



Seminar on Audit of Life Insurance Companies
Organized by : WIRC of ICAI

Significant issues in Audit of Premium and Re-insurance

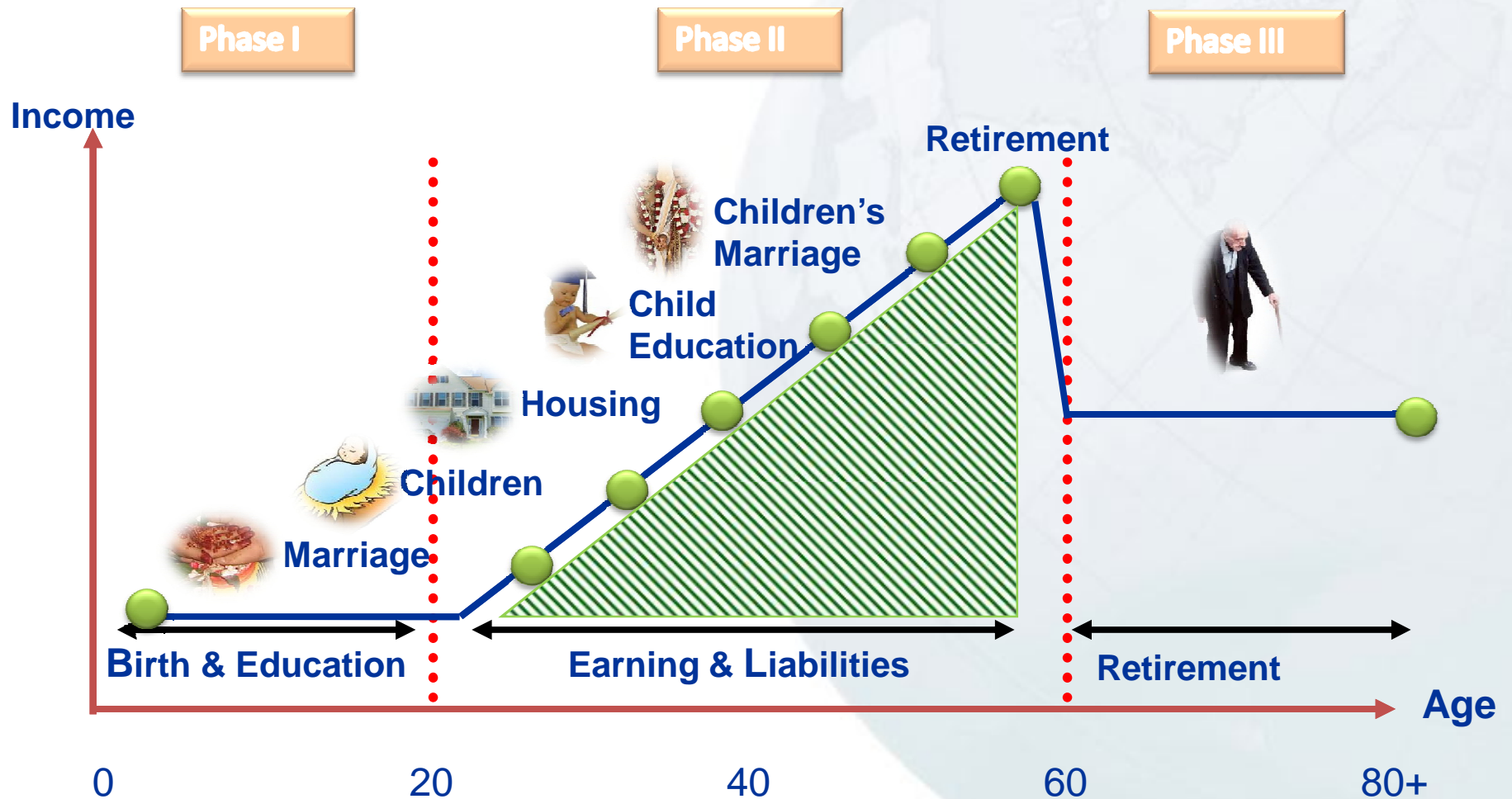
- CA Hasmukh B Dedhia

Major Highlights

- *Regulatory Framework*
- *What is Premium?*
- *Objectives of Audit of Premium*
- *Significant Audit procedures*
- *Underwriting*
- *Reinsurance*
- *Types of Reinsurance*
- *Objectives of Audit of Reinsurance*
- *IRDA Regulations*
- *Significant Audit Procedures*



Human Life Need Index



Need for Life Insurance

Risk - When You are Holidaying in Phuket > Tsunami

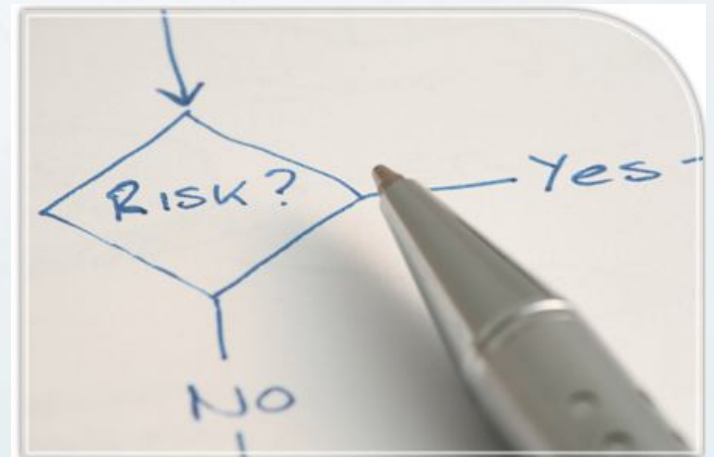
Risk – Sedentary Life Style >Heart Attack @ the Age of 29 ??

Risk - When You Dine in a Five Star Hotel > 26/11

Risk - When You Travel in Your BMW > 26/7

Risk – Loss of Job > Global Recession...

Only certain thing in life is change & death!



Strategies For Financial Planning

Managing Risk

- Premature death
- Illness
- Disability
- Investment risk
- Job loss
- Living long

Optimizing Opportunities

- Start early /invest regularly
- Emergency fund
- Protection first
- Do not unlock your investments
- Beat inflation
- Asset allocation
- Clear all outstanding loans before retirement

Regulatory Framework

- ✚ The Insurance Act, 1938
- ✚ LIC Act, 1956
- ✚ IRDA Act, 1999
- ✚ IRDA Regulations & Circulars etc
- ✚ Life Insurance Council
- ✚ Companies Act, 2013



Regulatory Framework cont'd...

- ✚ IRDA (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2000
- ✚ IRDA (Protection of Policyholders Interest) Regulations, 2000
- ✚ IRDA (Distribution of Surplus) Regulations, 2000
- ✚ IRDA (Manner of receipt of Premium) Regulations, 2000
- ✚ IRDA (Life insurance Re-insurance) Regulations, 2013

Reports submitted to IRDA

- ✚ **New Business Reporting** – monthly, the new business figures (number of policies, Sum Assured and Premium) on a segment wise basis are reported
- ✚ **Quarterly Public Disclosures** – Location wise new business figures (number of policies, Sum Assured and Premium) based on geographical divisions given by IRDA and channel wise new business premium etc.
- ✚ **Online Business Analytical Project (BAP) submission** – Currently in project phase. When the module goes live, new business and renewal figures (policies, sum assured and premium) need to be submitted.

Life Insurance Products – Broad overview

- Whole Life
- Term/Protection
- Endowment
- Money Back Policies
- Riders
- ULIP
- Universal Life
- Pension/Retirement
- Annuities
- Group insurance
- Health



What is Premium?

Definition:

“Premium is an amount paid periodically to the insurer by the insured for covering his risk.”

