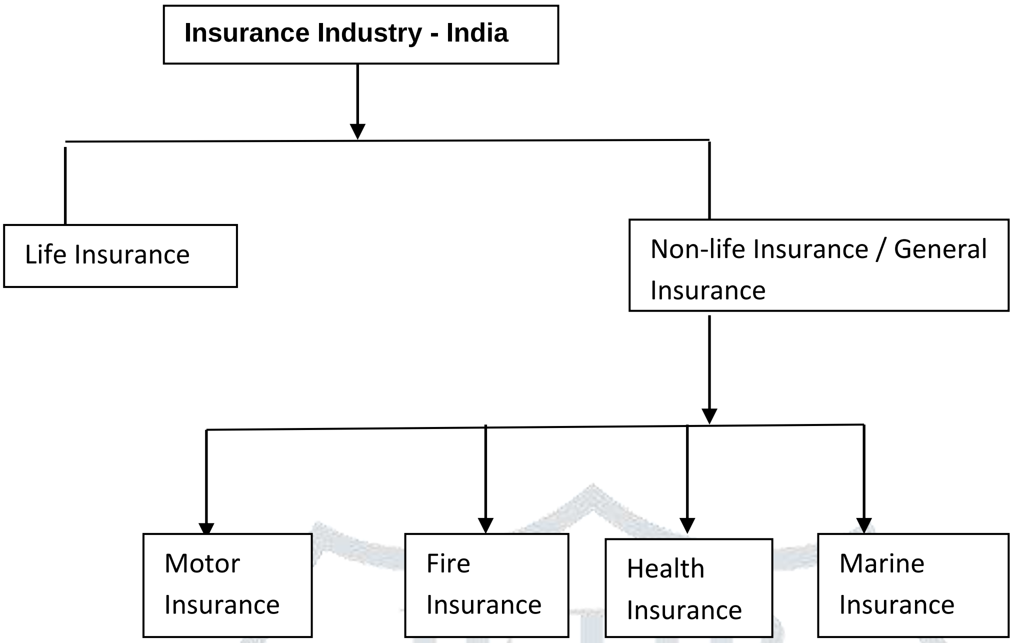
According to **J.B. Maclean**, Insurance is a method of spreading over a large number of persons a possible financial loss too serious to be conveniently borne by an individual.

Types of insurance:

Globally Insurance business is divided into following types of business namely:

1) Life Insurance, and
2) General Insurance
a) Marine insurance
b) Fire insurance
c) Motor vehicle insurance
d) Miscellaneous insurance

3) Reinsurance



Evolution of insurance in India:

In India, insurance has a deep-rooted history. It finds mention in the writings of Manu (Manusmrithi), Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra). The writings talk in terms of pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine.

This was probably a pre-cursor to modern day insurance. Ancient Indian history has preserved the earliest traces of insurance in the form of marine trade loans and carriers‘ contracts. Insurance in India has evolved over time heavily drawing from other countries, England in particular.

1818 saw the advent of life insurance business in India with the establishment of the Oriental Life Insurance Company in Calcutta. This Company however failed in 1834.

In 1829, the Madras Equitable had begun transacting life insurance business in the Madras Presidency.

1870 saw the enactment of the British Insurance Act and in the last three decades of the nineteenth century, the Bombay Mutual (1871), Oriental (1874) and Empire of India (1897) were started in the Bombay Residency.

This era, however, was dominated by foreign insurance offices which did good business in India, namely Albert Life Assurance, Royal Insurance, Liverpool and London Globe Insurance and the Indian offices were up for hard competition from the foreign companies.

In 1914, the Government of India started publishing returns of Insurance Companies in India. The Indian Life Assurance Companies Act, 1912 was the first statutory measure to regulate life business.

In 1928, the Indian Insurance Companies Act was enacted to enable the Government to collect statistical information about both life and non-life business transacted in India by Indian and foreign insurers including provident insurance societies.

In 1938, with a view to protecting the interest of the Insurance public, the earlier legislation was consolidated and amended by the Insurance Act, 1938 with comprehensive provisions for effective control over the activities of insurers.

