

INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY

DISCUSSION PAPER

SUBJECT: TYING AND BUNDLING INSURANCE POLICIES WITH OTHER SERVICES AND GOODS

I. Objective:

This paper seeks to discuss issues relating to tying and bundling insurance policies with other services and goods and how conflicts of interest that arise need to be dealt with. In particular, conflicts of interest that may arise in respect of manufacturers/agencies of automobiles and other goods and services in their role as Corporate Agents or where their group entities are Insurance Brokers need attention.

II. Introduction:

The insurance industry is an important component of the financial sector and insurance intermediaries play a vital role in that component of the industry. Insurance is, however, a very complex product often hard for ordinary people to understand. Insurance has to be sold the world over, and the Indian Market is no exception. The touch point with the ultimate customer is the distributor and the role played by them in insurance markets is critical. Given the product complexity, it is particularly important in the public interest that the sellers of insurance be both knowledgeable and trustworthy.

It is the distributor who makes the difference in terms of the quality of advice for choice of product, and servicing of policy post sale. In the Indian market, given its distinct cultural and social ethos of trust and long term relationships, these factors play a major role in shaping the distribution channels and their delivery.

The power of an agent or broker to influence the prospective buyer of insurance, for good or bad, is enormous. Therefore, it is important to have upfront disclosure in intermediation. Agents and Brokers should identify, manage and mitigate any potential conflict of interest in an appropriate and manner. They should provide clear and fair information on the nature of their services and the capacity in which they operate, including any administrative powers and delegated authorities they may hold from insurers, so that clients can make informed decisions on the purchase of insurance products.

The Code of Conduct laid down for Agents and Brokers in the respective Regulations require them to disclose the amount of remuneration they receive from the insurance company, on request from the client. Agents and Brokers play an important role in the development, placement and servicing of insurance contracts. In this process, conflicts of interests can arise from time to time.

III. Manufacturers/Agencies of Automobiles and other goods and services as Corporate Agents or where their group entities are Brokers

The distribution channel is the touch point for sales and is the face that is seen by the prospect or policyholder. When a product is sold through a distribution channel, the insurer becomes invisible. It is therefore important to understand how the visage of the distribution channel is seen. In this paper, the discussions are limited to (i). Corporate Agents whose primary business is manufacturing of automobile or other consumer goods or providing various services travel, financial etc as a dealer or agency and (ii). Insurance Brokers whose group entities are involved in manufacture or dealership or other services as mentioned above.

In the model of distribution under discussion, the insurance company or its representative is not the entity marketing the products. The insurance cover is sold by the concerned manufacturer or retail agency as an add-on product leveraging the brand of the manufacturer or retailer/dealer where the manufacturer or agency is a Corporate Agent or it is sold by a broking entity that is a group company of the manufacturer or retail agency. The risk is carried by the insurance company which underwrites it. Products like motor third party and package insurance, travel insurance, credit card related insurance including group accident and health covers, lost card insurance etc could be distributed using this channel. Infact this model could be adopted in all market segments where the lines of business fit manufacturing and marketing of a good or service.

What makes these arrangements attractive is the low distribution cost and captive customer base. However, repeat business or renewal of business cannot be assured. New distribution channels have emerged not only with the development of new technologies, but also with the use of other distribution networks such as supermarkets etc. Thus bancassurance is no longer the new channel, concepts such as mallassurance are catching up.

These distributors often have close, long-standing relationships with clients, which allows them to gather detailed information on the risks faced by clients at a much lower cost than would be the case for an insurer. This makes it attractive for the insurer to use such channels, especially for mass distribution.

It must be borne in mind that customers suffer due to asymmetric information with respect to the insurance market or a particular product or category of product (customer vis a vis insurer) and largely rely on the services of the distributor. This is the potential area of danger that gives scope mis-selling, mainly due to conflicts of interest at the distributor's end.

IV. Conflicts of interest:

There could be several situations giving rise to conflicts of interest :

(a). The **relationship between the distribution channel or a group entity and the targeted market segment**. The relationship could be long standing involving trust and blind faith such as with travel agencies tempting the distributor to push a product to its customer involving a bias to not only sell without considering whether the customer requires the product but sell it with a provider (insurer) bias and/or a product (a particular insurance policy) bias.

(b). The **contractual relationship between the distribution channel and the insurance company** could also lead to a push factor, such as whether it is a corporate agent (no choice of provider and perhaps product) that is involved or a broker(involving choice of product and broker).

(c). Impact of the **cost of the distribution channel on the contracting terms between the insurers and policyholders**. Critical mass as a result of volumes involved makes it cheaper for the insurance company to engage a particular channel to mass sell thereby diluting the quality of disclosures and giving information or providing clarification.

(d). **Marketing methodology that may lead to client confusion** regarding the role of the distributor vis a vis the insurer. Bundling the insurance product with the particular product or service that is the primary business of the channel leaves the customer with no choice but to take the insurance product offered.