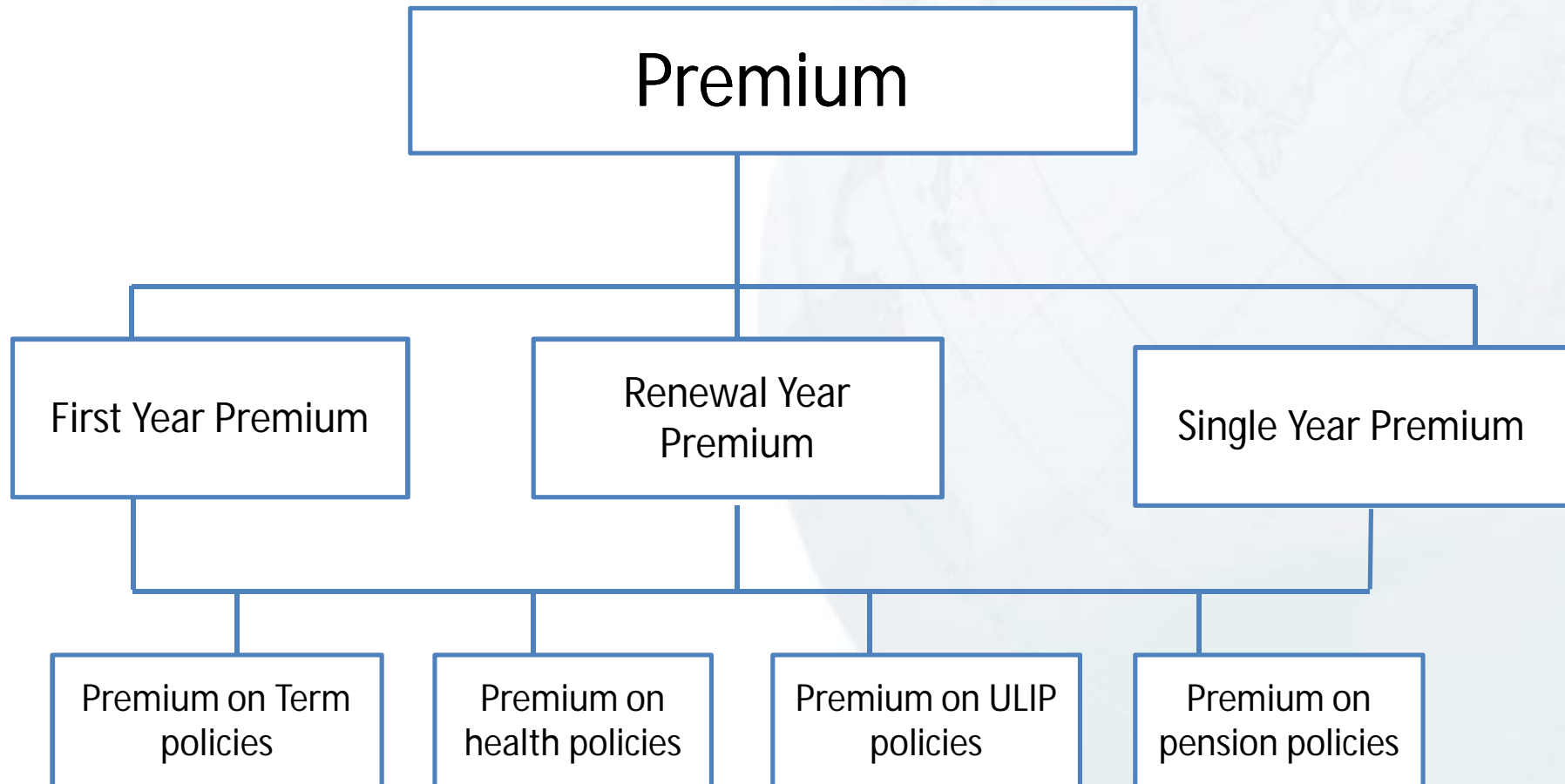


Description

- ✚ In an insurance contract, the insurer charges Premium for taking/assuming risk
- ✚ The premium being a function of number of variables like age, type of employment, medical conditions, etc is ascertained based on Actuarial assumptions of Life Cycle
- ✚ The periodicity of paying premium varies based on terms of every policy



Types of Premium



Types of Premium... cont'd

The premium is mainly divided into following parts for accounting:

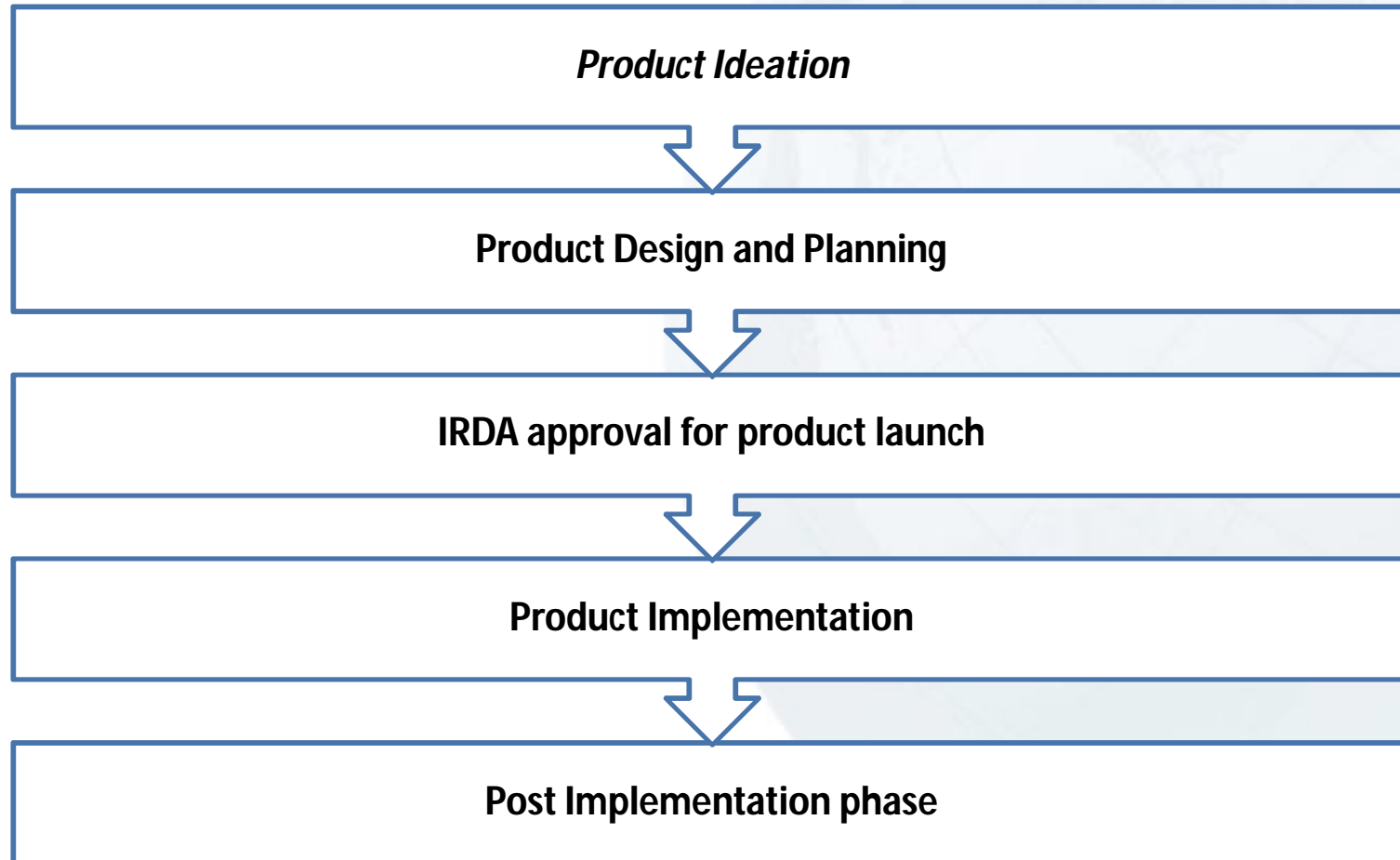
- + **First year Premium:** It is the premium received in the first year of the policy.
- + **Renewal Premium:** It is the premium received from the second year of the policy till the end of the policy.
- + **Single premium:** It is the only premium received in the whole life of the policy. Only once the premium is received in case of single premium.

