SUCCESS OF INDIAN INSURANCE BROKERS: A BUBBLE WAITING TO BURST

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The post detariffing war has begun in the $5 billion Indian general insurance market. The opening round of the pricing battle for business has gone in favour of the state owned insurers who have begun aggressively pitching for recovering their lost business to private sector insurers.

Since the opening up of the insurance sector, several private players, including foreign ones, have entered insurance business in India. In totality, India has about 16 players in life and 15 in the general insurance sector. Indian insurance market size is presently estimated at Rs. 5000 crores. By 2010, it is expected to grow five-fold. In 2000-01 fiscal year, total premiums stood at US$ 9933 million, which is 0.41 percent of total global premiums of US$ 2443.6 billion. Total premiums of Indian insurance industry in 2000-01 fiscal was 2.32 percent of country's GDP. Per capita premium stood at US $ 9.9.

Indian insurance market potential could be gauged by the fact that currently about 40-42 million people have been brought under insurance whereas the potential is estimated at 200-250 million. Insurance companies could tap only 5 percent of Indian middle class segment. Foreign equity is fixed at 26% as per current regulations. There is no statutory bar for a foreign firm to have a higher equity participation in the broking entity.Brokers are now emerging out as a powerful outsourced vendor for insurance marketing.

NATURE OF INSURANCE BUSINESS:

The nature of insurance business is such that legal standards alone are not sufficient to encourage professionalism in the industry. It is more a matter of ethical conduct and mindset and self-regulation at the level of brokers themselves that can bring in higher professional standards. It has to be self-motivated. This is unlikely to happen. The only deterrent against unethical conduct is a monitoring mechanism to ensure that breaches are detected quickly and the levels of punishment imposed severe. Professional standards, in the current environment, have to be enforced. Freeing the market of tariff price controls is giving the brokers an opportunity to display their professional wares but ultimately, in any market the professional standards can be raised only if the consumers make tough demands for improved services, and if there exists fair competition for excellence among the brokers themselves.The insurers are able to manage the high expectations of the consumers and the brokers by their professional expertise and ethical conduct. As of now, none of the stakeholders has dis played any initiative to respond to enhancing the demands for higher professional and ethical standards is disappointing. An international survey suggest that 73% of the corporate and significant clients considered brokers to be very important or essential. A major challenge being faced by the underwriters and sales force across the country is that they are under tremendous pressure to ignore sound underwriting principles with the pretext of competition. The market has become highly volatile, competitive after detariffing. The bid for the top slot has detetiorated into a fight for survival. At present, the entire industry has been through lot of turmoil in India.

THE SUCCESS FACTOR:

Brokers have been able to garner, an impressive brokerage income, and particularly in a predominantly tariff environment and with the other constraints, should be regarded as a success of regulatory intervention in introducing them into the system. In a fully non-tariff environment, their role and consequential prospects of higher earnings seems even brighter. A brokerage remuneration of Rs. 122 crores in 2004-05 and an estimate of Rs. 180 crores in 2005-06 has been received. Within three years of introducing the new distribution channel, it is a substantial progress.

The expected capital invested by about 222 brokers could be estimated at about Rs. 170 crores or less. Out of these 222 brokers today, the direct brokers number 193, with reinsurance brokers 4 and composite brokers 25. A majority of the brokers are based in the Western Zone and number 79; and in the Northern Zone they number 78. The Southern Zone has 47 and the Eastern Zone has only 18 brokers. There is, however, no licensed broker representation hailing from the States of Goa, Madhya Pradesh, Jammu & Kashmir, Haryana, Himachal Pradesh, Uttranchal, Bihar, Jharkhand and Orissa, all the Northeastern States and Pondicherry, rendering the broking activities enevenly spread.

In 2004-05 a business of Rs. 2500-3000 crores and in 2005-06 estimated Rs. 4000-5000 crores was placed by brokers. Quite a few brokers have opened branches or entered into franchisee arrangements with other bodies, as, currently, there is no regulatory requirement to seek the Authority's permission for it. Broking has been introduced only in 2002 and that too in an industry environment that is predominantly a tariff dominated one, wherein the Brokers have had no opportunities to demonstrate their professional expertise, knowledge and negotiating skills, but still the broker community has attracted persons of proven professional competence, insurance expertise and ethical conduct to its fold.

