12
Legislation and client advice

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Learning objectives

After studying this chapter, you should be able to:

- explain the provisions of key legislation relevant to life insurance agents in providing client advice.

Introduction

At this point in your studies you will have a good understanding of:

- how insurance works;
- the range and detail of the products that you will be advising on and selling;
- how best to provide a professional service to your clients; and
- what happens in the event of a claim.

The final section of the course is concerned with explaining the legal and regulatory measures that exist, focusing on the impact they have on your role as a life insurance agent in providing client advice.

In this chapter we will consider key legislation, starting with the Insurance Act 1938, and focusing on the provisions that have an impact on agents.

Key terms

This chapter features explanations of the following terms and concepts:

Remuneration	Prohibition of rebates	Licensing of insurance agents	Beneficiary
Solvency	Money laundering	Financial Intelligence Unit (FIU)	High and low risk customers
Trust	Trustor	Trustee	Know your customer (KYC)

A Insurance Act 1938

This is the most important legislation passed in India relating to insurance business and, as stated in chapter 1, it came into effect from 1 July 1939. The Act consolidates the law relating to the business of insurance and it was the first piece of legislation to govern all forms of insurance, providing state control over insurance business. The original 1938 Act was amended in 1950, 1956, 1968, 1972, and also in 1999 and 2002 following the establishment of the IRDA (see section D). The Act broadly contains provisions relating to the:

- registration of insurers and renewal of registration;
- manner of investment of premium;
- maintenance of insurers' solvency levels (see 'Be aware' below);
- appointment of staff;
- amalgamation and transfer of insurance business;
- assignment or transfer of policies and nominations;
- rural and social sector;
- control over management;
- licensing of agents and their commission;
- prohibition of rebates;
- power of investigation and inspection by the regulatory authority;
- protection of policyholders' interests; and
- constitution of the Insurance Association and Insurance Councils.

Be aware

In this context, solvency – in simple terms – means whether the insurer has sufficient resources to satisfy the IRDA that they are able to pay all claims at any point in time.

Until 1999 the Controller of Insurance (a person appointed by the Central Government to exercise all the powers, discharge the functions and perform the duties of the Authority) was responsible for administration of the Insurance Act 1938. The Controller was replaced by the IRDA.

A1 Provisions with specific relevance to agents

The following sections of the Act are particularly important for agents to understand, as they lay down the guidelines that must be followed regarding the:

- licensing of agents;
- commission payable to them; and
- prohibition of rebates.

A1A Section 40(1) – Prohibition of payment by way of commission or otherwise for procuring business.

Section 40(1) of the Insurance Act 1938 prohibits any form of remuneration for soliciting or procuring insurance business in India to any person other than a licensed insurance agent or an insurance intermediary.

Section 40(1)

No person shall after the expiry of six months from the commencement of this Act, pay or contract to pay any remuneration or reward whether by way of commission or otherwise for soliciting or procuring insurance business in India to any person except an insurance agent or an intermediary or insurance intermediary.

Example

Prashant has appeared for the prescribed pre-recruitment examination in life insurance, but has failed to score the minimum required mark to pass the examination and therefore is still not certified and still not licensed by the IRDA to solicit or procure life insurance business. So Prashant cannot be paid for soliciting or procuring insurance business as he is neither a licensed insurance agent nor an insurance intermediary. In fact, Prashant is not authorised to solicit or procure any life insurance business for any life insurance company until he is awarded the licence to do so from the Authority.

Section 40A(1) stipulates the limits on the remuneration or reward by way of commission or otherwise that can be paid to an insurance agent, the details of which have already been discussed in chapter 10.

Section 40B(1) also prescribes limits for expenses of management of life insurance business. All insurers have to comply with this and provide statements in the prescribed format, certified by an actuary, within a given time limit.