The Insurance Amendment Act of 1950 abolished Principal Agencies. However, there were a large number of insurance companies and the level of competition was high.

There were also allegations of unfair trade practices. The Government of India, therefore, decided to nationalize insurance business.

An Ordinance was issued on 19th January, 1956 nationalizing the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The LIC absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies—245 Indian and foreign insurers in all. The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector.

The history of general insurance dates back to the Industrial Revolution in the west and the consequent growth of sea-faring trade and commerce in the 17th century. It came to India as a legacy of British occupation. General Insurance in India has its roots in the establishment of Triton Insurance Company Ltd., in the year 1850 in Calcutta by the British.

In 1907, the Indian Mercantile Insurance Ltd was set up. This was the first company to transact all classes of general insurance business.

In 1957 saw the formation of the General Insurance Council, a wing of the Insurance Association of India. The General Insurance Council framed a code of conduct for ensuring fair conduct and sound business practices.

In 1968, the Insurance Act was amended to regulate investments and set minimum solvency margins. The Tariff Advisory Committee was also set up then.

In 1972 with the passing of the General Insurance Business (Nationalization) Act, general insurance business was nationalized with effect from 1st January, 1973. 107 insurers were amalgamated and grouped into four companies, namely National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd and the United India Insurance Company Ltd. The General Insurance Corporation of India was incorporated as a company in 1971 and it commenced business on January 1st 1973.

In December 2000, the GIC subsidiaries were restructured as independent insurance companies. At the same time, GIC was converted into a national re-insurer. In July 2002, Parliament passed a bill, delinking the four subsidiaries from GIC.

Legislative Regime:

The principal legislation regulating the insurance business in India is the Insurance Act of 1938. Some other existing legislations in the field are – the Life Insurance Corporation (LIC) Act, 1956, the Marine Insurance Act, 1963, the General Insurance Business (GIB) (Nationalization) Act, 1972 and the Insurance Regulatory and Development Authority (IRDA) Act, 1999. The provisions of the Indian Contract Act, 1872 are applicable to the contracts of insurance, whether for life or non-life.

Similarly, the provisions of the Companies Act, 1956 as well as Companies Act, 2013 are applicable to the companies carrying on insurance business.

The subordinate legislation includes Insurance Rules, 1939 and the Ombudsman Rules, 1998 framed by the Central Government under Sec.114 of the principal Act as also 32 regulations made by the IRDA under Sec.114 A of the principal Act and Sec.26 of the IRDA Act 1999.

Background to recent legislative changes:

The announcement of the new industrial policy in 1991, envisaged the transition of the economy from a regulated to a liberalized and deregulated regime leading to the privatization of insurance sector to provide a better coverage to citizens and to augment the flow of long-term financial resources.

This transition also meant that competition was bound to intensify in future with the entry of several private players in the field, particularly the foreign companies in joint venture with Indian partners.

In order to prevent misuse by insurers of policyholders' and shareholders' funds and to ensure accountability, it was imperative to have in place an effective regulatory regime. Insurers being repositories of public trust, efficient regulation of their business became necessary to ensure that they remained worthy custodians of this trust.

Further, insurance cash flows generated funds needed for investment in the social sector and for the development of infrastructure.Therefore, the regulation of insurance required a paradigm shift from just supervisory and monitoring role to development role so that the insurance business promoted economic growth.

Malhotra Committee Report:

In the backdrop of new industrial policy, the Government of India set up in 1993 a high-powered committee headed by Mr. R. N. Malhotra to examine the structure of the insurance industry, to assess its strength and weaknesses in terms of the objective of providing high quality services to the public and serving as an effective instrument for mobilization of financial resources for development, to review the then existing structure of regulation and supervision of insurance sector and to suggest reforms for strengthening and modernizing regulatory system in tune with the changing economic environment.

