Tuli & Co
Solicitors and Advocates

Commission Limits Lifted: IRDAI Commission Regulations & EOM Life and Non-Life Regulations

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Introduction

Commission payments to insurance agents and insurance intermediaries for distribution and servicing of insurance policies, as well as the overall expenditure of an Insurer vis-à-vis the premium earned by it in any particular financial year, has been historically subject to stringent limits in terms of the manner and timing of such payments/expenditure.

For several years now, various representations have been made to the regulator to consider some relaxations on the expenses of management ("**EOM**") that may be incurred by Insurers and to remove the strict payment caps for commission payments. Following the more recent discussions and representations, on 23 November 2022, the IRDAI issued exposure drafts re (i) payment of commissions to insurance agents/insurance intermediaries; (ii) expenses of management of Insurers transacting life and non-life insurance business.

Thereafter, following comments received from various stakeholders on these exposure drafts, the IRDAI has recently notified the: (i) IRDAI (Payment of Commission) Regulations 2023 on 27 March 2023 ("**Commission Regulations**"); (ii) IRDAI (Expenses of Management of Insurers Transacting Life Insurance Business) Regulations 2023 on 28 March 2023 ("**EOM Life Regulations**"); and (iii) IRDAI (Expenses of Management of Insurers Transacting General & health Insurance Business) Regulations 2023 on 28 March 2023 ("**EOM Non-Life Regulations**").

These final regulations are broadly in similar terms to their respective exposure drafts. The regulations have come into force from 1 April 2023, and each expressly sets out that the regulations will be reviewed once every three years from the date of their notification.

A brief summary of the key provisions under these regulations are as follows:

1. As a departure from terminologies previously applicable, the Commission Regulations now subsume remuneration and rewards within the ambit of "*commission*". The term is now defined to mean "*any compensation including <u>remuneration, or reward, by whatever name called</u>, paid by an Insurer to insurance agent, Intermediary or Insurance Intermediary, as applicable, for soliciting or procuring or transacting insurance business*".

Article

2. The Commission Regulations do away with the limits prescribed earlier on the maximum commission payable to insurance agents/intermediaries for each category of insurance products to now stipulate that the total amount of commission payable to an insurance agent/intermediary should not exceed the EOM limits specified under the EOM Life Regulations[1] (for Insurers transacting life insurance business) and the EOM Non-Life Regulations[2] (for Insurers transacting general and health insurance business), by a Life Insurer or a General Insurer, respectively.

3. The EOM Life Regulations and the EOM Non-Life Regulations (collectively “**EOM Regulations**”) prescribe the maximum EOM that can be incurred by an Insurer, based on the nature of insurance business undertaken and provide that:

    a. While the EOM Life Regulations continue to prescribe specific EOM limits for various segments of life insurance products, it has enhanced such limits for certain specific products such as individual pure risk policies and deferred annuity products in consideration of more than one premium;

    b. The EOM Non-Life Regulations remove the specific EOM limits across various segments of general and health insurance products and set out a single limit on such expenses that can be incurred: (i) for Insurers carrying on general insurance business, EOM limit is up to 30 percent of the gross premium written in India in a financial year; and (ii) for Insurers carrying on health insurance business, EOM limit is up to 35 percent of the gross premium written in India in a financial year.

4. The EOM Regulations also allow an Insurer to incur certain “*Additional Allowable Expenses*” over and above the EOM limit which include: (i) head office expenses; (ii) “*Insurtech expenses*” and “*insurance awareness*” expenses[3]; and (iii) expenses incurred towards rural sector including certain government and other schemes as notified by the IRDAI[4]. Specifically for the present FY 2022-23, if an Insurer exceeds the allowable EOM

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1 R5(a) of the Commission Regulations.