A1B Section 41(1) – Prohibition of rebates

Section 41(1) of the Insurance Act 1938 prohibits any insurance agent/intermediary from offering any commission/premium rebate as an inducement to any person to take out or renew or continue a policy of insurance. The section also prohibits any person from accepting any such rebates offered for taking out insurance.

Section 41(1)

No person shall allow or offer to allow, either directly or indirectly, as an inducement to any person to take or renew or continue an insurance in respect of any kind of risk relating to lives or property in India, any rebate of the whole or part of the commission payable or any rebate of the premium shown on the policy, nor shall any person taking out or renewing or continuing a policy accept any rebate, except such rebate as may be allowed in accordance with the published prospectuses or tables of the insurer.

Example

Santosh is a licensed life insurance agent with ABC Insurance Company. Santosh approaches Karan to buy life insurance based on his lifecycle needs. Similarly Karan has been approached by agents of other life insurance companies to consider their products.

In this case, as per section 41 of the Insurance Act 1938, Santosh cannot offer any rebates from the commissions he will receive from ABC Insurance Company to Karan as an inducement to buy life insurance from him and ignore the products of other companies.

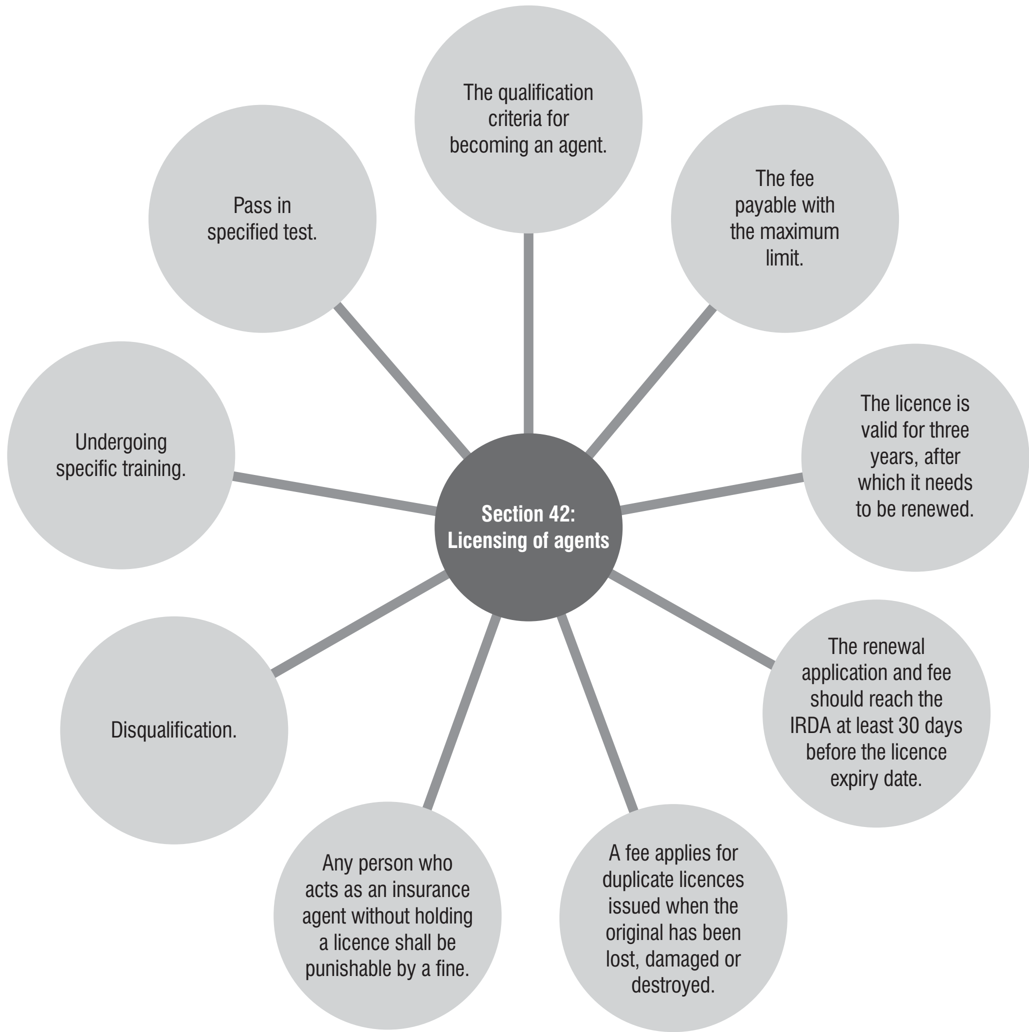
Similarly Karan cannot ask for any rebates from the agents of any company as an inducement to buy life insurance from them.