Types of Premium... cont'd

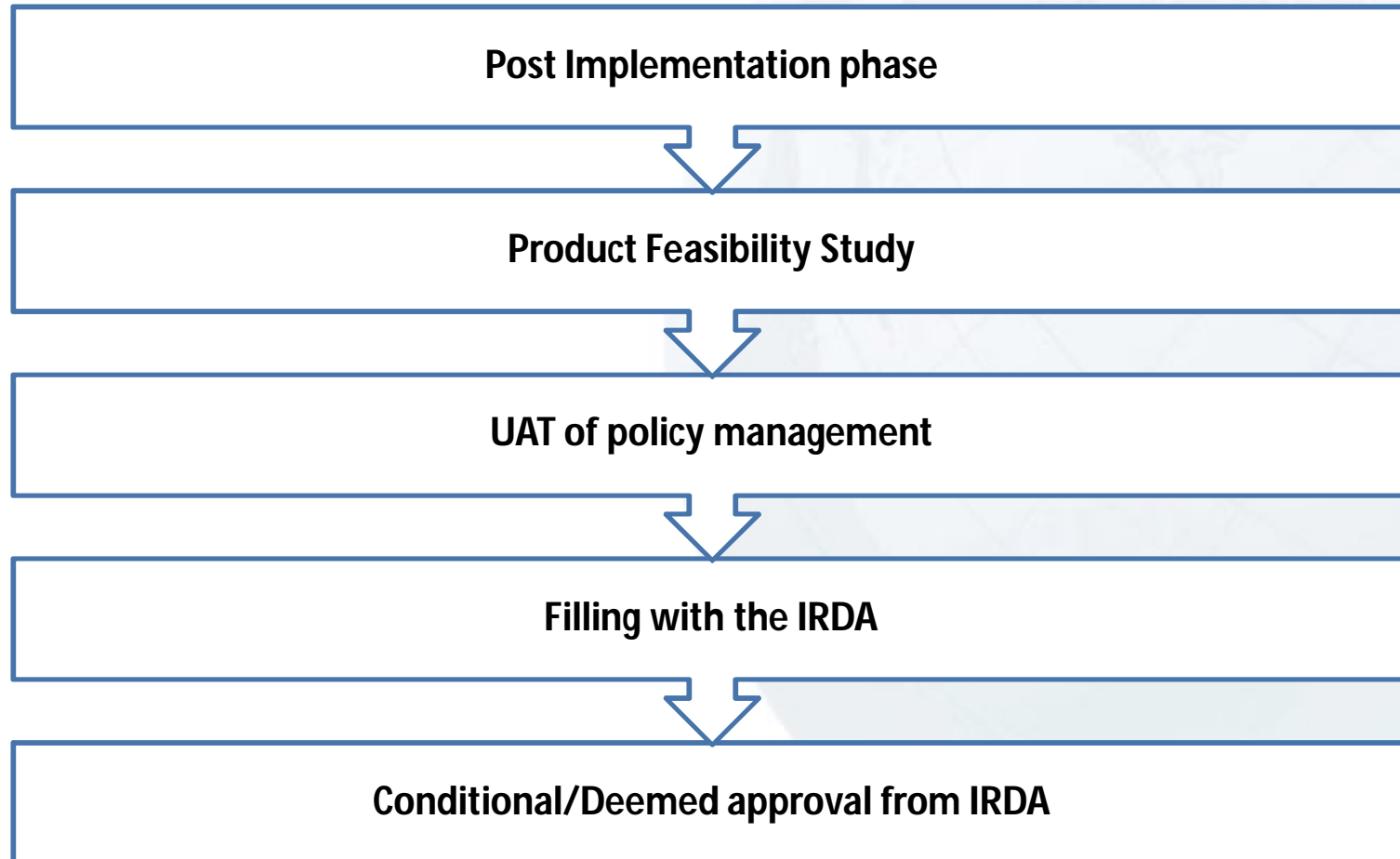
Then further these premiums are subdivided into following parts:

- + **Premium on individual policies:** These are the premiums received from the individual policyholders.
- + **Premium on group policies:** These are the premiums received from the group policy holders.

