

Chapter 5

Agency Commission and Brokerage

5.1 Introduction

Agency commission and brokerage represent the cost of procuring business for the insurance companies. The Insurance Act, 1938, regulations and circulars issued by the IRDA provide the legal and regulatory framework that governs the functioning of and remuneration payable to intermediaries like agents and brokers.

Agents represent the insurance companies while brokers are appointed by the insured i.e., client of the insurance company. Unlike insurance agents, brokers have only recently entered the insurance market as intermediaries. Brokers deal in either general insurance or reinsurance. There are also composite brokers, who deal in both general insurance and reinsurance.

Section 40 of the Insurance Act, 1938 prohibits the payment of any remuneration or reward by way of commission for soliciting or procuring business to any person except to an insurance agent, intermediary or insurance intermediary. Sec. 42 stipulates that the IRDA shall issue licenses to persons to act as insurance agents, in accordance with the Regulations framed by it.

As regards the rates of commission payable to insurance agents, Sec. 40 A (3) of the Insurance Act 1938 states that a maximum of 15 *per cent* of the premium payable can be paid out on a policy relating to fire, marine and miscellaneous insurance.

Remuneration of brokers is governed by Sec. 42 E of the Insurance Act, 1938 which prescribes a ceiling of 30 *per cent* of the premium, subject to which rates are prescribed by the IRDA.

Sec. 40 C of the Act also stipulates an overall limitation on expenses of management in the general insurance business. Payments on account of commission fall within the ambit of expenses of management and are required to be limited to such limits as may be prescribed by the IRDA from time to time.

5.2 Key indicators

The total premium earned on Indian business by the four PSUs in all the segments viz., Fire, Marine and Miscellaneous (including Motor) and the total commission outgo on Indian business for the period 2002-03 to 2006-07 are detailed in Table 5.1.

Table No. 5.1: Total Direct Premium earned vis a vis Total Commission Paid**(Rs. in crore)**

Year	NIA			NIC			UIIC			OIC		
	Prem.	Comm.	%	Prem.	Comm.	%	Prem.	Comm.	%	Prem.	Comm.	%
2002-03	4813	418	9	2870	199	7	2970	167	6	2868	151	5
2003-04	4921	453	9	3400	245	7	3063	202	7	2900	192	7
2004-05	5103	529	10	3810	273	7	2944	203	7	3090	228	7
2005-06	5675	611	11	3536	296	8	3155	244	8	3610	280	8
2006-07	5937	607	10	3827	315	8	3499	266	8	4021	302	7

The total commission outgo on Indian miscellaneous business (including motor) ranged from 74 to 91 *per cent* of the total commission on total Indian business for the period from 2002-2003 to 2006-2007 (Table 5.2)

Table No. 5.2: Total Commission vis a vis Miscellaneous Commission**(Rs. in crore)**

Year	NIA			NIC			UIIC			OIC		
	Total	Misc	%	Total	Misc	%	Total	Misc	%	Total	Misc	%
2002-03	418	315	75	199	181	91	167	137	82	151	125	83
2003-04	453	337	74	245	213	87	202	162	80	192	158	82
2004-05	529	402	76	273	235	86	203	163	80	228	186	82
2005-06	611	469	77	296	250	84	244	192	79	280	227	81
2006-07	607	460	76	315	271	86	266	207	78	302	244	81

While the motor segment is a loss making segment, it will be seen that commission payout on total Indian motor business, accounted for 34 to 69 *per cent* of total commission outgo on total Indian miscellaneous business during the period 2002-2003 to 2006-2007 (Table 5.3).

Table No. 5.3: Motor Commission vis a vis Misc. Commission paid**(Rs. in crore)**

Year	NIA			NIC			UIIC			OIC		
	Misc	Motor	%	Misc	Motor	%	Misc	Motor	%	Misc	Motor	%
2002-03	315	177	56	181	121	67	137	70	51	125	67	54
2003-04	337	187	55	213	129	61	162	79	49	158	93	59
2004-05	402	212	53	235	162	69	163	63	39	186	99	53
2005-06	469	247	53	250	148	59	192	70	36	227	116	51
2006-07	460	206	45	271	168	62	207	70	34	244	124	51

(Note: The expenditure incurred on tie-up with the Automobile dealers/Financial institutions is not included.)