Any person not complying with the provisions of this section shall be punishable with a fine up to Rs. 500.

A1C Section 42 – Licensing of insurance agents

Section 42 of the Insurance Act 1938 stipulates the conditions for issuing a licence to a person or company to act as an insurance agent for soliciting or procuring insurance business. The section covers the following:

Figure 12.1



The specific details of the procedure for issuing a licence to agents will be discussed in chapter 13.

A1D Section 44 – Prohibition of cessation of payments of commission

As we saw in chapter 10, under section 44 of the Insurance Act 1938, no insurance agent can be refused payment of renewal commission due to him on renewal premium, in respect of life insurance business conducted in India under the agreement. Even after the termination of agency the renewal commission is payable, except for fraud, provided that:

(a) the insurance agent has served the insurer continually and exclusively in respect of life insurance business for at least five years, and policies insuring a total sum of not less than Rs. 50,000 effected through him for the insurer were in force for one year before his ceasing to act as an agent for the insurer, and that the commission on renewal premiums due to him does not exceed 4%;

or

(b) the agent has served the insurer continually and exclusively for at least ten years and after his ceasing to act as an agent he does not directly or indirectly solicit or procure insurance business for any other person.

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Be aware

In the event of the death of an agent, any commission payable to him under the above points (a) and (b), is payable to his heirs for so long as such commission would have been payable had he been alive.

B Indian Life Assurance Companies Act 1912

The first statutory measure in India to regulate life insurance business was introduced in 1912 when the **Indian Life Assurance Companies Act** was passed. Prior to 1912, there had been no legislation to regulate insurance business in India.

As we saw in chapter 1, India's life insurance business in its present form owes its origins to other countries, in particular England, and the first insurance company established in India was the Oriental Life Insurance Company in Kolkata in 1818.

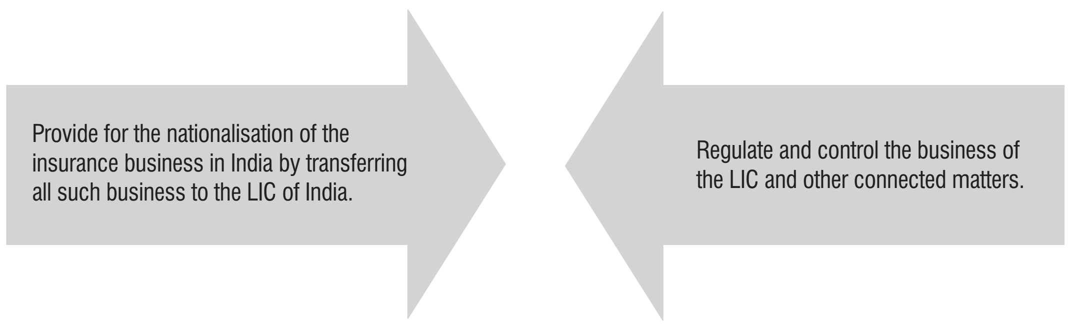
However, all the insurance companies established at this time catered to the needs of the European community and Indians were charged a higher premium than other policyholders. The Indian Life Assurance Companies Act 1912 stipulated for the first time in India that premium rate tables and periodical valuations of companies had to be certified by an actuary. However the Act discriminated between foreign and Indian companies in many areas, putting the Indian companies at a disadvantage.