Process of Product Development and File and Use



Process of Product Development and File and Use... cont'd



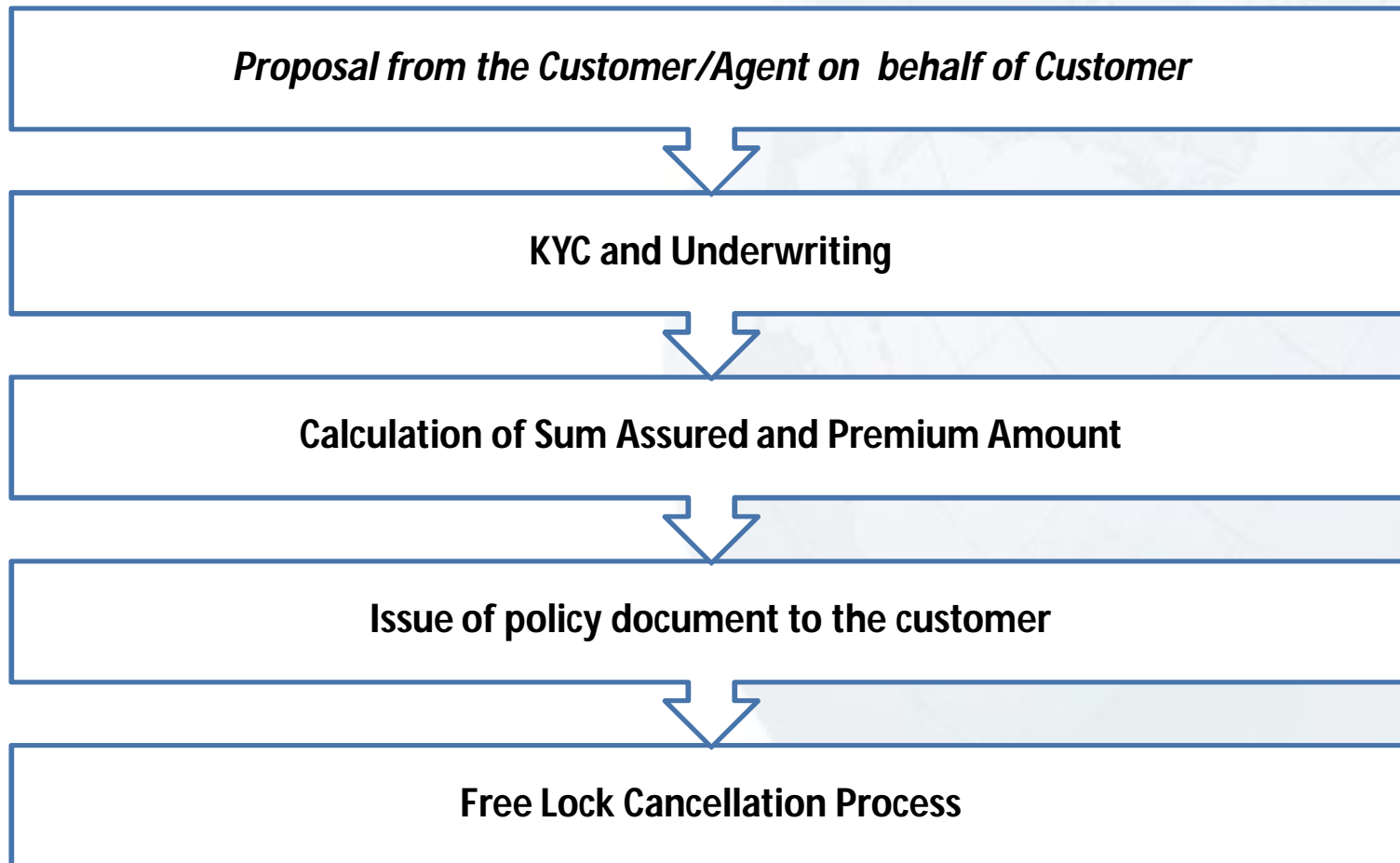
Objectives of Audit of Premium

- ✚ To review the new business process
- ✚ To review the process of acceptance of risk through the underwriting process
- ✚ To review the process for receipt of premium through different mode
- ✚ To review the process for revenue recognition
- ✚ Service Tax on Risk Premium

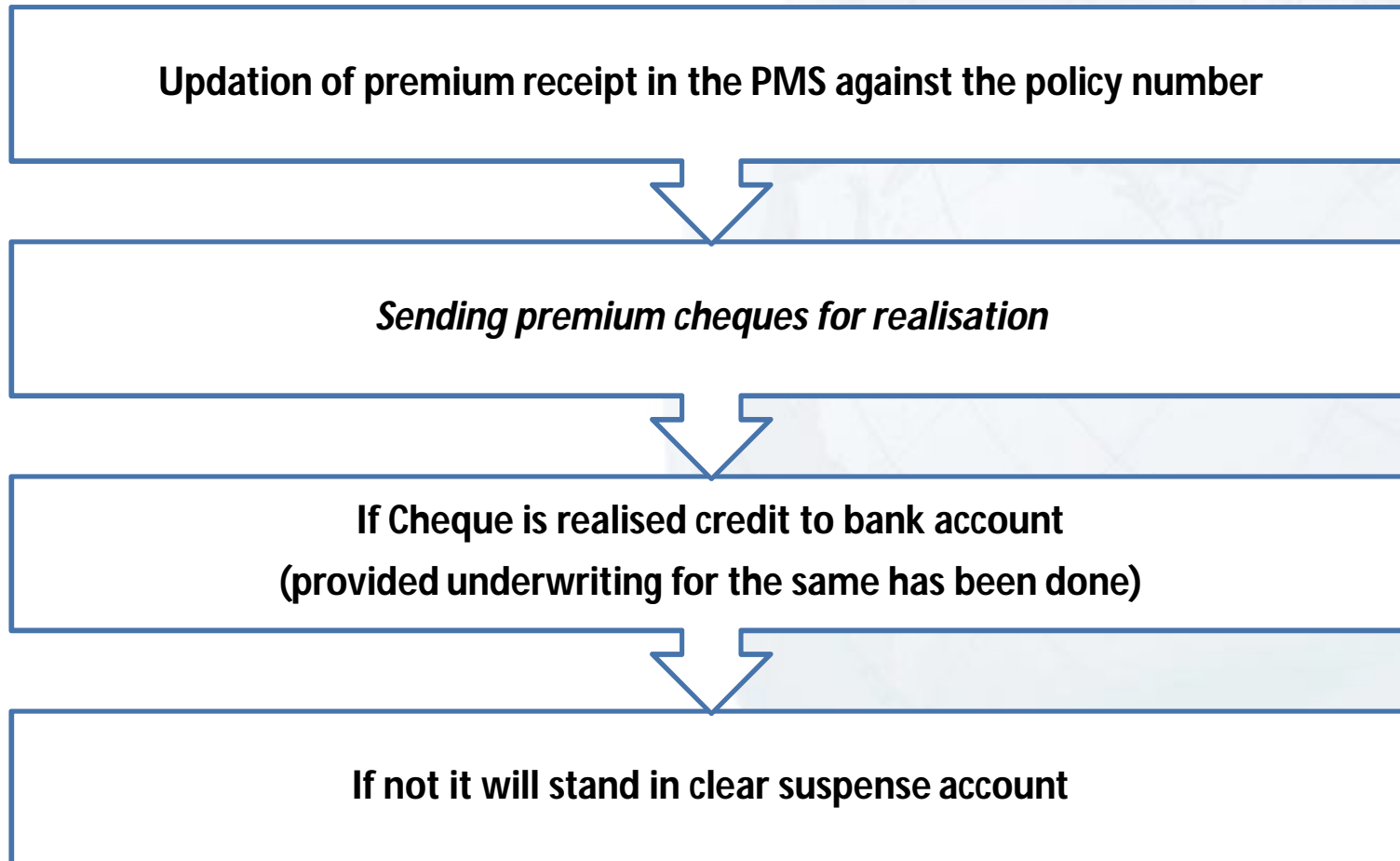
Risk and Subsequent Audit Procedures to overcome the risk in Product development

Risk	Audit procedures
Launching the product without IRDA Approval	Check whether IRDAI approval was obtained prior to launching the product
Delay in launching the product	Check the date of launch of product and match the same with IRDA approval date
UAT not done prior to launching the product	Check that UAT is done, documented and signed-off by all the stakeholders
Unauthorized access to product set-up in the Policy Management System (PMS or PAS)	Obtain, list of access rights in PMS and ensure that rights are documented
Accurate product set up in PMS or PAS	Check the masters and other fields of the product set up

Process of New Business



Process of New Business... cont'd



Premium Calculation

Calculation of Risk Premium

- *Risk Premium = Mortality rate x Sum Insured*
- *Mortality Rate is the probability of an individual dying before their next birthday*

Calculation of level premium

- *Setting up of premium to take into account the future expenses, claims and cost of inflation which the company will have to pay*