5.3 Audit objectives

The performance audit is aimed to assess that:

- only agents, holding valid license were allowed to procure business and receive commission;
- transfers of business from 'Direct code' to 'Agents code' were justified;
- compliance with relevant provisions of the Insurance Act, 1938 and IRDA Regulations/circulars relating to rates of commission/brokerage was satisfactory;
- payments to cover technical and other support expenses of agents/brokers were appropriate and did not exceed the rates of remuneration prescribed by the IRDA; and
- adequate evidence existed of brokers having specific mandate from the insured and that they rendered the services prescribed by the IRDA.

5.4 Payment to agents without valid license

It was noticed, during review of records in the operating offices, that commission was paid to 946 agents, whose license had expired. Such payments were made during 2004-05 to 2006-07 and are detailed in Table 5.4.

Table 5.4: Details of commission paid to agents having expired licenses

(Rs. in lakh)

Company	No. of Agents	No. of Policies	Amount
NIA	268	2456	16.25
NIC	368	14504	56.84
UIIC	214	7151	186.99
OIC	96	5200	8.61
Total	946	29311	268.69

A similar issue had also been reported in Paragraph 3.5.2.2 of Report No. 10 of 2007 of the Comptroller and Auditor General of India – IT controls in GENISYS.

5.5 Transfers from 'Direct Code' to 'Agent Code'

It was noticed that there were cases of transfer of business from 'Direct code' to 'Agents code' subsequent to issue of policies. Company-wise details are given in Table 5.5.

Table 5.5: Particulars of transfer of business from 'direct code' to 'agent code'

(Rs. in lakh)

Company	2004-05		2005-06		2006-07	
	No. of cases	Amount	No. of cases	Amount	No. of cases	Amount
NIA	165	1.38	94	1.37	87	0.52
NIC	194	1.50	786	5.09	298	12.86
UIIC	402	10.35	204	2.06	212	3.30
OIC	1	4.38	4	6.02	9	5.52
Total	762	17.61	1088	14.54	606	22.20

(No. cases were reported in respect of units in Eastern region)

These transfers were effected without appropriate authorisations.

NIA stated that transfers from direct code to agent code were generally not allowed unless a client insisted that the business be routed through a particular agent. UIIC stated that operating offices had already been instructed not to effect such transfers without appropriate authorisation.

5.6 Motor Business –support payments for facilities offered by dealers

Some of the insurance companies have entered into agreements with various automobile manufacturers and dealers. Such agreements are intended to form part of their customer service strategies. Consequently, dealers are performing various services for the companies including providing space in their premises, issuing cover notes and policies and processing claims of customers who have insured their vehicles through these dealers.

Some of these agreements were reviewed in the course of the performance audit. Apart from the fact that such agreements and the services contemplated to be provided under them could raise questions of potential conflict of interest; certain other issues are also involved.

Firstly, a review of the text/wording of some agreements revealed that the role of the other party viz. manufacturer/dealer is, in some cases, not clearly defined. This raises doubts as to whether the agreements, as worded, are in compliance with the provisions of the Insurance Act, 1938 insofar as it deals with the role and appointment of insurance agents including corporate agents.

Secondly, 'remuneration' to agents, in terms of the statute, has a specific connotation and the IRDA has prohibited any payments, in addition to remuneration, to agents. However, it was noticed that certain payments made by the companies to dealers/manufacturers did not appear to be in compliance with either the Insurance Act or the directions of the IRDA. The categorisation of payments as 'technical and support expenses', 'reimbursement of infrastructure expenses' etc. lacked clarity, when viewed with respect to statutory provisions or regulatory directions.

In order to illustrate these issues, specific cases are discussed below.