C Life Insurance Corporation Act 1956

The Life Insurance Corporation Act 1956 was passed on 19 June 1956 and subsequently the Life Insurance Corporation (LIC) was formed on 1 September 1956.

The Life Insurance Corporation Act 1956 was passed to:

Figure 12.2



Be aware

The Life Insurance Corporation of India was formed in 1956 with the merger of 245 Indian and foreign insurers in total (154 Indian, 16 non-Indian and 75 provident societies).

The LIC Act was passed with the objective of nationalising life insurance business in India and also to provide for the regulation and control of the business of the LIC and for all connected matters.

Section 30 of the Act gave the LIC an exclusive privilege to transact life insurance business in India. In 1999 this exclusive privilege was revoked by way of an amendment to the Act as part of the Government's policy of economic reforms.

D Insurance Regulatory and Development Authority (IRDA) Act 1999

The Insurance Regulatory and Development Authority (IRDA) Act 1999 was passed by Parliament in December 1999. The Act provided for the establishment of the IRDA as a corporate body:

- to protect the interest of holders of insurance policies;
- to regulate, promote and ensure orderly growth of the insurance industry; and
- for other related matters.

As mentioned in section A, the IRDA Act 1999 led to amendments in the Insurance Act 1938, the Life Insurance Corporation Act 1956, and also the General Insurance Business (Nationalisation) Act 1972.

Question 12.1

List the section 42 provisions related to the licensing of insurance agents.

As we have seen, the IRDA replaced the 'Controller of Insurance' in administering the provisions of the Insurance Act including registration, licensing and laying down regulations for the proper conduct of the business and the protection of the interests of policyholders.

Be aware

Section 4 of the IRDA Act 1999 specifies the composition of the IRDA. It consists of a Chairperson, not more than five whole-time members and not more than four part-time members. All the members are appointed by the Government of India. Section 14 of the Act lays down the duties, powers and functions of the IRDA.

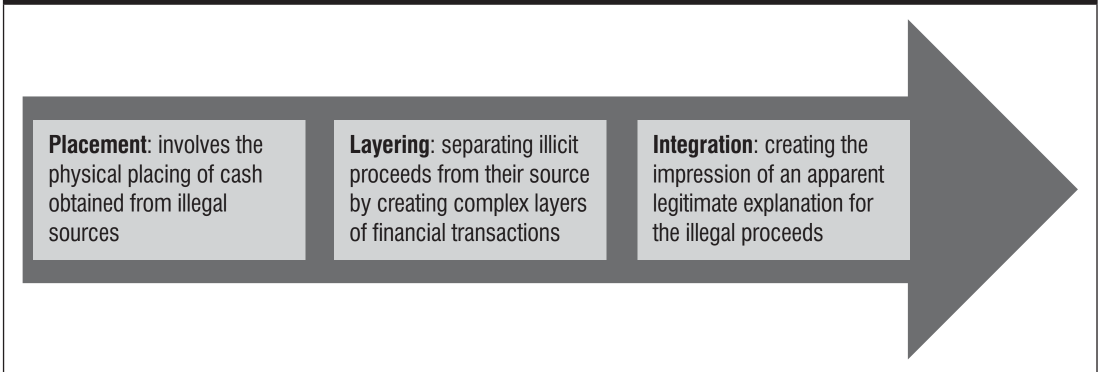
E Prevention of Money Laundering Act (PMLA) 2002

Before we explain the provisions of this important piece of legislation and the impact it has on life insurance agents, we shall explain what money laundering actually means.

Money laundering is the process of bringing illegal money into the financial system by hiding its illegal origin so that it appears to be legally acquired. Money laundering is the term used to describe the process of turning dirty money into clean money. Illegal or 'dirty' money is put through a cycle of transactions so that it comes out 'washed' at the other end as 'legal' or 'clean' money.