Calculation of Net Premium

- *Net premium = Premium (as above) – Interest earnings*

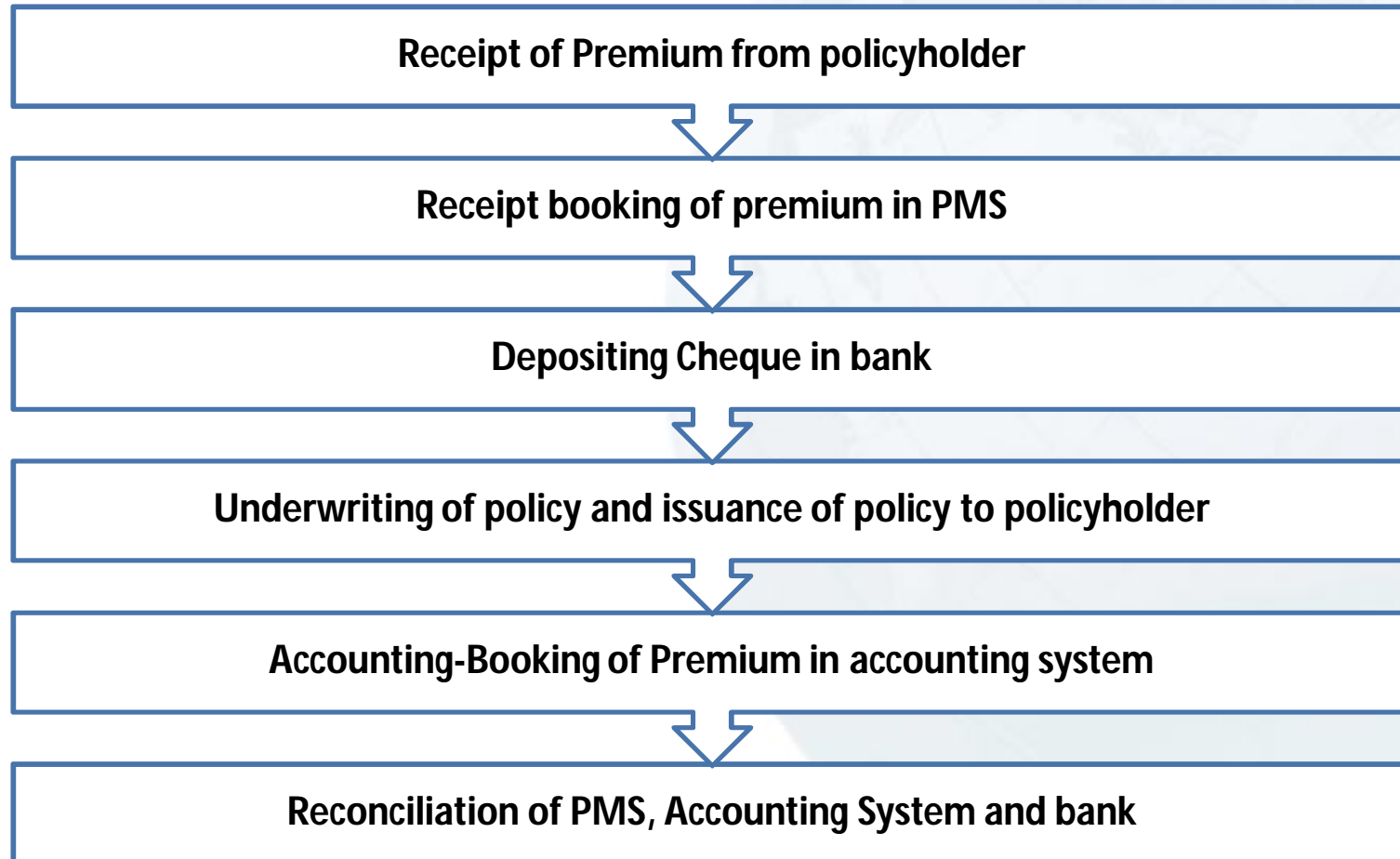
Add loadings

- *Adjustment to take into account of the expenses and profits of the insurance company*

Arrive at Gross Premium to be charged

- *The type of plan (single premium, flexible premium, renewable premium) will affect the gross premium to be charged*

Process for Premium Collection, Accounting and Reconciliation



Premium Collection and accounting

- # Daily reconciliation of premium amounts collected, deposited and entered in the books
- # Prevention of payment gateway frauds made through ECS/ Direct Debit/ Credit Cards/On-line
- # System correctly calculates premium on due dates
- # Income recognition is on the policies 'issued' and not on 'underwriting completed' date
- # Check whether premium mentioned in Proposal form is same as booked including Rider
- # Check that premium paid for particular policy is same as that calculated with the product broacher etc

Premium Collection and accounting

- + Check whether Correct premium figures are reported to IRDA
- + Refund payments are made after complete check for any receivables, etc.
- + Check “free look” allowed are duly recorded as premium returned and not as benefits paid
- + PAN is obtained from all the policyholder where the annual premium per policy is more than INR 1 lakh
- + Selectively verify the charges deducted from the premium received are as per the product features
- + Conduct process walk through for receipt and accounting of sums

Renewal Premium

- ✚ Premium due dates entered in the system are as per the proposal form (Monthly/ Quarterly/ Annually) & back dating, if any, is within permissible range
- ✚ Check the system generated notice based on due dates
- ✚ Correct NAV applied
- ✚ Premium received before due date should not ordinarily be recognised as premium
- ✚ Check 'top up' and Advance premium, if any, whether accounted correctly

As per **IRDAI/ACT/CIR/PRD/089/03/2013-14 dated 21st Mar,2014** Collection of advance premium shall be allowed within the same financial year for the premium due in that financial year. Where the premium due in one financial year is being collected in advance in earlier financial year, insurers may collect the same for a maximum period **of three months in advance of the due date of the premium'**.

Free Lock Cancellation(FLC) of policy

- ✚ FLC request is received within 15 days from receipt of policy. Ensure the system generated notice based on due dates.
- ✚ Ensure that for all FLC policy, commission is not paid
- ✚ FLC Refund= First Premium Paid (-) Proportionate Premium Risk (-) Medical Charges

'As per Clause 6(2) of **IRDA (Protection of Policyholders Interest) Regulations, 2002** the insured shall be informed by the letter forwarding the policy that he has a period of 15 days from the date of receipt of the policy document to review the terms and condition of the in case he disagrees he can return the policy and get its premium refunded, subject to deduction of Proportionate Premium Risk and Medical Charges.'

Premium Recognition

- ✚ Premium (net of service tax) is recognized as income when due from policyholders.
- ✚ For linked business, premium income is recognized when the associated units are allotted (i.e. upon receipt of renewal)
- ✚ Premium on lapsed contracts are recognized on receipt basis only
- ✚ Check the 'Due premium' grouped in current assets w r t subsequent receipts



Illustration by Chris Gash

Risk and Audit Procedures in Premium Collection, Accounting and Reconciliation

Risk	Audit Procedures
<p>Cash accepted from policyholder and</p> <ul style="list-style-type: none">i) Not enteredii) Incorrectly entered in PMSiii) Not deposited in bank account <p>Risk of short collection of premium and revenue leakage</p>	<p>Ensure that there is daily reconciliation of amount deposited in bank, entered in accounting system and amount collected</p> <p>Check that whether there is defined TAT for Cheques deposited into bank</p>
<p>PMS calculates incorrect due dates of premium leading to revenue leakage and lapsation of the policy</p>	<p>Check whether system correctly calculates the premium due dates</p>

Risk and Audit Procedures in Premium Collection, Accounting and Reconciliation

Risk	Audit Procedures
Incorrect recognition of premium amount, mortality charges, fund management charges etc.	<p>Check that whether system correctly allocates premium into various components.</p> <p>Check that system UAT is available for this and “process walk through” is carried out.</p>
Non accounting/inaccurate accounting of premium in the accounting system	<p>Check whether there is no manual intervention into transfer of all the amounts entered in PMS</p> <p>Check the BRS to identify instance of open items in collection accounts and reasons for the same</p>
Back-dating the policy issuance in the system thereby recognizing income for prior period	<p>Check whether there is any backdated policy issued i.e. policy issue date should always be on or after receipt of sum from PH</p>

Risk and Audit Procedures in Premium Collection, Accounting and Reconciliation

Risk	Audit Procedures
Advance premium entered in the system as regular premium	<p>Check that system has capability to identify regular and advance premium</p> <p>Check that all the advance premium is properly transferred to premium account when it becomes due</p>
Incorrect entry of premium, sum assured, gender, mode of payment, or any other detail updated in PMS, which can impact the premium amount	<p>Check on sample basis the details shown as per PMS is as per proposal form</p> <p>Check the shortage/excess of premium received as compared to the proposal form</p>
Premium not reversed on cancellation of the policy due to FLC, non-realization of premium/cheque dishonor	Check that there is defined TAT for processing cancellation in the system

Risk and Audit Procedures in Premium Collection, Accounting and Reconciliation

Risk	Audit Procedures
Risk of refund payment without verifying the receipt of clear funds and authorizing the refunds for high amounts in absence of matrix	Check whether finance is releasing funds only after clearing of it. Ensure that the duly approved Delegation of Authority Parameters Matrix is in place for authorization of refunds
Risk of incorrect reporting of premium figures to IRDA	Check whether the MIS is verified before forwarding it to IRDA. Check that there is reconciliation of premium income as per financials and as reported.