5.7 Payment to Maruti Udyog Limited

An agreement was entered into between Maruti Udyog Limited (MUL) and NIC on 2 September, 2004. The agreement states that:

- MUL and its dealers had made investments in developing Information Technology (IT) infrastructure, connectivity etc. for carrying on business;
- MUL dealers would permit NIC to use the above infrastructure and consumables including providing after sales service;
- NIC agreed to reimburse to MUL, the amount paid by it to its dealers towards the use of their infrastructure not exceeding five *per cent* of net premium duly realised by NIC;
- MUL would forward monthly invoices, duly certified by its auditors, seeking reimbursement of actual amount paid by MUL to its dealers for use of their infrastructure; and
- Dealers would not in any way represent themselves as agents of NIC.

Separately, NIC had also entered into an agreement in May 2002 with Maruti Insurance Brokers Limited (MIBL). The agreement, which was valid for three years, stated that:

- NIC agreed to appoint MIBL to act as its Corporate Agent, which MIBL agreed to on the terms and conditions and prevalent regulations in force from time to time.
- MIBL would establish/maintain insurance desks, solicit, and procure insurance business and distribute policies at mutually agreed outlets.
- NIC would provide trained employees/representatives and provide stationery at its own cost to MIBL.
- NIC authorised MIBL to sign cover notes, policies, endorsements, warranties and conditions and issue them directly to customers.
- NIC, at its cost, would provide interface with MIBL's central database at Divisional Office X, New Delhi.
- NIC would pay MIBL commission at rates of IRDA.
- MIBL to supply periodical reports, returns and accounts.

Since NIC had appointed MIBL as its corporate agent in May 2002, it is not clear as to why it entered into the subsequent agreement in September 2004 with the manufacturer viz. MUL. When MIBL was required to provide all the services at mutually agreed outlets as mentioned in its agreement with NIC, it would appear that no reimbursement was due to MUL (and its dealers) for providing infrastructure facilities. It may also be mentioned that commission was separately being paid by NIC to MIBL for the business being generated by it.

A scrutiny of the records in the operating offices revealed that MUL was paid Rs.21.73 crore, Rs.38.01 crore and Rs.59.81 crore in 2004-2005, 2005-06 and 2006-07, respectively as additional support expenses. NIC was not ascertaining the actual expenditure on infrastructure incurred by the dealers of MUL, though the agreement of September 2004 provided that MUL would forward monthly certified invoices to NIC; giving details of the amounts reimbursed by it to its dealers for the use of their infrastructure. Since payments being released by NIC to MUL are linked to the business being generated by the dealers; these tantamount to "remuneration for soliciting business", in terms of the provisions of the Insurance Act, 1938. Such remuneration cannot be paid to dealers since they are not agents.

It was also noticed that NIC was not only reimbursing 'expenses support' to MUL; it subsequently (August, 2005) decided to extend additional expenses support for penetration into new business and for increasing business volume. These 'additional expenses support' were payable at different percentages of the premium obtained from new and additional business.

NIC stated that providing insurance services at the dealers' outlets was part of the "single window" concept and resulted in qualitatively enhanced customer service. This had resulted in reducing the company's administrative overheads. The infrastructure of the dealers was being utilised by NIC, the cost of which was being reimbursed. NIC further

stated that infrastructure expenses were no longer being reimbursed to MUL with effect from 1 January 2007.

However, NIC's reply does not address the specific question as to why it had entered into the agreement in September 2004 with MUL, when it had already contracted with MIBL in May 2002 to provide similar services. Further, while MUL was not being reimbursed infrastructure expenses with effect from 1 January 2007, NIC has not offered any clarification on the additional support expenses paid by it to MUL up to 1 January 2007.