There are three common stages of money laundering:

Figure 9.3



The **Prevention of Money Laundering Act (PMLA) 2002** came into effect from 1 July 2005 to control money laundering activities as well as to combat the financing of terrorism. Guidelines on anti-money laundering (AML) for insurance companies were issued on 31 March 2006 which require all insurers to establish an anti-money laundering program. Each company is required to have an AML policy and accordingly file a copy with the IRDA.

Insurance companies offer a variety of products through trained agents and other intermediaries. Hence these guidelines are of importance to insurance agents to the extent indicated in the guidelines.

Compliance with the PMLA is applicable to all financial institutions regulated by the Reserve Bank of India (RBI) – the banking regulator, the Securities Exchange Board of India (SEBI) – the capital markets regulator, and the Insurance Regulatory Development Authority (IRDA) – the insurance regulator and all other financial intermediaries.

The IRDA made it mandatory for all life insurance companies to follow the AML guidelines from 1 August 2006. The guidelines require every insurer to have an AML program which at a minimum should include:

- internal policies, procedures and controls;
- the appointment of a principal compliance officer;
- recruitment and training of insurance agents/employees on AML measures; and
- internal audit/control.

Be aware

You should be aware that the following must be adhered to in respect of the AML guidelines while conducting your business.

Know your customer (KYC)
Insurers need to determine the true identity of their customers, and agents have a major role to play in this. Agents should make sure that their clients submit the necessary identity and address proofs. KYC needs to be carried out at all stages – issue of policy, top-ups and at the time of claim payment.

Information on customers must be collected from all sources including insurance agents, and agents need to educate their clients on the importance of adhering to KYC requirements. The IRDA has provided an indicative list of documents that can be obtained from the customer for customer identification, residence proof and income proof. See chapter 9, section E4 for more details.

Risk profile of the customer
Individuals whose identity and source of funds can be easily identified are categorised as **low-risk customers**. However, even in such cases, if the customer profile is inconsistent with the policies/investments taken out, proper diligence is to be conducted through enquiry and by obtaining all the necessary documents.

High net worth individuals (HNIs), politically exposed persons (PEPs), Non-Governmental Organisations (NGOs), Non-resident Indians (NRIs) are all categorised as **high-risk customers**.

Insurance agents must be very careful while dealing with high-risk customers. Agents need to make sure proper screening of such people is carried out and that all KYC and AML requirements have been adhered to while dealing with these clients.

Example

Low-risk customers include:

- salaried employees; and
- Government employees.

Other high-risk customers apart from the ones mentioned above include:

- money changers;
- arms and explosives dealers;
- film personalities;
- persons dealing with real estate; and
- antique dealers.

Sources of funds
The customer's source of funds (from which the premium is being paid) and their estimated net worth needs to be verified and properly documented. Insurance agents must obtain suitable income proofs to establish the customer's need for insurance cover. If the customer is paying a single premium, which is of a substantial amount, insurance agents need to obtain suitable documents to establish the source of funds.

Threshold for payment of premium in cash
To ensure that the premiums are being paid out of a legitimate source of funds, payment of premiums by cash cannot exceed Rs. 50,000. Premiums of Rs 50,000 and above can be paid only by cheque, demand draft, credit card or any other banking channels.

Insurance agents therefore need to educate their clients about AML provisions.

Be aware

- The services of defaulting agents who expose insurers to AML-related risks on multiple occasions should be terminated and details are to be reported to the IRDA for further action.
- If faced with a non-compliant agent, the insurance company must take all necessary actions to secure compliance. This can include termination of the business relationship with the agent.

F Married Women's Property (MWP) Act 1874

Section 6 of the Married Women's Property (MWP) Act 1874 provides that a life insurance policy that has been taken out by a married man on his own life, for the benefit of his wife and children, shall be deemed to be a trust and will be outside the control of the life insured, his creditors, court attachments etc.

Be aware

A trust is a legal agreement, which has three parties associated with it – a trustor, a trustee and a beneficiary.

