Chapter 4
Reinsurance

4.1 Need for reinsurance

The Company was issuing short term policies to exporters and ECIB covers to Banks covering the risk of default in payment by the buyer and exporters respectively. The table below indicates the maximum liability underwritten by the Company in respect of short term policies, ECIB covers and long term project covers:

(₹ in crore)

Year	Net worth	Maximum Liability		
		Policy	ECIB	Project Exports
2008-09	1886	24492	27327	2100
2009-10	1959	24590	28832	5984
2010-11	2062	25757	30812	2190

It could be seen from the above table that the maximum liability under Policy, ECIB and Project covers was far more than the net worth of Company, indicating the risk needed to be adequately protected through reinsurance[28].

4.2 Reinsurance arrangement

In terms of the IRDA Regulations, during 2008-09 to 2010-11, all the risks undertaken by the Company were automatically reinsured to the extent of 10 *per cent* (obligatory cession) by the General Insurance Corporation of India (GIC).

[28] *The practice of insurers transferring portions of risk portfolios to other parties by some form of agreement in order to reduce the likelihood of having to pay a large obligation resulting from an insurance claim.*

Apart from the above statutory reinsurance protection, during 2008-09 and 2009-10, the Company also arranged proportional treaty[29] (voluntary quota share) covering all risks to the extent of 10 *per cent* and 15 *per cent*, respectively. However, this arrangement could not be continued in 2010-11.

The arrangement under proportional treaty did not protect the Company from the risk of large losses occurring due to the default of the buyer/exporter. As a risk mitigation measure in this regard, the Company (February 2008) arranged an Excess of Loss Treaty (EOL), under which the losses beyond a threshold limit were to be passed on to the reinsurer for 2008-09 and 2009-10. However, EOL could not be entered in 2010-11 as discussed in later paragraph.

4.3 Deficiencies in the reinsurance arrangement

Audit observed the following deficiencies in the reinsurance protection arranged by the Company:

4.3.1 Non-coverage of long term and medium term projects

Under the EOL treaty, the loss above ₹ 5 crore in respect of short term policies and loss above ₹ 10 crore in respect of ECIB covers were covered for 2008-09. This limit was revised to ₹ 10 crore and ₹ 20 crore in respect of short term policy and ECIB covers during 2009-10 respectively.

It was observed that the Company's EOL treaty did not cover the Company's medium and long term exposures i.e. project exports[30] though the maximum liability ranged between ₹ 2100 crore to ₹ 5984 crore during the three years ending 31 March 2011.

It was seen that a policy issued to an exporter M/s Gannon Dunkerley, for the period 13.08.2010 to 12.08.2013 with a maximum liability of ₹ 2730 crore, was a single large risk without any appropriate reinsurance protection. It was also observed in audit that in respect of another project export relating to M/s Punj Lloyd Upstream Limited, the policy cover was issued for ₹ 193.27 crore for the period 07.12.2009 to 23.08.2011 and the Company had received a claim for ₹ 57.11 crore which was under examination (May 2012). The Company's liability in this case was likely to be ₹ 51.40 crore (as stated by the Company) which could have been reduced with appropriate reinsurance cover.

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[29] *The premium and claim would be shared between insurer and reinsurer in the same proportion*

[30] *Export of engineering goods on deferred payment terms and execution of turnkey projects and civil construction contracts abroad are collectively referred to as 'Project Exports'.*

The Company did not offer any comments in its reply (March 2012) on the issue of non-coverage of long term and medium term projects through re-insurance. The Ministry in its reply stated (June 2012) that the EOL was arranged for short term policies and in respect of long and medium term business, the Company extended cover on case to case basis and therefore, reinsurance had to be arranged only under facultative arrangement. It further stated that the facultative covers for long term and medium term business were not available at competitive rates.

The reply was not convincing as though the long and medium term policies were issued on case to case basis, yet the exposure needed to be adequately protected through EOL to save from the steep losses. Further, the pricing of long or medium term policies needs to factor the reinsurance cost instead of allowing the exposure without reinsurance backup on grounds of competitiveness.

4.3.2 No protection under EOL in 2010-11

The Company did not take EOL protection in 2010-11. Scrutiny highlighted that the Company approached GIC in February 2010 to obtain quotes for EOL cover. GIC quoted a premium of ₹ 76 crore for EOL cover in June 2010. However, the Company felt that the premium demanded was too high and did not take any EOL protection.

It was observed that there were large claims in respect of two exporters during the year under ECIB for ₹ 157.27 crore. In the absence of EOL cover, the entire amount was borne by the Company. The EOL cover could have resulted in a recovery of ₹ 101.55 crore as detailed in the table below, if it had continued at the same level of retention as in the year 2009-10.

(₹ in crore)

Exporter Name	Claim paid	Obligatory recovery @ 10 *per cent*	Amount left after obligatory recovery	EOL retention	Amount recoverable from reinsurance
J B Diamonds	77.64	7.76	69.88	20.00	49.88
Biotor Industries Ltd	79.63	7.96	71.67	20.00	51.67
Total	**157.27**		**141.55**	**40.00**	**101.55**

Further, another major claim pertaining to M/s Teledata Informatics for the year 2010-11 amounting to ₹ 64.43 crore was pending as of February 2012 and chances of receipt of more such claims pertaining to the year 2010-11 also could not be ruled out.

The Company in its reply (March 2012), stated that GIC was the only company having capacity for providing reinsurance in respect of credit insurance business and its quotes were not cost effective and further that the non-obtention had not resulted in adverse effect up till now.

The Ministry endorsed (June 2012) the reply of the Company regarding the high quotes of GIC. It was further stated that the premium quoted by the reinsurer was ₹ 76 crore and considering the likely reinstatement cost, the net benefit was only ₹ 10 crore. It added that had the Company accepted the high premium rates for the year 2010-11, the same would have formed the basis for the future years.

The Ministry agreed that had the reinsurance protection been obtained during 2010-11, it would have resulted in savings to the Company. However, the contention that premium quoted for 2010-11 would have formed the basis for future years is not acceptable as re-insurance premium rates varied on year to year basis which is evident from fact that after quoting ₹ 76 crore as premium in 2010-11, GIC accepted a premium of ₹ 31 crore in 2011-12. Further, the need for appropriate reinsurance protection cannot be undermined.