5.8 Payments to Hero Honda

An Agreement was entered into on 2 January 2004, between NIC and Hero Honda Corporate Services Limited (HCSL). HCSL was licensed to carry on the business of soliciting and procuring business on behalf of NIC as its corporate agent. The Agreement, *inter alia* provided that:

- HCSL would solicit and sell insurance products at its outlets.
- HCSL would establish and maintain insurance desks at its Delhi office or any other place to be intimated by NIC.
- NIC would develop an interface with HCSL's central data base, at NIC's cost, and provide stationery.
- HCSL was obliged to compile, consolidate and verify the correctness of the proposal forms, cover notes, policies to be generated and documents relating to payment and receipt of premium.
- NIC would authorise HCSL/its employees, authorised representatives, business associates to sign and issue policy documents, endorsements except refunds.
- NIC would arrange collection of documents, remittances from HCSL and would issue policy notes online at HCSL specified outlets.
- Vehicle repairs would be carried out HCSL specified workshops and NIC would make settlements to such workshops. Total loss claims would be settled directly with customers by NIC.
- NIC would pay HCSL commission/remuneration at maximum commission of 15 per cent on premium (OD and TP) generated for new and old policies.
- Workshops would charge rates, including labour, as recommended by the manufacturer.
- HCSL would provide claims data to the insurer.

It was noticed that, in addition to the 15 per cent commission on premium generated on new and old policies that was paid to HCSL, NIC also "reimbursed" infrastructure costs amounting to Rs.0.09 crore, Rs.1.74 crore and Rs.5.90 crore to the Hero Honda dealers during 2004-2005, 2005-2006 and 2006-2007, respectively. There was no provision in the agreement with HCSL for such reimbursement to the dealers. HCSL was the agent and was to perform specific functions as detailed in the Agreement. For such services, commission was paid accordingly by NIC. It is, therefore, not clear as to why additional payments were being made by NIC to dealers of Hero Honda. Secondly, there was no

record of the actual expenses being incurred by the dealers, for which reimbursement was being made. More importantly, since payment of the infrastructure costs is directly linked to the volume of business generated by the dealers, it would amount to “remuneration” for soliciting business, which can only be paid to agents, in terms of Sec. 40 of the Insurance Act, 1938.

While NIC did not offer specific responses to these observations, it stated that its clarification offered in respect of its agreement with MUL be referred to. However, as pointed out, payment of infrastructure cost was being made to the dealers of Hero Honda though there was no such provision in the agreement with HCSL. Moreover, since dealers were being paid infrastructure costs in proportion to the volume of business being generated by them, such payments were in violation of Section 40 of the Insurance Act.

5.9 Payments to Advait Motors

Regional Office, NIC, Bengaluru entered into an Agreement on 1 March 2005 for “reimbursement of expenditure” with Advait Motors Limited and its three group companies viz. Advait Marketing Private Limited, Cauvery Motors Private Limited, and Garuda Autocraft Private Limited. The agreement, provided that:

- (a) Advait group would provide services like motor insurance to its customers through their insurance agents (i) Prameela Devi (ii) M V Koteswara Rao and (iii) other agents of Advait Group.
- (b) The Advait group had made investments in IT and other infrastructure and would permit NIC to use the infrastructure, consumables and manpower for issuing motor and general insurance products and also after sales services.
- (c) Advait group would raise demand for part reimbursement of such expenditure on infrastructure. NIC agreed to reimburse such expenditure. Advait group would provide monthly invoices certified by chartered accountants.
- (d) Reimbursement to Advait group was not to exceed five *per cent* of net premium realised by NIC through the above insurance agents.

Scrutiny of records revealed that during the period 2004-05 to 2006-07 Rs. 0.47 crore was paid (Rs.0.03 crore, Rs.0.16 crore, and Rs.0.28 crore during 2004-2005, 2005-2006 and 2006-2007, respectively) towards reimbursement of expenses to Advait Group.

Such payments are in violation of the Insurance Act, 1938 as the business was procured through a person not representing the insurance company. Hence no commission is payable to them.

NIC stated that infrastructure costs were being reimbursed in the same manner as in the case of MUL.

5.10 Prerana Motors, Bengaluru–Payment of additional remuneration

A Memorandum of Understanding dated 30 January 2004 (effective from 1 February 2004 for three years) was entered into between OIC Divisional Office 8, Bengaluru and

Prerana Motors (dealer). The dealer was to place all its insurance business for new vehicles sold with OIC. The MOU provided that:

- Proposal form and cover note would be supplied by OIC.
- Dealer would issue cover notes.
- OIC would issue policies.
- Labour charges/cost of parts in claim settlement would be based on schedules agreed/attached to MOU.
- Agency Commission at applicable percentage would be transferred to Clover Enterprises, Corporate agent.
- Claim payments would be made directly to Prerana Motors.

