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FRAUD RISK MANAGEMENT IN INSURANCE

Original Text in book

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4. Insurance Act, 1938 & Insurance Laws Amendment Act, 2015

The Insurance Act, 1938 also does not have any provisions to specifically deal with the fraudsters in insurance. It has certain provisions related to prohibition of rebate in the insurance premium.

However, the Insurance laws (Amendment) Act, 2015 has some provisions for penalties for insurance fraud committed by agents/ insurance companies for wrongly selling the products or misrepresentation of facts. These amendment laws are about the role of insurance agents and other insurance intermediaries and the duty of insurers about monitoring them. Sec.49, 50, Sec.51 and Sec.55 of the Insurance Act 2015 may be referred to determine the scope and cases of violation. Let us learn about some of the sections.

4.1. Section 49 of the Insurance Act

Sec.49 (4) of Insurance Laws (Amendment) Act, 2015 states that any person who acts as an insurance agent in contravention of the provision of this Act, shall be liable to a penalty which may extend to ten thousand rupees. Similarly, if an insurer or any person acting on behalf of the insurer appoints any person as an insurance agent who is not permitted to act as such, or transacts any insurance business in India through any such person shall be liable to penalty which may extend to one crore (10 million) rupees.

Sec.49(5) states that the insurer shall be responsible for all the acts and omissions of its agents including violation of code of conduct specified under clause (h) of sub-section (3) and liable to a penalty which may extend to one crore (10 million) rupees.

4.2. Section 50 of the Insurance Act

The Section provides that:

- 1) No insurer shall, on or after the commencement of the Insurance Laws (Amendment) Act, 2015 appoint any principal agent, chief agent and special agent and transact any insurance business in India through them.

- 2) No person shall allow or offer to allow, either directly or indirectly, as an inducement to any person to take out or renew or continue an insurance policy through a multilevel marketing scheme.
- 3) The Authority may, through an officer authorized in its behalf, make a complaint to the appropriate police authorities against the entity or persons involved in a multilevel marketing scheme.

Sec 50 further explains that for the purpose of this section, "multilevel marketing scheme" means any scheme or program or arrangement or plan (by whatever name called) for the purpose of soliciting and procuring insurance business through persons not authorised for the said purpose with or without consideration of whole or part of commission or remuneration earned through such solicitation and procurement and includes enrolment of persons into a multilevel chain for the said purpose either directly or indirectly.

4.3. Section 51 of the Insurance Act

Sec 51 (8) of the Insurance Laws (Amendment) Act, 2015 states that any person who acts as an intermediary or an insurance intermediary without being registered under this section to act as such, shall be liable to a penalty which may extend to ten lakh (one million) rupees and any person who appoints as an intermediary or an insurance intermediary or any person not registered to act as such or transacts any insurance business in India through any such person, shall be liable to a penalty which may extend to one crore (10 million) rupees.

Sec 51 (9) of the Act, 2015 states that where the person contravening sub-section (8) is a company or a firm, then without prejudice to any other proceedings which may be taken against the company or firm, every director, manager, secretary or other officer of the company and every partner of the firm who is knowingly a party to such contravention shall be liable to a penalty which may extend to ten lakh (one million) rupees.

4.4. Section 55 of the Insurance Act

Sec. 55 (2) of the Act, 2015 provides that a policy of life insurance may be called in question at any time within three years from the date of issuance of the policy or the date of commencement of risk or the date of revival of the policy or the date of the rider to the policy, whichever is later, on the ground of fraud, provided that the insurer shall have to communicate in writing to the insured or the legal representatives or nominees or assignees of the insured the grounds and materials on which such decision is based.

Explanation to Sec.55 (2) provides that for the purposes of this sub-section, the expression "fraud" means any of the following acts committed by the insured or by his agent, with intent to deceive the insurer or to induce the insurer to issue a life insurance policy:

- a) the suggestion, as a fact of that which is not true and which the insured does not believe to be true;
- b) the active concealment of a fact by the insured having knowledge or belief of the fact;
- c) any other act fitted to deceive; and any such act or omission as the law specially declares to be fraudulent.

Explanation II to Sec.55 (2) provides that mere silence as to facts likely to affect the assessment of the risk by the insurer is not fraud, unless the circumstances of the case are such that regard being had to them, it is the duty of the insured or his agent keeping silence, to speak, or unless his silence is, in itself, equivalent to speak.

Sec.55 (3) provides that notwithstanding anything contained in sub-section (2), no insurer shall repudiate a life insurance policy on the ground of fraud if the insured can prove that the misstatement of or suppression of a material fact was true to the best of his knowledge and belief or that there was no deliberate intention to suppress the fact or that such misstatement of or suppression of a material fact are within the knowledge of the insurer:

Provided that in case of fraud, the onus of disproving lies upon the beneficiaries, in case the policyholder is not alive.

Sec, 55 (4) provided further that in case of repudiation of the policy on the ground of misstatement or suppression of a material fact and not on the ground of fraud, the premiums collected on the policy till the date of repudiation shall be paid to the insured or the legal representatives or nominees or assignees of the insured within a period of ninety days from the date of such repudiation.

Sec.50, Sec.51 and Sec.55 of the Insurance Act, 2015 as mentioned above define and determine the scope and consequences of frauds perpetrated by any person in the insurance business. Insurance professionals need to have proper understanding of the above-noted provisions of the Insurance Amendment Act, 2015 to legally handle insurance frauds.