- The trustor, or author of the trust, is the person who forms the trust.
- The trustee can either be a person or an entity, who/which is responsible for managing the assets, the ownership of which is entrusted to them as a 'trust' by the trustor.
- The beneficiary is an individual/entity who receives the benefits from the trust.

The proposer can appoint:

- a person (or failing him, another person) as a trustee;
- two or more persons (or survivor(s) of them) as trustees; or
- a corporate trustee, such as a bank transacting trustee business.

A trustee must be a major (18 years and above) and their consent to act as a trustee should be taken and added to the policy as an endorsement. If a trustee is not appointed or not existing, Official Trustees will be appointed by a competent Government Authority.

The beneficiaries of a life insurance policy affected by the MWP Act can be:

- the wife alone;
- one or more children; or
- the wife and one or more children jointly.

The main features of this Act are listed below:

- The proposer should be a married, divorced or widowed man. Only his wife and children can be beneficiaries. Children include sons and daughters. In the case of Hindus, adopted sons and daughters are also included.
- The policy must be on his own life.
- Each policy will remain a separate trust.
- The policy is insured as a trust. Either his wife or child (if over the age of 18) can be appointed as a trustee. The individual has the choice of revoking the trustee(s) and appointing new ones at any time.
- Two or more trustees can be appointed.
- Insurance under the MWP Act is free from court attachments, tax attachments, and creditors, and even the life insured does not have any right to deal with the policy.
- When a claim arises, the policy monies will be paid to the trustees according to the policy. The trustees hold the policy money for the beneficiaries.
- The policy cannot be amended or surrendered.
- It should not have been formed to defraud creditors.
- Nomination and assignment are not allowed.

Mohammedan Law

A non-Mohammedan proposer can specify equal shares or unequal shares for the beneficiaries and provide that the benefit should go to them jointly or the survivors or survivor of them and can specify the beneficiaries by class.

In the case of Mohammedan proposers, the beneficiaries have to be named as it is 'Persona Designata'. The name of the wife and children as beneficiaries should be stated in the policy and they must be existing at the time the policy is taken out. In circumstances where there are more than two beneficiaries, the proposer needs to mention the respective share for each beneficiary.

Question 12.2

What are the key aspects of the AML guidelines that are relevant to an agent?

G Other key legislation

We will look at other key pieces of legislation and regulations that have an impact on your role as an insurance agent in this section.

G1 Redressal of Public Grievance Rules 1998

The Governing Body of Insurance Council (GBIC) was established under the Redressal of Public Grievances Rules 1998 (RPG rules 1998) to set up and facilitate the Institution of Insurance Ombudsman in India.

Be aware

The GBIC consists of one representative each from all insurance companies. The representative should be either the Chairman or Managing Director or a Director of the company.

The RPG rules contain provisions regarding:

- the appointment and office term for the Insurance Ombudsman;
- stipulations in respect of staffing and administration of the Ombudsman centre;
- the powers of the Ombudsman; and
- the manner of lodging complaints and disposing of complaints by the Ombudsman either by way of ‘recommendation’ or ‘award’.

We shall return to the role of the Insurance Ombudsman in protecting customers’ interests and how this impacts on the role of an agent in chapter 14.

G2 Insurance Regulatory and Development Authority (Insurance Advertisement and Disclosure) Regulations 2000

The IRDA (Insurance Advertisement and Disclosures) Regulations 2000 define ‘insurance advertisement’ as:

> any communication directly or indirectly related to a policy and intended to result in the eventual sale or solicitation of a policy from members of the public. It includes all forms of printed and published materials or any material using the print and/or electronic medium for public communication.

Unfair or misleading advertisement includes any advertisements that:

- fail to be identified as an insurance product;
- make claims beyond the ability of the policy; or
- describe such benefits that do not match policy provisions.