Subsequently, OIC in a letter dated 16 December 2004 approved five *per cent* 'additional remuneration' in addition to agency commission. This was subsequently (February, 2006) termed by OIC as "additional payment on infrastructure expenses".

On scrutiny of records during the period 2004-05 to 2007-08 (up to July 2007) revealed that OIC paid infrastructure expenses of Rs.4.57 lakh, Rs.40.48 lakh, and Rs.36.85 lakh to Prerana Motors during 2004-2005, 2005-2006 and 2006-07, respectively. Commission, in terms of the MOU, was being released to M/s Clover Enterprises, the Corporate agent identified in the MOU. There can be no "additional remuneration" payable, as mentioned in OIC letter of 16 December, 2004, since remuneration can only be paid to agents, in terms of the Insurance Act, 1938. Prerana Motors was not an insurance agent.

5.11 Agreement with Magma Leasing

An agreement dated 27 July 2004 and valid for three years was entered into between NIC and Basukinath Commerce Private Limited (BCPL), a sister concern of Magma Leasing Limited (MLL), Kolkata. The agreement provided that:

- BCPL would act as corporate agent and NIC would provide proposal forms.
- BCPL would identify its offices for the purpose of setting counters for issuing policies.
- BCPL would submit filled in proposal forms and arrange for printing of required documents and NIC would reimburse the costs.
- NIC could set up extension counters at BCPL to centralise and for issuance of documents and settlement of claims.
- NIC would pay commission at rates fixed by IRDA.

A scrutiny of records revealed that NIC paid 'expense support' of Rs.0.23 crore, 0.28 crore and Rs.3.11 crore during the period 2004-2005, 2005-2006 and 2006-2007, respectively to BPCL

BCPL was appointed as a corporate agent by NIC. The agreement also detailed the specific services that were to be rendered by BCPL. There was no provision in the

agreement to reimburse expenses on infrastructure as support expenses to MLL in addition to commission. Such payment was, therefore, incorrect. Moreover, it is not clear as to why additional payments were required, since such services are required to be provided by BCPL to NIC, in terms of the agreement.

NIC stated that BCPL was a corporate agent. Additional services were being provided by MLL for which it was being reimbursed infrastructure costs.

5.12 DSC Motors Private Limited

NIA permitted operating offices to reimburse certain expenses for promotion of sale of Motor Package policies through tie-up. Chennai Divisional Office V paid Rs.32.02 lakh to M/s. DSC Motors Private Limited, during the period 2004-05 to 2007-08 (upto July 2007). However no formal tie-up arrangement with DSC Motors Private Limited was executed by the Divisional Office.

5.13 Payment of Referral Fee to Dena Bank

OIC entered into a Memorandum of Agreement (MOA) with Dena Bank in July 2004. The MOA provided that the Bank would refer its customers requiring insurance to OIC. The MOA also provided for payment of Referral Charges, not exceeding the rate of commission allowed by IRDA on the premium collected by OIC from such customers. A referral fee of Rs.28 lakh, Rs.91 lakh and Rs.1.63 crore in the years 2004-05, 2005-06 and 2006-07, respectively was paid to Dena Bank.

In terms of IRDA Circular No. IRDA/Cir/003/2003 dated 14 February, 2003, referral fee is payable only for access to banks' Customers data bases. However, apart from directing customers in need of insurance to OIC, Dena Bank had not provided access to its customer data base. Therefore, in terms of the IRDA circular cited above, no referral fee was payable to Dena Bank.

5.14 Shriram Transport Finance Company Limited

Shriram Transport Finance Company Limited entered into three Memoranda of Understanding (MoU) with OIC Divisional Office 3, Chennai, on 28 January 2005, 20 April 2006 and on 18 December 2006, to place the insurance business of vehicles financed by it and all its group companies with any office of OIC. The MOUs specifically stated that "OIC solicited to accept motor insurance business from Shriram" and Shriram accepted to place the business with OIC. Cover notes would be provided by OIC and were to be signed and issued by the authorised representatives of Shriram, on behalf of OIC.