2 R5(b) of the Commission Regulations.

3 Please note that the EOM Regulations have defined “*insurtech expenses*” and “*insurance awareness*” in the following manner:

> *“**“Insurtech Expenses”** means expenses incurred towards technology enabled innovation in insurance services (Policyholder oriented) that could result in new business models, applications, processes or products.*
>
> ***“Insurance Awareness”*** *means awareness creation done by Insurers through (a) direct campaigns including through branches, social media campaign, etc. and/or (b) supporting the General Insurance Council, to educate its customers and public at large in making the right choices by being aware of insurance requirements and role of insurance agents, intermediaries or insurance intermediaries.*
>
> ***Provided*** *that it shall not include Insurance Advertisement as defined under IRDAI (Insurance Advertisements and Disclosure) Regulations, 2021 as amended from time to time.*

4 R6 and R7 of the EOM Life Regulations and R4 of the EOM Non-Life Regulations.

during this period, the IRDAI may grant forbearance to such Insurer, taking such Insurer's business model into consideration and subject to its Board undertaking to bring such actual expenses within the allowable limits by FY 2025-26[5].

5. The regulations also require Insurers to have policies approved by its Board of Directors on the following matters:

    a. The Commission Regulations require that every Insurer is required to have a Board approved policy for payment of commission. This policy is to be prepared while considering certain objectives, including among others, protecting the interests of the policyholders and intermediaries, increasing insurance penetration and, improving cost efficiencies in the conduct of business[6]. In addition, the Board policy is required to be reviewed on a periodic basis. The IRDAI also issued a subsequent circular re "*Guidance note – Board Policy of the insurer on the commission structure*" of 31 March 2023 ("**Commission Circular**") which stipulates that the Board approved policy should contain certain key elements, such as (i) clear "*Objectives and Principles*"; (ii) "*Fairness and Reasonableness*" towards other stakeholders; and (iii) "*Regular Review*" of commission structure.

    b. The EOM Regulations stipulate that every Insurer carrying on either life, general or health insurance business is required to have a well-documented Board approved EOM policy, which should, at least, specify certain measures and processes, such as measures to reduce EOM and make business cost effective, structure of commission payable to insurance agents and insurance intermediaries etc. Such Board policy shall be reviewed on a periodic basis.

6. In addition, the EOM Regulations also require Insurers to prepare a Business Plan which, at a minimum, specifies certain projections, such as projected requirements of capital, projection of solvency margin on a quarterly basis etc. and which shall be monitored by the Insurer's Board at regular intervals.

7. The IRDAI's "*Guidelines on Motor Insurance Service Provider*" of 31 August 2017 ("**MISP Guidelines**") which permit automobile dealerships to distribute motor insurance through tie-ups with Insurers and insurance intermediaries ("**MISPs**"), also placed maximum limits on the "*distribution fees*" that may be payable to such MISPs. Similar to the changes proposed for the *erstwhile* commission limits, the IRDAI by way of its Circular on "*Payment of Distribution Fees to Motor Insurance Service Provider*" of 31 March 2023 ("**MISP Circular**"), removed ¶15(5)(c) of the MISP Guidelines which imposed limits on the distribution fees payable to MISPs. It is relevant to note, however, that various other

5 R14(2) of the EOM Life Regulations and R11(2) of the EOM Non-Life Regulations.

6 R4 of the Commission Regulations.

provisions under the MISP Guidelines continue to remain applicable.

Concluding Remarks

The changes brought about by way of the Commission Regulations and the EOM Regulations after almost 2 decades of representations for the expense limits, particularly in relation to commissions, to be lifted, now provide flexibility to Insurers in terms of the compensation payable to intermediaries for distribution of insurance, and management of their overall expenses within an overarching limit. However, these regulations effectively introduce a model of self-regulation and the actual impact of these changes are yet to be seen by the market.

Press reports indicate that the move has broadly been welcomed by Insurers and insurance intermediaries but smaller players in the industry appear to have expressed some concerns in terms of the impact on competition. It remains to be seen how the market players will adapt their business strategies to these changes while continuing to comply with the underlying objectives of these regulatory amendments.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

For further information on this topic please contact Tuli & Co

Tel +91 120 693 4000, Fax +91 120 693 4001 or Email lawyers@tuli.co.in

www.tuli.co.in

Author(s)

Celia Jenkins

Partner

Anuj Bahukhandi

Managing Associate

Rohan Bangia

Associate

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