Advertisement by insurance agents

An advertisement by an insurance agent that affects an insurer must, before it is issued, be prior approved by the insurer in writing. The insurer needs to ensure that the advertisement is not deceptive or misleading before granting such approval.

An agent is not required to obtain the prior approval of the insurer before placing an advertisement if the advertisement:

- has been developed by the insurer itself and is provided to its agents;
- is generic and information is limited to the agent’s name, logo, address and phone number; or
- contains only statements that mention the experience, service and qualifications of the agent and makes no reference to specific policies, benefits or costs.

G3 Insurance Regulatory and Development Authority (Manner of Receipt of Premium) Regulations 2002

These Regulations define the manner in which premium can be paid by a policyholder for purchasing an insurance policy as follows:

- cash;
- any negotiable instrument such as cheques, demand draft, pay orders, bankers cheque drawn on any scheduled bank in India;
- postal money orders;
- credit or debit card held in the policyholder’s name;
- bank guarantee or cash deposits;

- internet;
- E-transfer;
- direct credit, via standing instructions of the proposer or the policyholder or the life insured through bank transfers; and
- any other method of payment as may be approved by the IRDA from time to time.

The insurer has the option to recover the collection charges of the payment instrument from the proposer.

Be aware

Except where the premium has been paid in cash, the risk will commence only after receipt of the premium by the insurer.

G4 Insurance Regulatory and Development Authority (Licensing of Corporate Agents) Regulations 2002

In October 2002 the IRDA issued a notification under the IRDA (Licensing of Corporate Agents) Regulations 2002. The Regulations deal with the issue of licensing and other matters related to corporate agents such as companies, firms, banks, co-operative societies etc. who are not individuals and can still become agents.

G5 Foreign Exchange Management (Insurance) Regulations 2000

These Regulations, notified by the Reserve Bank of India, prohibit resident Indians from taking out life/general insurance policies issued by an insurer outside India.

The Foreign Exchange Management (Insurance) (Amendment) Regulations 2002 subsequently added the following: 'Provided further that the prohibition against taking a general insurance policy issued by an insurer outside India shall not apply to a unit located in Special Economic Zone'.

G6 Foreign Exchange Management (Insurance) Regulations 2000 – Life Insurance Memorandum (LIM)

This sets out exchange control regulations that govern issues relating to the issue of life insurance policies in Rupees and in foreign currencies to non-residents, collection of premium and settlement of claims and other related matters.

- **Issue of policy and collection of premium** – in the case of resident individuals with Indian nationality, life insurance policies can be issued in foreign currency, provided that the premium is being paid out of remittances from foreign currency funds held by them abroad, or from their resident foreign currency accounts with authorised dealers in India.

  In the case of non-residents, life insurance policies denominated in foreign currency by insurers, through their offices, either in India or abroad, provided that the premium is collected in foreign currency from abroad or out of NRE/FCNR accounts of the insured or their family members held in India.
- **Claim settlement** – in cases where the claimant is a resident outside India, for rupee life insurance policies, payment in foreign currency will only be in proportion to the amount of premium paid in foreign currency. In the case of non-resident beneficiaries, settlement in foreign currency can be made in their NRE/FCNR account.
- **Commission to overseas agents** – commission by insurance companies can be paid to their agents who are permanently resident outside India, notwithstanding that the part of the business booked by them has been for resident Indians with premiums paid in rupees in India.

G7 Consumer Protection Act (COPA) 1986

- Under this Act, a consumer, as an individual, can approach the various forums prescribed under the Act for redressal if they are not satisfied with the goods or service provided.
- COPA applies to the insurance industry as well.
- Policyholders have the right to seek redress against unfair trade practices or unsatisfactory service from insurers and from agents.
- The majority of disputes relating to insurance arise out of repudiation and delays in claims.

Consumer dispute redressal forums are established in each district and for each State. The forum at the district level will hear complaints up to the value of Rs. 20,00,000, and the forum at the State level will hear complaints up to the value of Rs. 1,00,00,000. The National Commission will attend to matters beyond the jurisdiction of the State forums and also appeals against the decisions of a State forum.