LIFE INSURANCE SCENARIO:

In India, Life insurance is generally considered as a tax-saving device instead of its other implied long term financial benefits. Indian people are prone to investing in properties and gold followed by bank deposits. They selectively invest in shares also but the percentage is very small—4-5%. Even to this day, Life Insurance Corporation of India dominates Indian insurance sector.

With the entry of private sector players backed by foreign expertise, Indian insurance market has become more vibrant. Indian government considers insurance as one of major sources of funds for infrastructure development.The contribution of brokers is not insignificant in the area of Life insurance. Though a Direct Broker does not require any extra qualification to deal with life insurance but because of the long term nature of business, brokers have not shown much interest in life segment. Insurers also have the tendency to develop their agency force to create new business with personal report both in urban and rural areas. LIC has the biggest Agency force so far and also have launched the Micro Scheme to cover the length and breadth of the country.

MISUNDERSTOOD ROLE OF BROKERS:

The role of insurance brokers in India is not well understood. Interestingly, many customers buy insurance polices without knowing whether they need them and why. It is argued that "why do you need a broker to buy an insurance policy when you can buy it directly from the insurance company at a discount?" This is the question many corporates ponder over when a broker is engaged for buying a policy. There is a lack of understanding even among brokers who are already out in the market as to really what the role of a broker is; and the customers don't know it either. A few brokers have positioned themselves as discounters, rebaters of premium, or glorified agents.

The role of broker is to generate risk awareness at both sides. He adds a lot of value at both ends of the purchase. He is not the one to merely sell a policy to the customer, but he also enables the customer to identify the type of policy most suited to his needs. A real broker will also add a lot of value at the other end, where the insurance company as the underwriter needs to know exactly what the customer requirements are and quite often, need to be encouraged to develop new products. Thus brokers operate at both ends of the supply chain, What has been happening till now is that people from insurance companies come knocking on the door and offer discount on insurance premium by 5-10 percent; and customers think that is a good deal. They may not even need that fire insurance in the first place. Customers have got dozens of fire insurance policies from different insurers. It is the worst possible scenario that insured can have at the time of a big claim. He would have a horrendous time trying to get a claim settlement that would benefit the company. The way insurance is being purchased is going to change as brokers who know their role come into the market and quality companies will use them. Companies that are only interested in price will go direct and get a discount or whatever and will not have the proper protection.

INDIAN CONCEPT OF BROKING:

Broking is not a new concept. In West Asia, companies run by non-resident Indians go to brokers. It is not as though it is an alien concept or unusual thing to do. It's quite the other way in India. Insurance is being purchased just on the basis of price and nothing else. People really don't know half the time why they are buying. In developed countries, many brokers will work for free when it comes to big business. There is still commission paid in many parts of the world. But for bigger blocks of business, like aircraft insurance, which is complex and very risky, the broker giving professional advice can be sued if proved that he had given wrong advice either to the customer or to the insurer. There are some cases against brokers already in the insurance market. It is a matter of contractual rights and obligations. The broker represents the customer, and if he gives incorrect or wrong advice then he is held responsible, and the broker has to take insurance against those risks. If the insurance is badly put together, then you have the right to sue your broker. The IRDA regulations are quite clear on the brokers' responsibilities. There are many cases of brokers being sued in all sorts of jurisdiction. In addition to fully understanding the business and benefits environment in an emerging country, multinational companies must determine how they want to be competitively positioned against other firms. To optimally position themselves, they must take a holistic approach to remuneration. The key to success is striking the precise balance between insurers and the brokers. The Authority is of the considered view that further licensing of Composite Brokers be stopped. Those that have been issued licenses may be asked to apply separately for licensees for direct and reinsurance broking at renewal. There would be two legal entities with separate responsibilities and accountability norms.