What is underwriting?



Is the process of deciding whether or not a person who wants insurance gets it and at what rates....

Underwriting is the name given to the procedure of:



- ✚ assessing the risk which people bring to the pool;
- ✚ deciding whether or not to accept the risk, or how much to accept ;
- ✚ determining the terms, conditions and scope of the cover to be offered;
- ✚ calculating a suitable premium

Why to Underwrite?

- ✚ Keep the portfolio within the mortality¹ and morbidity² assumptions used to calculate premium rates
- ✚ Ensure that appropriate premium is charged for the particular risk involved
- ✚ Maintain equity between policy holders
- ✚ Protect the company from anti-selection³
- ✚ Remain competitive
- ✚ Offer cover to as wide a group of lives as possible (spreading the risk)



¹ Mortality is the term used for the number of people who died within a population

² Morbidity refers to the state of being diseased or unhealthy within a population.

³ Selection of a large number of unhealthy individuals as against healthy individuals

Types of Underwriting

✚ *Medical*

✚ *Non Medical*

✚ *Financial*



Medical Underwriting

- ✚ Underwriter researches the health and medical history of the proposer in a detailed and accurate manner .
- ✚ If the proposer is found to be in good health, then they would be considered as low risk by the underwriter.
- ✚ An individual's health information may be used in making two decisions:
 - Whether to offer or deny coverage?
 - What premium rate to set for the policy?



Non Medical Underwriting

It is not practical to assess each and every case with medical evidence

- ✚ Insurer offer certain limits under which proposals can be considered without medical evidence. This scheme is usually called Non Medical Scheme.
- ✚ Insurance is based on physical characteristics of individual such as age, height, weight etc as revealed in the proposal form
- ✚ Carries more risk as proposers may have a medical condition which may not be revealed through proposal form
- ✚ As the risk is more, the policies may be priced at a higher rate.

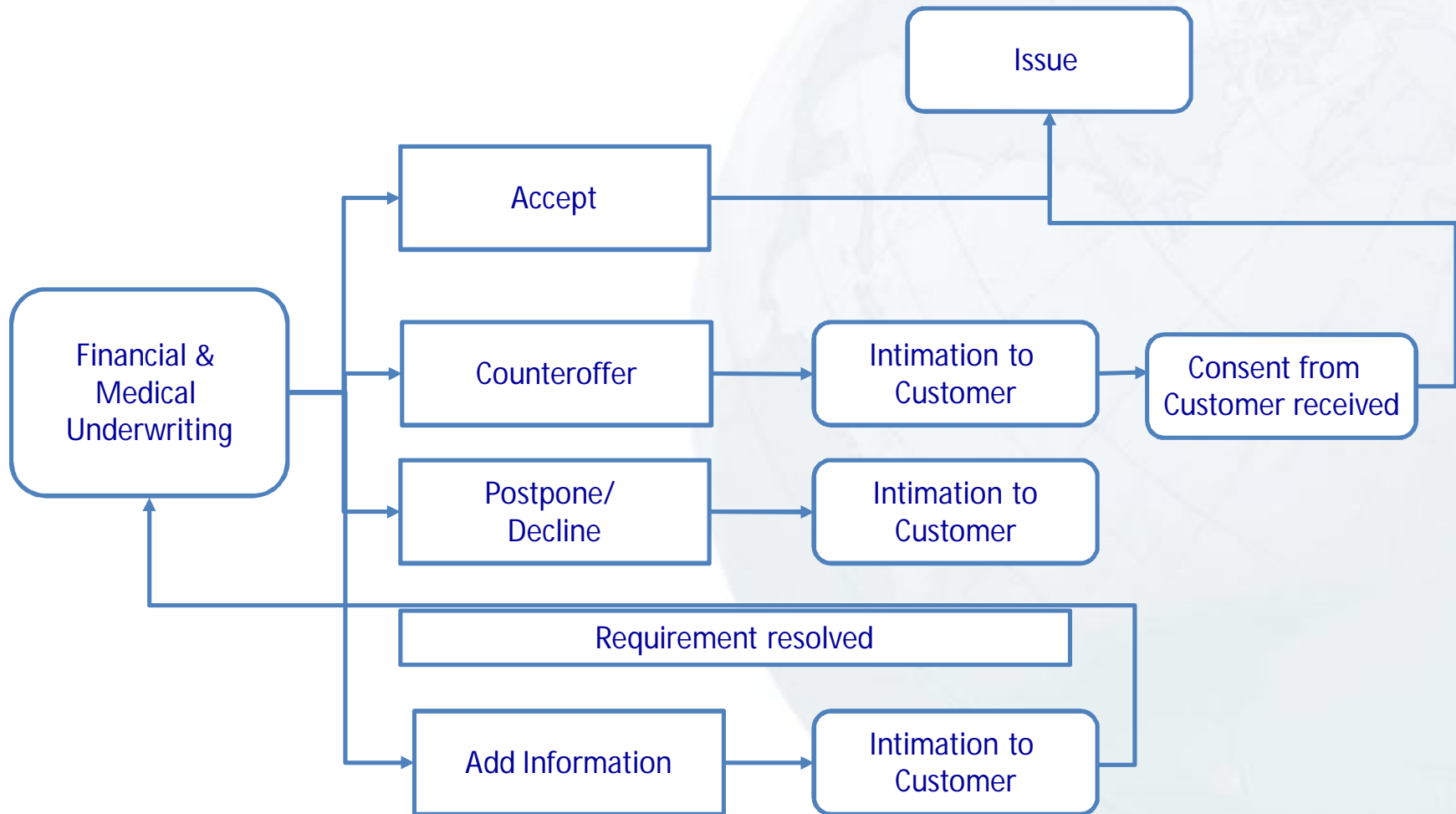


Financial Underwriting

- ✚ Used to make sure that the proposer qualifies for an amount of insurance that does not exceed their insurable interest
- ✚ Proposer's personal and family income is considered
- ✚ Financial documents of the insured are required such as Form 16, audited P&L a/c, Balance sheet, salary slips etc.
- ✚ Eligible amount arrives through 'Human Life Value' concept trying to measure the economic value of a person in monetary terms



Underwriting Decisions



Underwriting Decisions



Standard

- Persons who have a likelihood of loss that is less than the average age.
- Normal Premium rates for the particular age and gender are charged for such persons