The Malhotra Committee submitted its report in 1994. Some of the major recommendations made by it were as under:-

a) the establishment of an independent regulatory authority (akin to Securities and Exchange Board of India);
b) allowing private sector to enter the insurance field;
c) improvement of the commission structure for agents to make it effective instrument for procuring business specially rural, personal and non-obligatory lines of business;
d) insurance plans for economically backward sections, appointment of institutional agents;
e) setting up of an institution of professional surveyors/loss assessors;
f) functioning of Tariff Advisory Committee (TAC) as a separate statutory body;
g) investment on the pattern laid down in Sec.27;
h) marketing of life insurance to relatively weaker sections of the society and specified proportion of business in rural areas;
i) provisions for co-operative societies for transacting life insurance business in states;
j) the requirement of specified proportion of the general business as rural nontraditional business to be undertaken by the new entrants;
k) welfare oriented schemes of general insurance;
l) technology driven operation of General Insurance Corporation of India (GICI); GIC to exclusively function as a reinsurer and to cease to be the holding company;
m)introduction of unlinked pension plans by the insurance companies; and
n) Restructuring of insurance industry.

LIST OF LEGISLATIONS REGULATING THE INSURANCE SECTOR IN INDIA

The Insurance sector in India is regulated by the following Acts:

a) The Insurance Act, 1938
b) The Life Insurance Corporation Act, 1956
c) Marine Insurance Act, 1963
d) General Insurance Business (Nationalization) Act, 1972
e) Insurance Regulatory and Development Authority (IRDA) Act, 1999

General Insurance:

Insurance other than Life Insurance ‘falls under the category of General Insurance.

General Insurance comprises of insurance of property against fire, burglary etc, personal insurance such as Accident and Health Insurance, and liability insurance which covers legal liabilities.There are also other covers such as Errors and Omissions insurance for professionals, credit insurance etc.

Non-life insurance companies have products that cover property against Fire and allied perils, flood storm and inundation, earthquake and so on.

There are products that cover property against burglary, theft etc. The non-life companies also offer policies covering machinery against breakdown. There are policies that cover the hull of ships and so on.

A Marine Cargo policy covers goods in transit including by sea, air and road. Further, insurance of motor vehicles against damages and theft forms a major chunk of non-life insurance business.

In respect of **insurance of property**, it is important that the cover is taken for the actual value of the property to avoid being imposed a penalty should there be a claim. Where a property is undervalued for the purposes of insurance, the insured will have to bear a rateable proportion of the loss.

For instance if the value of a property is Rs.100 and it is insured for Rs.50/-, in the event of a loss to the extent of say Rs.50/-, the maximum claim amount payable would be Rs.25/- (50% of the loss being borne by the insured for underinsuring the property by 50%). This concept is quite often not understood by most insured.

Personal insurance covers include policies for Accident, Health etc. Products offering Personal Accident cover are benefit policies. Health insurance covers offered by nonlife insurers are mainly hospitalization covers either on reimbursement or cashless basis.

The cashless service is offered through Third Party Administrators who have arrangements with various service providers, i.e., hospitals. The Third Party Administrators also provide service for reimbursement claims. Sometimes the insurers themselves process reimbursement claims.

Accident and health insurance policies are available for individuals as well as groups. A group could be a group of employees of an organization or holders of credit cards or deposit holders in a bank etc. Normally when a group is covered, insurers offer group discounts.

Liability insurance covers such as Motor Third Party Liability Insurance, Workmen‘s Compensation Policy etc offer cover against legal liabilities that may arise under the respective statutes-Motor Vehicles Act, The Workmen‘s Compensation Act etc.

Some of the covers such as the foregoing (Motor Third Party and Workmen‘s Compensation policy) are compulsory by statute. Liability Insurance not compulsory by statute is also gaining popularity these days. Many industries insure against Public liability. There are liability covers available for Products as well.

There are general insurance products that are in the nature of package policies offering a combination of the covers mentioned above. For instance, there are package policies available for householders, shop keepers and also for professionals such as doctors, chartered accountants etc. Apart from offering standard covers, insurers also offer customized or tailor-made ones.

Suitable general Insurance covers are necessary for every family. It is important to protect one‘s property, which one might have acquired from one‘s hard earned income. A loss or damage to one‘s property can leave one shattered.

Losses created by catastrophes such as the tsunami, earthquakes, cyclones etc have left many homeless and penniless. Such losses can be devastating but insurance could help mitigate them. Property can be covered, so also the people against Personal Accident. A Health Insurance policy can provide financial relief to a person undergoing medical treatment whether due to a disease or an injury.