GLOBAL BUSINESS SUCCESS:

Emerging multinational companies are seeking expansion into new markets. China and India have become particular hot spots for this activity because of their abundant human capital resources. Populations in both countries exceed 1 billion, with more than 50 percent between the productive ages of 18 and 64 years old. With the inherently low business operating costs and highly skilled and educated workforce, the utilization of these two markets is causing rapid change and increasing the competitive environment. China, for example, has 23 different provinces each with a distinct set of provincial plans. To operate there, companies need to understand the landscape so that they can create the right supplemental employee benefits plans for the provinces in which they operate. In addition, different employee benefits plans are required depending on the type of legal entity that is established. Typical employee benefits, including group health care, life insurance and retirement benefits, can be delivered through the Foreign Enterprises Service Corporation (FESCO) for joint-venture companies or tailored to the employers needs if the company operates as a wholly owned foreign enterprise (WOFE). As expected, it is simpler to establish a state-owned company than it is a WOFE. Internationally brokers are an expert lot and recognised Risk Advisors, Claim Consultants, Prudent underwriters who add value to the insured. European market is mainly dominated by the brokers as against Indian market dominated by the Agents.

ACCEPTABILITY IN THE INDIAN MARKET:

As the general insurance market gears itself up to the new detariffied, free-pricing regime that took effect in January 2007, consumers expect premium rates to nosedive and stabilise in three years. A nationwide survey by FICCI reveals that brokers as intermediaries are still not wholly acceptable for the corporate or individual clients in India. While 80 percent of the respondents give two-three years for the market to stabilize, a big majority (92 percent) prefer to deal with insurance companies directly and 60 percent opt for companies for expert advice rather than insurance brokers. This fact has been noted by the Insurance Regulatory & Development Authority, which is framing new guidelines for brokers.

Unhealthy competition in the market has also affected the professional image of brokers. Most of the brokers still do not have professional expertise and their ostrich-like attitudes of not owning up their deficiencies in their mindset and the poor morale of the staff would act as huge barriers to their perceived strategic strengths at the market place. Post-free pricing, markets would need expert advisory services which can be provided by brokers. However, 60 percent of respondents would like to deal with the insurance company directly rather than dealing with the brokers and only 40 percent would prefer to deal with brokers for expert advice post-free pricing. Indian customers feel that:

1. Insurance companies pay brokers a lot of money to place insurance with them and customers do not always get the service they deserve. A good broker should deliver much more than a spreadsheet once a year. Value-added services may include newsletters, wellness magazines, customer satisfaction surveys, benefit statements, and assistance with claim follow up. Customers want the broker to deliver these extra services.

2. They choose a broker who has a

competent, attentive support staff. A good staff is critical in the day-to-day operation of benefit plans and they can make or break the employees' perception of the program. Broker should be competent with back up support to solve a critical problem.

3. Small and mid-sized companies often become lost within national brokerage houses and may receive a higher level of service from a small regional broker. Conversely, a company that has grown very rapidly might outgrow their original broker and require the services of a larger firm to help evaluate their program. An average-size account is more likely to get preferential treatment from a small regional broker than a large national one. There are advantages of being a big fish in a small pond.

4. Any broker can solicit bids and place insurance. Customers look for someone who provides new ideas and multiple solutions to their benefit problems. Basic rate/benefit comparisons will not cut it anymore.They look for a broker who provides a lot of options like self funding and managed-care alternatives.

5. A broker who recommends an insurance company who subsequently fails or doesn't deliver as expected, a lawsuit may follow. It makes good business sense to deal with a broker who is not only aware of the company's financial health, but also smart enough to have liability coverage should it ever be needed.

6. It is not customer's job to "train" someone who lacks the experience to properly handle his account. His broker should have a minimum of 5 years experience in the group insurance business; 10 years is even better.

FINANCIAL VIABILITY:

The Authority has prescribed specific minimum capital quantum structures as the threshold norms. Among several other reasons, the threshold limit of capital is pitched, at the current levels to take into account the minimum capital required to equip the offices of a broker with IT connectivity, to enable him buy other office equipment, to incur office expenses such as rent and communication cost, to pay for manpower costs, marketing costs etc. Since 20% of the minimum capital is tied up, as a fixed deposit in a Bank, only 80% of the paid-up capital is available to a broker to carry on his business operations on a sustained basis till he generates his brokerage income. Brokers, in the absence of prior regulatory approval, to open their new offices, without having to enhance their current paid up capital structure have expanded their activities. The Authority is of the view to refix the minimum paid-up capital norms based on the status of the city in which the broking firm is headquartered. The Metros should have a minimum paid up capital Rs. 50 lakhs, State capitals Rs. 40 and at all other centers Rs. 30 lakhs. 40% of the above will be required in addition for each new branch office. Financial viability of a broking firm can be gleaned mainly from examining the annual financial statements. Onus should be on the statutory auditors 'to blow the whistle,' if any irregularities are suspected or detected. As the broker is a legal representative of the consumer, more care is necessary to ensure their financial and professional discipline. The regulations on remuneration applies only to what should transpire between the broker and the insurer.