The following are basic consumer rights:

- Right to Protection against marketing Goods & services.
- Right to Information.
- Right to be Safe.
- Right to Choose.
- Right to be Heard.
- Right to Seek Redressal.
- Right to Consumer Education.

The complaint should be filed within two years from the date on which the cause of action has arisen, unless otherwise condoned by the competent consumer Forum.

There are various other measures taken by all insurance industry stakeholders, including the IRDA, for the protection of policyholders. We will look at these measures in more detail in chapter 14.

Key points

The main ideas covered by this chapter can be summarised as follows:

- The Insurance Act 1938 is the most important insurance legislation passed in India.
- Section 40(1) of the Insurance Act 1938 prohibits the payment of any remuneration for procuring insurance business to any person other than a licensed insurance agent.
- Section 41(1) of the Insurance Act 1938 prohibits any insurance agent from offering any rebate as an inducement to buy insurance. The section also prohibits any person from accepting any such rebates offered for taking insurance.
- Section 42 of the Insurance Act 1938 stipulates the conditions for issuing a licence to a person or company to act as an insurance agent for soliciting insurance business.
- Subject to certain conditions, under section 44 of the Insurance Act 1938, no insurance agent can be refused payment of renewal commission due to him in respect of life insurance business conducted in India.
- The first statutory measure to regulate life insurance business in India was the Indian Life Assurance Companies Act 1912.
- The LIC Act 1956 was passed to provide for the nationalisation of life insurance business in India by transferring all life insurance business to the LIC.
- The LIC was formed with the merger of more than 200 life insurance companies and provident societies.
- The IRDA Act 1999 was passed to regulate, promote and ensure orderly growth of the insurance industry.
- The IRDA replaced the 'Controller of Insurance' in the registration, licensing and laying down of regulations for the proper conduct of the business and the protection of interests of policyholders.
- Money laundering is the process of illegally bringing money into the financial system by hiding its origin so that it appears to be legally acquired. There are three stages: placement; layering; and integration.
- All insurers must have an AML program in place and which must be adhered to by all agents in the course of their business.
- Section 6 of the MWP Act 1874 provides that a life insurance policy that has been taken out by a married man on his own life, for the benefit of his wife and children, shall be deemed to be a trust and will be outside the control of the life insured, his creditors, court attachments etc.
- The beneficiaries of the life insurance policy can be the wife alone, one/more children alone, or the wife and one/more children jointly.

Other legislation:

- The Governing Body of Insurance Council (GBIC) was established under the Redressal of Public Grievances Rules 1998 (RPG rules 1998) to set up and facilitate the Institution of Insurance Ombudsman in India.
- The Insurance Regulatory and Development Authority (Insurance Advertisement and Disclosures) Regulations 2000 govern issues related to unfair advertisements and advertisements by insurance companies and insurance agents.
- The Insurance Regulatory and Development Authority (Manner of Receipt of Premium) Regulations 2002 define the manner in which premium can be paid by a policyholder for purchasing an insurance policy.
- The Insurance Regulatory and Development Authority (Licensing of Corporate Agents) Regulations 2002 deal with the issue of licences and other matters related to corporate agents who are not individuals and can still become agents.
- The Foreign Exchange Management (Insurance) Regulations 2000 prohibit resident Indians from taking out life/general insurance policies issued by an insurer outside India.
- The Foreign Exchange Management (Insurance) Regulations 2000 – Life Insurance Memorandum (LIM) set out exchange control regulations that govern issues relating to the issue of life insurance policies in rupees and in foreign currencies to non-residents, the settlement of claims and other matters.
- Under the Consumer Protection Act (COPA) 1986 an individual can approach various forums for redressal if they are not satisfied with the goods or services provided to them. Accordingly policyholders have the right to seek redress against unfair trade practices or unsatisfactory service from insurers and their agents.