The issue of conflict of interest needs to be studied and discussed from the point of view of both the Regulations and other framework that exist today,

within which the distributor and the insurer operate, and the actual market practices. The latter is a monitoring and enforcement issue which is already being addressed adequately and which has in fact given rise to the current discussion. The former, namely revisiting the existing framework is what is now being exposed to discussions across stakeholders in a bid to ensure that there is no scope for conflict of interest to the detriment of the interests of the policyholders.

V. Current provisions and practices:

It has been observed that insurers leverage multiple distribution channels for cost effectiveness. The existing framework allows manufacturers and dealers or retailers to become corporate agents or allows them to have group entities who are insurance brokers. Except to the extent of the **IRDA (Insurance Brokers) Regulations, 2002** requiring, under Regulation 20(1) laying a ceiling on business from a single client (where the term “client” includes in the case of a firm or a company, an associate or a subsidiary or a group concern under the same management), there are no restrictions in terms of either group entities being manufacturers or dealers or manufacturers or dealers being corporate agents themselves. In fact it is not uncommon to see such a category of brokers and corporate agents among those who currently exist.

Going further, outsourcing of certain activities by insurer, was till recently a grey area and gave scope for delegation of certain not only administrative activities but also underwriting and claims related activities to the distribution channels under discussion. For example it is common for a motor dealer to tie up with an insurance company and offer a single window facility to the customer. Under the arrangement, a dealer selling motor vehicles would provide motor insurance cover to customers through a group entity that is a broking firm for which another group entity would provide the software, back office and call centre support. Generally in the single window system, the insurance proposal form would be automatically issued to the new customer by the administering entity after receiving the database of the car and its owner from the dealer. The insurance intermediary receives the remuneration for the business from the insurer while the administering entity receives “remuneration” for “infrastructure services”. Whether this “remuneration” only covers the cost of “infrastructure services” or goes beyond is also a moot point. In addition, there is remuneration paid by the insurer to the dealer as well for access to the customer database. This would mean that there are three types of payments being made in respect of the same business.

The above is only one example in the area of motor insurance and this might as well be happening in other areas, including travel insurance, credit card insurance etc.

On outsourcing, the recent guidelines issued by IRDA address the concerns relating to conflicts as a result of outsourcing so far as the insurers are concerned. However, policyholders could be vulnerable to unethical and unfair practices when insurance products are thrust upon them as a result of their being customers of a product or service because of the forced bundling that takes place.

VI. Other issues relating to Tying and Bundling per se:

Going beyond the role of the Intermediaries and conflicts of interest that arise due to intermediation, the issue of tying and bundling per se, especially with other financial services, needs further discussion from the point of view of the role of the other service provider (whether or not he is a corporate agent) and the insurance company. Tying insurance products with Mutual Funds is a case in point. Generally, group insurance covers are bundled with Mutual Fund products. One of the concerns that arises here is the manner in which this is advertised by the service provider. Providing information regarding the insurance cover is okay but highlighting that more than the core service being provided misleads the public. This violates the IRDA (Insurance Advertisements) Regulations, 2000. The other important concern is complying with the group guidelines issued by IRDA. The insurance cover will have to be incidental to the other financial product. There could be instances where the public is led to believe that the insurance cover is the main feature of the product that is being sold. "White labeling" of insurance products makes it difficult for them to differentiate between the core product and the incidental one. This area, therefore, needs attention consumer protection point of view.

VII. Issues to mull :

(1). Whilst on manufacturers of goods, should we take a view that manufacturers or dealers of automobiles and other goods shall not be allowed to sell insurance products to their customers? In other words, we do not allow bundling of insurance products with goods.

(2). Or should we allow this activity with some checks built in? What kind of checks can be built in? Perhaps the codes of conduct for agents and brokers need to be revisited and made more elaborate and stringent from the point of view of disclosure and transparency.

(3). What about bundling of insurance products with services including travel, financial etc? We should lay down a framework that would prevent forced selling and mis-selling

(4). “White labeling” of insurance products needs to be prevented. The onus of ensuring that this does not happen by monitoring the market should lie with the particular insurance company that has got into the tie-up arrangement.

(4). Is there a need to revisit the concept of professional training and skills pertaining to corporate agency, especially where the touch point is a dealer or manufacturer where quite often complex policies such as Extended Warranty policies may be sold or a bank or a credit card company where a Lost Card Liability Insurance policy may be sold?

(5). Else, should we have a restriction on the type of insurance product that may be sold through such channels? Perhaps we should restrict it to only a few simple products.

(6). Should we not ban brokers from distributing products belonging to their group entities?

(7). Does not tying an insurance policy with a product or service and offering discounts of any sort on the tied product or offering freebies along with it for taking the insurance cover construe “rebating”?

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