THE FAILURE FACTOR:

In the sixth year of liberalisation the number of insurers have reached to 30 plus but still many big groups are in queue to make foray and tying up with their foreign counterparts. As compared to private players, brokers are still junior in experience but more in number. The Regulator was not very supportive to brokers in first three years, however, after detariffing w.e.f. 01.01.2007 brokers have found a level playing field to prove their capability. Some of the brokers have closed their shops and many are out of the race. More than 40% are just pulling on. With the recommendations of expert committee on certain major issues, brokers feel that they will soon have their voice in the market. During these three tough years in the market, many brokers have died their natural death. The success bubble of insurance brokers may burst because of following reasons:

1. The lack of representation of licensed brokers from so many states and Union Territories is glaring. This could be due to several factors; the large amount of minimum paid-up capital required, the lack of entrepreneurship of locals, the inadequate availability of insurance potential, the proximity of metros to a few of the states, the expansion of licensed broker offices through opening of branches, franchising arrangements and sub-broking.

2. A few brokers have opened a number of

branches, without regard to the adequacy of working capital requirements, and without ensuring the availability of qualified and trained manpower at such offices. Franchisee arrangements and sub broking practices have already been brought in. A few brokers are also working as agents of insurers, under a binding authority to issue policies and service customers, for which insurers pay them remuneration.

3. The injection of professionalism and the mindset for implementing acceptable best practices among the brokers must start at the entry point. The entry into the broking profession has been regulated, based more on the threshold of the minimum paid-up capital norm of Rs. 50 lakh for a direct broker than on any professional insurance qualification or expertise of the personnel that form the broking firm.
4. Such easy entry norms have perhaps encouraged non-insurance professionals to enter the profession, who view broking, as a business worth investing in. With commercial instincts, rather than professional capabilities, guiding the broking business of the firm, it is likely that the available opportunities for unethical practices of kickbacks to creep in are quite high.
5. No value addition has been brought in by the broker, who is arguably not a professional with proven expertise; and that the percentage quantum too is high. Customers do not adequately appreciate the professional capabilities and inherent talents of the brokers. Now in the de-tariff regime brokers have to be totally professional to impose risk management capabilities and negotiating skills of the highest order.
6. The quality level of the professional expertise required in a non-tariff environment cannot be below the international level because both international insurance companies (Joint ventures) and insurance brokers are already in the market. The knowledge gap between the two is likely to bring in and promote unethical practices.
7. The broker has currently no access to financial information, in the absence of non-publication of quarterly un-audited financial statements by insurers. Even annual statements are not published. He has also no authority to ask and satisfy himself, on behalf of the insured, that effective reinsurance placement with BBB rated reinsurers has been done and the extent thereof..
8. As far as healthy competition is concerned now in the detariffed environment, there is full opportunity for brokers to display or leverage their professional capabilities. After three years of opening, brokers have opportunities to display their professional skills and expertise.
9. In the beginning, the brokers were concerned more with protecting their invested capital and wanting to raise their brokerage revenues, quickly as the market has been 'hostile' to their entry. As new entrants, they are unwanted by most stakeholders; their difficulties are compounded due to the market being tariff one.
10. The brokers seem disappointed that their brokerage incomes are below their expectations. The demand for kickbacks out of the current remuneration structure further compel them for unethical practices.
11. IRDA have no mechanism to keep the financial status of insureres under regular review and watch in a price freed market. While in a non-tariff market the rates are expected to go downward rather than upward, placing the financial resources of insurer's under strain. It is imperative that the public, including the insured and the brokers, should be reassured of the financial viability of insurers themselves.
12. It is not clear why when a surveyor is permitted to offer consultancy services to a client, he does not service, a broker should be prohibited from doing so. There is always a conflict of interest and a possibility of unethical conduct.
13. The Authority is strictly in the mood to discourage the sub-broking system since the relationship between the two is fraught with legal implications from the point of privity of contract among the broker, the sub-broker and the consumer. Who is responsible to whom for liabilities?
14. Broking distribution channel has yet to prove its professional credentials and make meaningful contributions in a non-tariff market.

