WHOSE COST IS IT ANY WAY?

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The non-life insurance industry evolved into tariff free regime since 2007 exposing its players to intense market competition. According to Insurance Regulatory and Development Authority (IRDA), detariffing would compel the insurers to develop better risk management practices, scientific pricing of products and to devise innovative customized products.

In the free market regime, the insurers are mandated to file all their products with their pricing with the Authority under "File & use" regulation before they are introduced in the market. Thus, detariffing had provided the best opportunity to insurers to launch their products with their own pricing.

However, the immediate reaction of insurers, as expected, was to resort to mindless price cutting of their products totally oblivious of the need at least for comparable risk improvement.

The insurers in their overmuch concern either for retaining their business or as an attempt to satiate their passionate appetite for new portfolio chose to ignore all norms of underwriting and tried to book business at abysmally low rates of premium.

It ought, however, to be mentioned here that while doing away with the erstwhile administered pricing mechanism, the Authority had very clearly indicated to all industry players about the need for them to develop their own pricing structure based on their underwriting experience and giving due consideration to industry dynamics.

As could be seen, the insurers gleefully ignored the cautioning and conveniently adopted the simplistic method of price cutting which, though primarily beneficial to insuring public, was self-defeating for the insurers. Paradoxically, the non-existent tariff continued to be referred to for the purpose of allowing such discounts.

The ever increasing discounts so doled out over a period of more than half a decade, reached to a point that in the case of property insurance like Fire and Allied Insurance, the risk rate charged was virtually a negligible percentage of the erstwhile tariff rate.

The period also witnessed substantial discounting of premium rates for other classes of insurance such as Marine, Engineering, Misce. and Group Health

Schemes as well. This adverse development had a cascading effect on the finances of the entities which were already grappling for survival.

Insurance Regulatory and Development Authority of India (IRDAI) concerned about the perilous situation towards which the non-life industry was moving, decided to intervene in the functional methodology and ethos of the stake holders by introducing a system of having an analytical study of the transactional data collected from various stake holders.

Insurance Information Bureau (IIB) which was formed for the purpose of collating data from various industry players submitted its analytical report to IRDAI and on the basis of that report, industry wise Burning Cost was introduced for Fire Insurance business, to start with. The authority also confirmed that IIB shall publish such data for other classes of insurances as well.

The Burning Costs so published by IIB are supposed to be the basis for deciding the pricing of their products by the insurers. It is anybody's guess that the rate so arrived after adjusting, as required, for insurer's operating expenses and claim experience, however best that may be, would be a tad higher than the irrationally discounted rate that was hitherto prevailing in the industry.

At any rate it was a welcome step taken by the Authority with a view to saving non-life industry from the brink of a virtual collapse. In fact any impartial observer of non-life insurance industry ought to be wondering as to whither the industry was going in as much as, for some time in the recent past it looked like there was no hope for restoring a modicum of financial propriety to the industry.

The main advantage of the introduction of Burning Cost was that it provided an opportunity to the insurers who were virtually beleaguered by unreasonable discounting of premium rates, to have a system in place enabling them to conduct analytical study of their industry wise business exposure and formulate rates based on the principle of real risk underwriting.

Insurers could then claim to have their own internal rating structure contrary to the hitherto prevailing situation of their having had to agree to the rates dictated by the market forces.

Thus, economical rating of products and proper risk underwriting would stand the insurers in a good stead. Of course, the fall out of the development would be a slight hardening of the market rates whereby insuring public would have to shell out some extra amount of premium.

But this disadvantage is insignificant if we consider the fact that the step would help restoring the desired discipline and decorum in the insurance market and the players adopting good business practices. Besides, it should also be appreciated that the financial stability of the industry players alone can guarantee real protection to the insuring public.

In spite of whatever is said about well-intentioned Burning Cost, the manner in which the insurers reacted to the directive appeared really baffling as if the advisory of the Regulator was an affront to them.

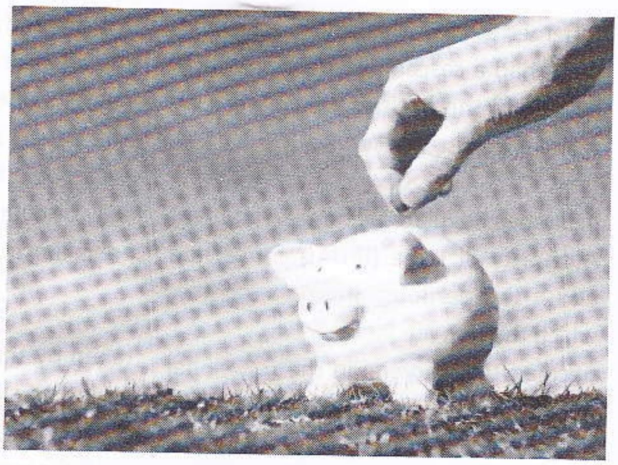
Some insurers encouraged their clients to get their current policies proponed or to take out new policies at the old heavily discounted rates to escape from the effect of Burning cost rates.

Some other insurers chose to simply ignore the advisory and continued to underwrite the risk by charging the old rates. It is noteworthy however, that, all this was done to favour big corporate clients only and for medium and small industries, largely, the rates as per burning cost were applied thus meting out to them a patently discriminative treatment.

Undoubtedly the objective of the Authority's Advisory was all the more apparent and its intent, firm and forceful. For the first time perhaps it was found that, notwithstanding the clear objective that had been spelt out, the insurers were reluctant to heed to the directive of the Authority or rather it appeared so from their response.

The lackadaisical attitude shown by the insurers to this vital issue created the impression in the minds of insuring public that the so-called Burning Cost is irrelevant to their business operation. The entire episode however, has already created great deal of confusion in the non-life insurance market.

When viewed against the prospect of the authority issuing similar advisories in future, the situation that has arisen out of large scale non-compliance by the insurers is very serious and needs correction.



There can be no two opinions as to the urgent need for stake holders to restrain themselves from going overboard with discount gala and to introduce their own product pricing and also to have in place a system of good business practice which in turn will help restoring greater customer confidence.