Sub-Standard

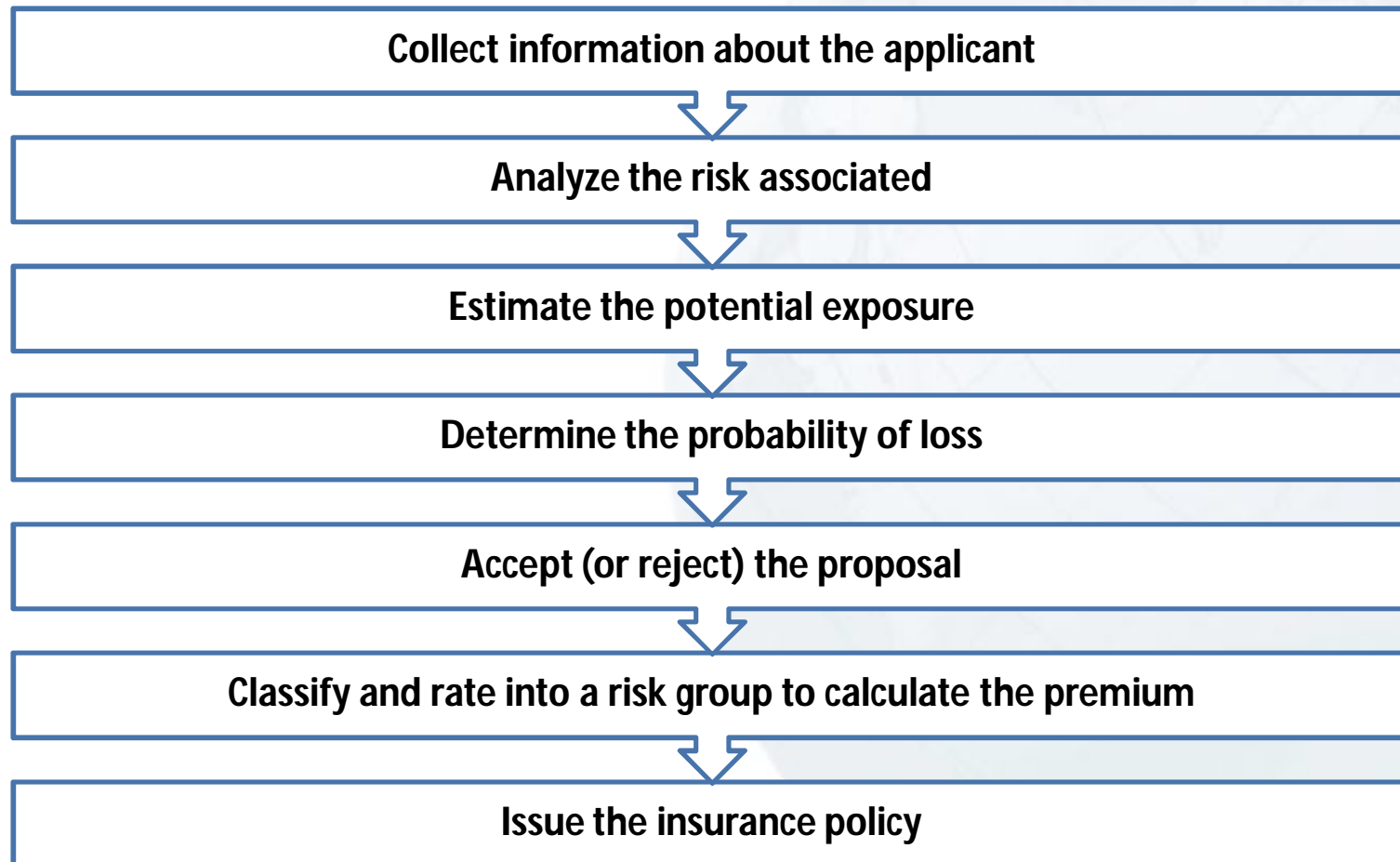
- As the risk is higher, the Insurer's offer may not include some policy benefits or some rider may be excluded.
- Sub standard premium (an extra premium) is charged based on the individual's risk class.



Postpone/ Decline

- Risk is very high so the insurer doesn't take a chance
- Insured has serious sickness or has definite possibility of developing it. e.g. cancer diagnosed.

Process of Underwriting



Points to Note

- ✚ The work 'RISK' in life insurance is mainly used with reference to the life insured or the insured person.
- ✚ Different insurance companies use different criteria for deciding whether a proposal is acceptable. If an existing disease is not considered suitable for cover by a certain company, another company might cover it to some extent with the payment of extra premium.
- ✚ The regulations issued by the IRDA require that the decision on the proposal must be conveyed to the proposer within 15 days of receiving the proposal.
- ✚ Insurance companies maintain a schedule that determines the degree of medical testes required depending upon the proposer's age, medical history and the amount of insurance cover they are requesting.

Points to Note... cont'd

- ✚ Mortality rate is the probability about death rate in the given range of population
- ✚ Mortality tables are prepared by Actuaries, who determines the premium to be charged, based on mortality rates. It is based on death statistics collected over the past 100 years or more.
- ✚ Maximum expenses are incurred at the time of inception of the policy. These expenses have to be spread over the entire term of the policy when determining the premium.
- ✚ Human life value (HLV)* is not a one –time calculation. It is an ongoing process which needs to be revisited form time to time. As age increases human life value diminishes.

*HLV is the amount of insurance cover that a person should take out; the insurer needs to assign a monetary value to human life.

Risks & Audit Procedures of Underwriting

Risk	Audit Procedures
Risk of Incorrect Underwriting Decision	<ul style="list-style-type: none">• Check the underwriting limits fixed for medical and non-medical check.• Check whether underwriting is done by underwriters within the limit assigned to them• Check whether maker-checker process is followed• Check the documents based on which underwritten decision is taken is current ones and not old/outdated. (specially for medical case)• Check that underwriting decision is obtained on all the components of the product. (including Rider)• Ensure whenever there is rider sum assured and premium rider the same is as per the File & Use• Scrutinize facultative cases of underwriting

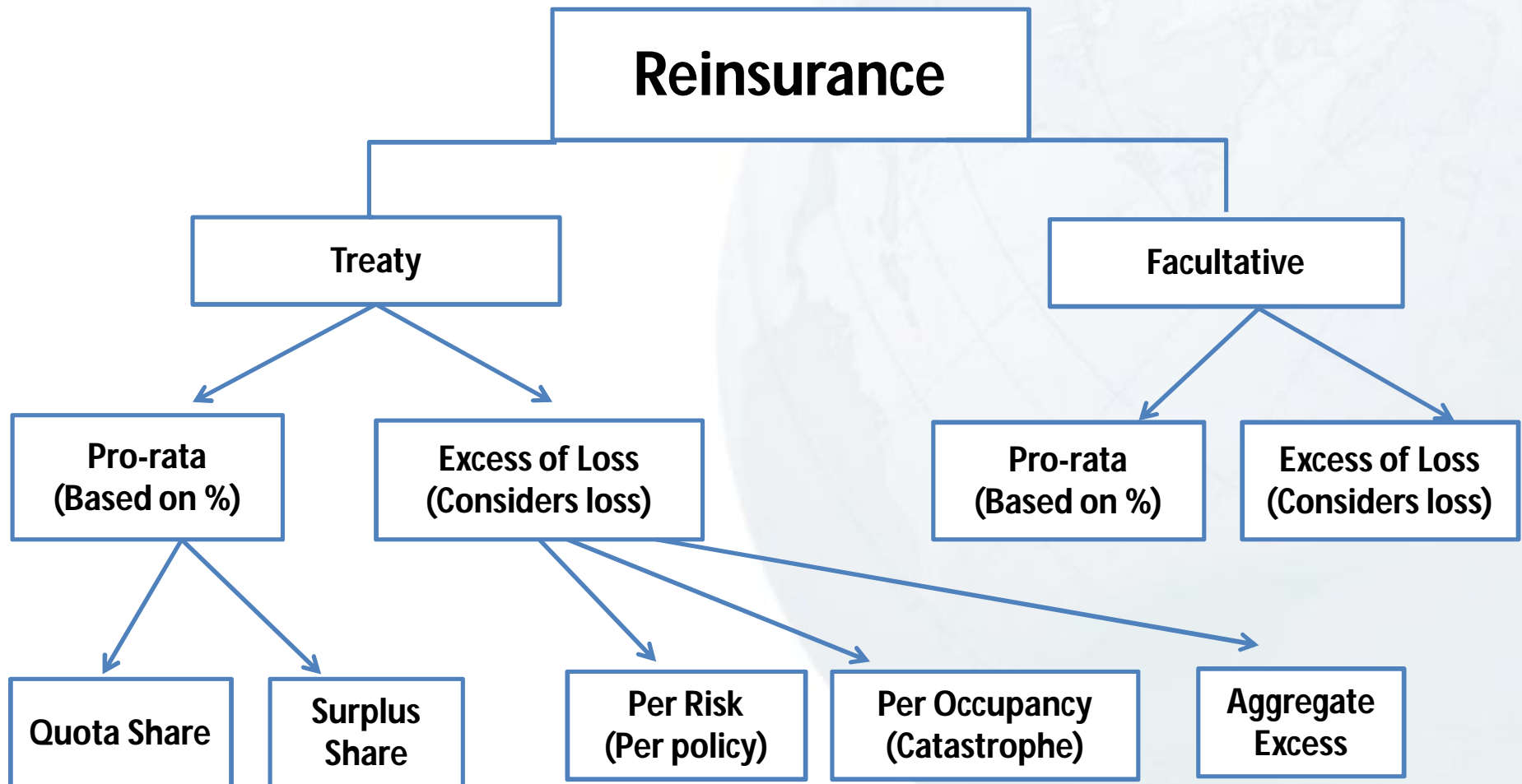
Risks & Audit Procedures of Underwriting... cont'd