Because Indian market is so dynamic, multinational companies are continually monitoring the human resources solutions being offered to ensure that they are attuned to the environment. They are sure that their compensation structures are current so that they continue to attract and retain the talent critical to their success. In addition, with the influx of foreign insurance companies and other vendors in this region, it is imperative that multinationals have local advisers who know the market and who can establish suitable relationships to serve the companies needs. The market is an open and free one. But no financial information is made available to the consumers, at regular intervals to make their choice of the insurer with whom they or their brokers wish to deal. In a total non-tariff environment, wherein the rates could go down to uneconomic levels, the un-audited underwriting results and the comparative profitability of each insurer needs to be measured at frequent intervals. The Authority has no other financial mechanism to assess the direction in which the competition among the insurers is taking the industry and for any course- corrective actions to be initiated. This single step would improve corporate governance of insurers.

Customers today have different priorities; one may be price-conscious' the other may be performance-conscious, yet another may be time-conscious and yet another convenience-conscious. By making price as the sole issue, brokers have not even attempted to determine ways by which they could enhance value addition in the transaction to make them unique. What is at stake in the bargain is the capture of emotion, enthusiasm and mind of the customer in fovour of the particular insurer. Here comes the opportunity for innovation and creativity on the part of the brokers to excite the interest in the customer. Broker should be looking for this aspect in the transaction.

Right now private insurers have a host of compelling strategies. They are selective in their acquisitions of accounts. They are focussed on what they want. They are money-minded and are strictly commercial. The PSU insurers are status conscious, and are a proud lot, as a class, the feeling being nurtured by their staff day in and day out. The customer segment itself would emerge as their bigger rate competitors. Now that the rates are freed, the customers would play games at 'reverse marketing'. This term refers to bluffing the PSU insurers. They are more aggressive and more determined and more united than before. Brokers have a tough role to deal with them on pricing terms. Any rate quoted by the broker have to be supported by the respective insurers. Unstability and reluctance may give place to unreliability of both insurer and the broker.

There is a need for the Authority to ensure that the insurance broking firms are serious enough, businesswise to run as a professional broking company, with competence and with necessary insurance expertise.

There is a compelling necessity, in the free market to ensure that a minimum number of the Directors of the broking company are knowledgeable in insurance technicalities and are ethical in their conduct and do behave as professional experts in their field, to the satisfaction of the Authority and the consumer public. The issue of 'kickbacks' has to be relentlessly monitored to ensure that neither the insurers nor the brokers are indulging in it. "Providing services related to insurance consultancy and risk management," and "assisting in the negotiation of claims," are the functions to be necessarily performed by a broker, as part of his duties to his client.

The justification to maintain a differential in the remuneration levels between a qualified broker and a qualified agent cannot be easily brushed aside.

Insurance brokers have been given a wider field to display their professional expertise in risk management, consultancy and claims advice to all consumers, and with the brokers continuing to have a choice provided in the code of conduct to collect fees from the client but the brokerage payable will not exceed the current norms. Further the legality of reimbursing brokers with the service tax on brokerage paid by insurers, who do not receive professional services, needs examination in the light of existing laws. The biggest constraint compelling the brokers to die their own death is the provision that brokers are not entitled to receive any 'fee' from insurers other than the prescribed brokerage." This is a direction to the insurers, who are the beneficiaries of business. The word 'fee' is added only in case of brokerage in the Insurance Act, 1938, Section 42 E. If any additional 'fee' or any other remuneration is paid to the broker by an insurer or any other service is rendered to the insurers on the insurance policy placed with him, it amounts to breach of the Section 42E. It may also amount to rebating. If the provisions amended and the 'fee' is not allowed at least in claim consultancy services, the bubble of success of insurance brokers may burst soon.