4. Insurance Act, 1938 & Insurance Laws Amendment Act, 2015

The Insurance Act, 1938 also does not have any provisions to specifically deal with the fraudsters in insurance. It has certain provisions related to prohibition of rebate in the insurance premium.

However, the Insurance laws (Amendment) Act, 2015 has some provisions for penalties for insurance fraud committed by agents/ insurance companies for wrongly selling the products or misrepresentation of facts. These amendment laws are about the role of insurance agents and other insurance intermediaries and the duty of insurers about monitoring them. Sec.40, Sec.41, Sec.42 and Sec.45 of the Insurance Act 2015 may be referred to determine the scope and cases of violation. Let us learn about some of the sections.

4.1. Section 40 of the Insurance Act

The Section provides that:

- 1) No insurer shall, on or after the commencement of the Insurance Laws (Amendment) Act, 2015 appoint any principal agent, chief agent and special agent and transact any insurance business in India through them.
- 2) No person shall allow or offer to allow, either directly or indirectly, as an inducement to any person to take out or renew or continue an insurance policy through a multilevel marketing scheme.
- 3) The Authority may, through an officer authorized in its behalf, make a complaint to the appropriate police authorities against the entity or persons involved in a multilevel marketing scheme.

4.2. Section 41 of the Insurance Act

Sec 41 (8) of the Insurance Laws (Amendment) Act, 2015 states that any person who acts as an intermediary or an insurance intermediary without being registered under this section to act as such, shall be liable to a penalty which may extend to ten lakh (one million) rupees and any person who appoints as an intermediary or an insurance intermediary or any person not registered to act as such or transacts any insurance business in India through any such person, shall be liable to a penalty which may extend to one crore (10 million) rupees.

Sec 41 (9) of the Act, 2015 states that where the person contravening sub-section (8) is a company or a firm, then without prejudice to any other proceedings which may be taken against the company or firm, every director, manager, secretary or other officer of the company and every partner of the firm who is knowingly a party to such contravention shall be liable to a penalty which may extend to ten lakh (one million) rupees.

4.3. Section 42 of the Insurance Act

Sec.42 (4) of Insurance Laws (Amendment) Act, 2015 states that any person who acts as an insurance agent in contravention of the provision of this Act, shall be liable to a penalty which may extend to ten thousand rupees. Similarly, if an insurer or any person acting on behalf of the insurer appoints any person as an insurance agent who is not permitted to act as such, or transacts any insurance business in India through any such person shall be liable to penalty which may extend to one crore (10 million) rupees.

Sec.42(5) states that the insurer shall be responsible for all the acts and omissions of its agents including violation of code of conduct specified under clause (h) of sub-section (3) and liable to a penalty which may extend to one crore (10 million) rupees.

Sec 42A further explains that for the purpose of this section, "multilevel marketing scheme" means any scheme or program or arrangement or plan (by whatever name called) for the purpose of soliciting and procuring insurance business through persons not authorised for the said purpose with or without consideration of whole or part of commission or remuneration earned through such solicitation and procurement and includes enrolment of persons into a multilevel chain for the said purpose either directly or indirectly.

4.4. Section 45 of the Insurance Act

Sec. 45 (2) of the Act, 2015 provides that a policy of life insurance may be called in question at any time within three years from the date of issuance of the policy or the date of commencement of risk or the date of revival of the policy or the date of the rider to the policy, whichever is later, on the ground of fraud, provided that the insurer shall have to communicate in writing to the insured or the legal representatives or nominees or assignees of the insured the grounds and materials on which such decision is based.

Explanation to Sec.45 (2) provides that for the purposes of this sub-section, the expression "fraud" means any of the following acts committed by the insured or by his agent, with intent to deceive the insurer or to induce the insurer to issue a life insurance policy:

- a) the suggestion, as a fact of that which is not true and which the insured does not believe to be true;
- b) the active concealment of a fact by the insured having knowledge or belief of the fact;
- c) any other act fitted to deceive; and any such act or omission as the law specially declares to be fraudulent.

Explanation II to Sec.45 (2) provides that mere silence as to facts likely to affect the assessment of the risk by the insurer is not fraud, unless the circumstances of the case are such that regard being had to them, it is the duty of the insured

or his agent keeping silence, to speak, or unless his silence is, in itself, equivalent to speak.

Sec.45 (3) provides that notwithstanding anything contained in sub-section (2), no insurer shall repudiate a life insurance policy on the ground of fraud if the insured can prove that the misstatement of or suppression of a material fact was true to the best of his knowledge and belief or that there was no deliberate intention to suppress the fact or that such misstatement of or suppression of a material fact are within the knowledge of the insurer:

Provided that in case of fraud, the onus of disproving lies upon the beneficiaries, in case the policyholder is not alive.

Sec, 45 (4) provided further that in case of repudiation of the policy on the ground of misstatement or suppression of a material fact and not on the ground of fraud, the premiums collected on the policy till the date of repudiation shall be paid to the insured or the legal representatives or nominees or assignees of the insured within a period of ninety days from the date of such repudiation.

Sec.40, Sec.41, Sec.42 and Sec.45 of the Insurance Act, 2015 as mentioned above define and determine the scope and consequences of frauds perpetrated by any person in the insurance business. Insurance professionals need to have proper understanding of the above-noted provisions of the Insurance Amendment Act, 2015 to legally handle insurance frauds.