The names of three brokers were mentioned in the MOUs and brokerage payments were released by OIC to them, as depicted in Table 5.6:

Table 5.6: Particulars of the brokerage paid by OIC**(Rs. in lakh)**

Name of the Broker	Amount Paid			
	2004-05	2005-06	2006-07	Total
Richard Strauss Insurance Broking Private Limited	-	51.21	218.37	269.58
Bharat Reinsurance Service Private Limited	-	15.62	40.81	56.43
Armour Consultants Direct Insurance Brokers	58.70	218.55	75.24	352.49
Total	58.70	285.38	334.42	678.50

The term 'soliciting business' has a specific connotation in the Insurance Act, 1938. When the MOUs provided that "OIC solicited to accept motor insurance business from Shriram"; it would mean, in terms of the Act, that business was directly obtained by OIC and hence, no commission/brokerage was payable to intermediaries. It is evident that the text of the MOU was incorrect, insofar as the reference to OIC "soliciting business" is concerned.

5.15 In the cases discussed in the preceding paragraphs, payments were made to intermediaries like automobile dealers. These payments were made using different terms like "support expenses", "infrastructure costs", "technical and support expenses", etc. Since such payments are linked to volume of business procured, they would amount to "remuneration" for soliciting business. As remuneration is payable only to agents, such payments would be in violation of Section 40 of the Insurance Act, 1938. The companies (NIC and NIA) stated that such measures were aimed at improving customer service in a competitive environment and that the role played by various intermediaries needed to be recognised. While appreciating the context in which the companies function, the fact remains that such payments do not conform to statutory provisions. It may also be mentioned that the General Insurance Council, in December 2007, decided that all commission/brokerage payments to intermediaries will conform to limits stipulated by IRDA Regulations. Any other payout to any intermediary or others, by whatever nomenclature, would be discontinued with effect from 1 January 2008. Consequently, NIA, UIIC and OIC have issued circulars to their operating offices to discontinue such payments effective 1 January 2008.

5.16 *Payment of brokerage without evidence of brokers rendering required services*

IRDA (Brokers) Regulation 2002, provided that functions of a direct broker include:

- Familiarising with clients business and underwriting information so that the same can be explained to the insurer/client.
- Submitting quotations received from insurers for consideration of clients.
- Providing requisite underwriting information as required by insurer for assessing the risk to decide pricing terms/conditions for cover.

- Assisting in negotiation of claims.

In the following instances (Table 5.7), it was noticed that there was no evidence to suggest that appropriate documentation was maintained to support broker's involvement in securing the following businesses.

Table 5.7: Particulars of brokers lacking documentation of involvement

(Rs. in lakh)

Company	Insured	Broker	Brokerage paid
NIA	HDFC Bank	Heritage Insurance Solutions	55.08
NIA	Intel Group	Marsh	36.89
NIC	Ceat Limited	Savior Insurance Broking Limited	13.40
NIC	Fiat India	Savior Insurance Broking Limited	1.72
NIC	Indofil Chemicals	Savior Insurance Broking Limited	1.54
NIC	Gammon Heinz	Miclows Insurance Services (P) Limited	1.39
NIC	Madhusudhan Industries	AR Insurance Brokers Limited	2.16
NIC	Cera Sanitaryware	AR Insurance Brokers Limited	24.34
NIC	17 Numbers	SRG Insurance Limited	1.76
OIC	Cadilla	Mangal Keshav Insurance Brokers	24.33
OIC	Morarjee Group	Hindustan Insurance	1.61
Total			164.22

Recommendation No.4

The Companies should:

- (i) ensure that only agents with valid licenses are permitted to procure business.***
- (ii) ensure that transfers of business, originally booked as direct to Agent Code should be supported by proper authorisations.***
- (iii) review the agreements with automobile manufacturers/dealers finance companies, etc. in order to ensure clarity and compliance with the provisions of the Insurance Act, 1938 and regulatory directions.***