Industries also need to protect themselves by obtaining insurance covers to protect their building, machinery, stocks etc. They need to cover their liabilities as well. Financiers insist on insurance. So, most industries or businesses that are financed by banks and other institutions do obtain covers. But are they obtaining the right covers? And are they insuring adequately are questions that need to be given some thought.

Also organizations or industries that are self-financed should ensure that they are protected by insurance. Most general insurance covers are **annual contracts.** However, there are few products that are long-term. It is important for proposers to read and understand the terms and conditions of a policy before they enter into an insurance contract. The proposal form needs to be filled in completely and correctly by a proposer to ensure that the cover is adequate and the right one.

Corporate India is seeing a wave of regulations being introduced to streamline inorganic corporate growth in the country. This momentum is not limited to central legislations governing corporate transactions. Industry specific regulations governing such transactions are also on the rise.
The insurance industry has witnessed the first of such regulations with the Insurance Regulatory and Development Authority having unveiled the regulations to govern the mergers and amalgamations in the general insurance space in the form of IRDA (Scheme for Amalgamation and Transfer of General Insurance Business) Regulations 2011 which came into force from May 31, 2011. 'General Insurance Business' is defined under the Insurance Act, 1938 to mean fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them.
The Regulations have been introduced after a period of 10 years since the insurance sector opened up for the private sector in August 2000 and have been made applicable specifically for insurance companies in the private sector.
The two-step approval process of the IRDA has not been made a substitute for other statutory approvals. Any merger and amalgamation of insurance companies is still governed by the provisions of the Companies Act, 2013 and requires the sanction of the relevant Courts to become effective.
The Regulations lay out an elaborate process for seeking approval of the regulator in the event of merger or an amalgamation of insurance companies but are not devoid of certain lacunae especially given the plethora of new laws governing such corporate transactions. This article summarizes some of the key aspects of the Regulations and highlights certain areas that may need to be addressed by the regulator.

Requirements of the Regulations

- The Regulations prescribe a comprehensive process for obtaining the two-fold approval of the IRDA:
- **Notice of Intention:**

The Regulations continue to stipulate a 'notice of intention' to be filed with the IRDA prior to application for the implementation of the scheme.
The documents to be filed along with the notice of intention now include a report on the manner in which the interest of the policyholders will be protected and a report on compliance with applicable laws including the Competition Act, 2002.
This addition is in furtherance of the spirit of the Regulations namely to safeguard the interests of the insurance policyholders.

- **In-principle approval***:*

The first of the two staged process is the in-principle approval to be accorded by the IRDA prior to the insurance companies making an application in this regard to the Courts and other regulatory authorities for their approvals. The in-principle approval could stipulate and be subject to certain conditions or changes as the IRDA may deem necessary.
Upon receipt of the in-principle approval, the nature and terms of the scheme are required to be published in at least one national daily and one vernacular newspaper. Thereafter approvals from the other regulators and Courts need to be sought.

- **Final Approval:**

Pursuant to scheme being approved by the various regulatory authorities, the transacting parties are required to approach the IRDA for a final approval of the scheme. As per the Regulations, the amalgamations and transfer of the general insurance business will be effective from the date as specified by the IRDA while granting the final approval.
The Regulations also prescribe a filing fee payable to the IRDA for processing the in-principle approval being 1/10th of 1% of the total gross premium writing direct in India by the transacting entities during the financial year preceding the financial year in which the application was filed subject to a minimum of INR 5,000,000 and a maximum of INR 50,000,000.

Analysis:

The following paragraphs examine the issues that may arise and require clarity pursuant to the Regulations:

- **Scheme of Amalgamation v/s a transfer of assets**

The Regulations, although titled "Scheme of Amalgamation and Transfer of General Insurance Business", appear to govern only schemes of amalgamations formulated under Sec.230-240 of the Companies Act,2013 since the definition of the term 'scheme' has been limited to the ones formulated thereunder.

What needs to be clarified is whether other transfers by way slump sale or acquisition of the insurance business would also be subject to procedures under the Regulations or whether such transfers would be subject to the provisions of the Act.