Risk	Audit Procedures
Risk of cases accepted by underwriting without obtaining acceptance of Reinsurance	<ul style="list-style-type: none">• Check that all the facultative cases are being forwarded to Reinsurance• Check the acknowledgement received from Reinsurer regarding acceptance of the case• Check that all the cases are accepted only after acceptance by Reinsurer in terms of treaty• Ensure that name of Reinsurer is the same as the one with whom the policy has been placed

What is Reinsurance?

- ✚ **Risk mitigating tool** whereby the risk underwritten by Insurer is transferred partially to another Insurer.
- ✚ In other words, an insurer purchasing coverage from a second insurance company for a risk that the first insurer is insuring
- ✚ Functions of Reinsurance:
 - Stabilizing of loss experience
 - Large line capacity
 - Financing surplus relief
 - Catastrophe protection
 - Underwriting assistance

Types of Reinsurance



Types of Reinsurance... cont'd

+ Treaty Insurance

Business is done as per the terms and conditions of the treaty

+ Quota Treaty

Insurer cedes a fixed proportions of all the business it underwrites up to a fixed amount within the class or classes

+ Surplus Share Treaty (Pro-rata or proportional reinsurance)

Under a surplus treaty, ceding company decides the limit of liability which it wishes to retain on any one risk or risks and reinsures only the surplus over and above the own net retention

Types of Reinsurance... cont'd

Facultative Reinsurance

- ✚ The contract relates to one particular risk and is expressed in the reinsurance policy.
- ✚ This is oldest method of reinsurance and it necessitates consideration of each risk separately



Indian Reinsurance Scenario

Prior to nationalization: No reinsurance market. Insurance Companies accessed international reinsurance industry for reinsurance needs

Post nationalization:

- November 2000 -General Insurance Corporation of India (GIC) became National Reinsurer; now called GIC Re
- GIC Re undertakes both domestic reinsurance and international reinsurance
- GIC Re provides reinsurance facilities companies operating in SAARC countries, South East Asia, Middle East and Africa
- GIC Re as a member of the Federation of Asian Insurers and Reinsurers (FAIR) Pool extends additional facilities in the Indian market
- As of 2012, GIC Re ranked 15th largest Reinsurer and 5th largest Aviation Reinsurer (S&P ratings)

Overview of Reinsurance

Treaties are entered with the reinsurer to share the risk for the products covering life risk launched by the insurer



Rates applicable to the products launched by insurer are agreed with the reinsurer and treaty/addendum is entered



The rates agreed with the reinsurer are entered in the system



Upon issuance of the policy, proportionate risk as agreed in the treaty is placed with the reinsurer in accordance with the treaty entered

Overview of Reinsurance... contd

The risk placed with the reinsurer is communicated to the reinsurer in accordance with the process mutually agreed between both the companies



Based on the rates agreed with the reinsurer and recorded in the system, the reinsurance premium is calculated for all policies issued



At regular intervals, a report is generated from the system for the reinsurance premium payable to the reinsurer for policies placed which is shared with the reinsurer for generation of invoice

Overview of Reinsurance... contd

Based on the report shared with the reinsurer invoices are raised and sent to insurer along with requisite documents



Based on the report shared with the reinsurer invoices are raised and sent to insurer along with requisite documents



Upon receipt of invoice the same shall be reviewed internally and post requisite approval, payment is made to reinsurer

Objective of Reinsurance Audit

- ✚ Check and confirm that reinsurance premium and claim is in accordance with agreement
- ✚ Necessary **provision** has been made for **outstanding reinsurance premium** and claim and is properly accounted
- ✚ Checking ensures
 - determination of **correct amounts for reinsurance ceded**
 - **proper valuation of assets and liabilities** arising out of reinsurance transactions
 - adherence to **legal provisions**
 - **regulations and reinsurance agreements**

Process of Reinsurance

- Entering into agreement with the reinsurer
- Underwriting guidelines on different limits
- Updating of agreement and system upon launch of products
- Adherence to terms and conditions of the agreement
- Placement of risk to the insurer
- Reinsurance premium payment
- Recording of reinsurance premium payment

Significant Issues in audit of Reinsurance

- Audit In Complex IT Environment
- Huge Volume of data
- Improper updating of required field of data from input file since manual intervention involved
- Improper calculation of Premium amount and claim amount
- Delay in settlement of balances with the reinsurer

Steps for Audit of Reinsurance

- ✚ Understand the process of reinsurance in the company.
Perform a walkthrough of the reinsurance process
- ✚ Read the duly signed agreement to evaluate the type of treaty and ensure proper accounting is done. Also capture significant points
 - List of Product Reinsured
 1. **Benefits Covered: Eg:-**
 - a) Death Benefit : Excess of Death Benefit over the fund value
 - b) Accidental Death Benefit: Accidental Death SA..
cont'd

Steps for Audit of Reinsurance... cont'd

2. Facultative Limit: Eg:-

- a) Base Life Cover: Rs 12,50,000
- b) Accidental Death Benefit (in built Rider): Rs 6,25,000

3. Retention: Eg:-

- a) Base Life Cover: Rs 3,00,000
- b) Accidental Death Benefit: Rs 1,50,000

4. Share : Eg:- 40%

5. Any Specific clause. Eg:- Arbitration

Steps for Audit of Reinsurance... cont'd

- ✚ Ensure all enforceable policies as on date have been properly captured while calculating the amount. Ensure proportionate reinsurance premium is claw backed for all lapsed or surrender policies
- ✚ Obtain list of new products introduced during the period and ensure proper updation of various field in software has occurred properly
- ✚ Same samples as taken for premium shall be taken for audit of reinsurance. Care to be taken the samples include cases of facultative cases also and covers at least one product covered in the treaty

Steps for Audit of Reinsurance... cont'd

- ✚ Samples selected shall be checked for
 - Whether **all policies** to be reinsured have been reinsured
 - The **sum assured** of the policies is correctly captured in the reinsurance data
 - Whether premium and claim amount have been calculated properly as per the **treaty based on retention limits**
 - Any **specific clause** have been considered in calculation of the amount of premium and claims
 - In case of **facultative nature**, obtain communication sent to reinsurer for placement of risk, study specific terms and conditions and compliance of the same

Steps for Audit of Reinsurance... cont'd

- ✚ Ensure correct accounting of
 - re-insurance cession premium
 - paid claims recovered
 - outstanding losses recoverable on cessions
- ✚ Maker checker process in place by the insurer
- ✚ Profit sharing ratio has been calculated as per the terms and conditions of the agreement and amount is booked only after approval by both parties
- ✚ Balance Confirmation from reinsurer and reconciliation
- ✚ **Form LR-8** submitted within 35 days from quarter end
- ✚ Check % **pattern of gross to net premium, claims paid and outstanding claims** to ensure comparative justification