Sec. 35 of the Act that previously governed such transactions includes within its scope all forms of agreements relating to transfer of the insurance business and is not restricted to a scheme formulated under Sec 230 -240 of the Companies Act.

- **Shareholders and Creditor Meetings**

Under the Companies Act, every scheme under Sec 230 to 240 thereof is required to be approved by the shareholders and creditors of both the transferee and the transferor companies. These meetings are called for pursuant to the directions of the Courts.

Whilst the Regulations require the scheme to be approved in-principle prior to the same being sanctioned by the Courts, it is not clear as to whether the in-principle approval needs to be sought prior or post the shareholders/creditors meeting approving the scheme.

Should the in principle approval be obtained prior to the shareholders and creditors approving the same, a change that may be requested by the shareholders and creditors may again require the approval of the IRDA.

In the alternative, obtaining the shareholders'/creditors approval prior to seeking an in-principle approval may also result in the transferor and transferee companies going back to shareholders to approve any change that the IRDA may propose.

Further, the requirement to publish the terms of the scheme in newspapers after receipt of in-principle approval may also have a bearing on when the shareholders and creditors meeting need to be held.

Overlap of jurisdictions

A merger of two insurance companies may also attract the filing requirements of the Competition Act, 2002 relating to combinations under which the Competition Commission of India is required to look into whether such mergers would have an appreciable adverse effect on competition in India.

Although there are no objective criteria to determine 'appreciable adverse effect on competition', the CCI is bound to look into the following factors in arriving at a determination on the appreciable adverse effect on competition like

A whether the arrangements creates barriers to new entrants in the market;

B whether the arrangements will drive existing competitors out of the market;

C whether the arrangements will foreclosure competition by hindering entry into the market;

D whether the arrangements accrue benefits to consumers; grant improvements in production or distribution of goods or provision of services etc.

The objective of the Competition Act is to promote competition and to protect the interests of the markets. The aim of the Regulations is to regulate the growth of the insurance sector and also to protect the interests of policyholders and consequently, it would appear that the objective of the Regulations and the Competition Act overlap to a substantial extent.

Since both regulations need to view a transaction on a holistic basis and given the similarity of the objectives of the regulations, a single window clearance from both regulators may prove beneficial for such transactions from a consumer and industry perspective. Further, both regulators are empowered to require the transacting parties to make changes to the scheme if the regulators so deem necessary.

These changes may also require to be reconciled by both regulators to sustain the commercial viability of the transaction.

Timelines:

Since the IRDA has not stipulated any particular timeline for the grant of both, in-principle approval as well as the final approval, the total time frame for the consummation of the scheme cannot be ascertained and the process could be long drawn especially since the sanction of a scheme may be subject to the approvals of various other regulators.

Costs:

Extended costs would have to be incurred in seeking approval from the IRDA for a merger, given that the filing fees are a minimum of INR 5,000,000 and a maximum of INR 50,000,000.

This along with the filing fees payable to other regulators would make the cost of entering into a scheme of arrangement exponential. Such additions to the Regulations could be viewed as a disincentive for transacting parties to use the route of court approved mergers for purposes other than genuine commercial and business purposes.

Effective Date:

The Regulations vest with the IRDA, the authority to stipulate when the scheme of amalgamation becomes effective. These powers of the IRDA may have to be reconciled with the provisions of the Companies Act, which requires every scheme of arrangement approved by the Courts to be filed with the Registrar of Companies within 30 days of an order being passed for the scheme to become effective.

Conclusion and Suggestions:

While the Regulations appear to lay down elaborate procedures to be undertaken in the event of a merger and amalgamation of general insurance companies including a two-step approval from the IRDA, the Regulations are definitely a step toward balancing the interests of the policyholders and liberalization and consolidation of the insurance sector in India.

It’s a question of time to see how the Regulations will unfold and how the issues arising out of the implementation of these Regulations will be tackled. The IRDA should address the concerns of the industry to ensure that the benefits of the Regulations are not overshadowed by the procedural difficulties.

While the Regulations are only applicable to general insurance companies, the industry now awaits the IRDA to unshackle regulations for mergers and amalgamations of companies engaged in other streams of business in the insurance sector.