i-notes
Newsletter from India's Leading Insurance Broking House
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India Insure
The risk managers

# Message from the Editor

Dear Readers,

September has come and almost gone, and the expected "*re-de-tariffing*" of prices did not happen. The unofficial revised deadline is November 1st. The market, however, doesn't seem to be as excited about the second round as it was for the first round on January 1, 2007. And understandably so! After all, the bulk of the price discounting (51.25%) has already been experienced – the expected further drop after November 1st is only around 10 – 20%.

Knowledge, or rather the absence of it, among the insurance marketing and underwriting teams (in insurers and intermediaries alike) is proving to be a big hurdle in the orderly growth of the Insurance industry. Shortage of trained and qualified professionals is leading to desperate measures by the players, with poaching and compensation wars hotting up by the day. We at India Insure have always been a bit hawkish on this issue – exhorting the industry to wake up before it becomes a full blown crisis. In this issue, we continue this crusade by writing on the state of training & education in the industry.

The product article focuses on Life Insurance for a change – we discuss the importance of Gratuity schemes and options for managing them.

Trust you find the articles useful and interesting.

**V Ramakrishna**
Editor – ***i-notes*** & Managing Director, India Insure



# Shortage of Insurance Talent – need for training & education

### Introduction

The Indian insurance market has exploded over the past few years. There is more demand than supply of trained manpower. Technical insurance knowledge now comes at a premium. How will the industry handle this situation? Are we gearing up or shutting our eyes to it? Or are we burying our collective heads like an ostrich hoping that the problem will go away? Where has all the knowledge of the past three decades gone?

Which brings us to some basic issues: *Is there a requirement for technical knowledge in this industry*? Is it more required in non life insurance in comparison to life insurance? Can the industry survive without an adequate knowledge bank? Questions, questions and more questions keep coming up if one pauses….. but then is anyone pausing to think of tomorrow when so many crises are being battled today?

### Is this a knowledge based industry?

Before we move on, the very basic question that needs to be addressed is this: **is the insurance industry a knowledge based industry**? Which are the areas in the insurance industry which are knowledge based? Do we look only for 'pre-trained manpower' or do we recruit freshers and train them? How has the industry been managing until now?

It is very apparent that knowledge requirement in the non-life branch of insurance is diversified and is more of a necessity than in the life segment. This article will, therefore, focus more on the non life than on the life segment.

The prime areas where non life insurance requires knowledge include the following:

**Underwriting:** An underwriter is one who understands the risk completely and decides on the terms and conditions of acceptance. This is a technical area requiring knowledge and expertise not only in insurance but also preferably in varied industries. He is to assess the risk either segment wise or client wise and would need industry specific knowledge.

**Marketing and Servicing:** The primary function of any marketing force is to create market awareness of the various products they offer and persuade prospective customers to deal with them. While the retail market in India is tapped by insurers primarily through agents, the corporate segment is tapped through intermediaries, bancassurance and also agents. To create awareness and convince hard-boiled CFOs, a fair degree of technical knowledge is essential.

Post sales service primarily involves keeping the customer completely protected through the year and also handling the claims. The sale of insurance is the sale of a 'promise' – a promise to settle a claim if it occurs. Claim settling can involve tricky situations and the team handling claims whether with insurers or brokers needs to know the nuances of the policy wordings and the various Insurance laws that govern them.

**New product development:** To design an insurance product, the insurer needs to do a great amount of market research and arrive at not only the product wordings but also the pricing which requires actuarial studies and also ensure that there would be a demand for this product. This requires in-depth knowledge.

**Surveyors:** Insurance surveyors are independent parties who assess the loss in the event of a claim. They are deputed by insurers for the expertise they have in various industries and it is considered to be requiring a high level of technical expertise.

### What is the present situation in the industry?

Today the industry is at a very precarious situation. The "grey haired", highly experienced insurance professionals are all close to their retirement age, and there is another group of early retirees. Who is going to replace them?

An often heard comment in the corridors of insurers is that, "It now takes longer for an insurer to understand the customer's question than it used to in getting a definite answer", ie. it is getting tougher to find people in the company who understand

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the coverages if it is something beyond the pre-designed covers. We face this pitiable situation today as Insurance started being offered as a course in universities and colleges only after liberalization. Until then, insurance knowledge had to be picked up on the job only (or in PSU training centres).

The insurance talent pool is fast shrinking, and the industry doesn't seem to be attracting the best and the brightest yet. And even for those who are in it, today there are plenty of temptations outside the industry. The situation is clear from the fact that last year only 100 new surveyors joined the profession.

- There are only a handful of colleges across the country offering full time Insurance & Risk Management courses even today.
- During campus recruitment at these institutes, insurance companies and brokers (the few that believe in campus recruitment) lose out to Software companies who hire these youngsters at far higher packages than the industry can offer.
- It is mandatory for marketing teams working with Broking companies to be trained for a minimum of 100 hours (followed by an exam), but very interestingly no such rule is applicable to their counterparts in Insurance companies.
- While training is mandatory, there is an acute shortage of training colleges across the country – in fact, Hyderabad & Bangalore don't have a single college for Brokers Training. Brokers have no choice but to sponsor employees for training in outstation centres – incurring huge costs on travel and stay.
- Insurers and intermediaries are expecting knowledge transfer to happen through osmosis. While some insurers and intermediaries are improving their training programmes, it is yet to attain priority in any organization.
- Unfortunately when times are bad for a company the first expense to be cut is training and also when times are good it is the last to be added. In an effort to reduce the expense ratio, formal training programs have been reduced or eliminated at a number of companies.
- In-house training programmes have become mere formalities of training an employee for a week on all products and then packing him off to his table containing 100 pending claim folders with an instruction of "Please start handling claims"

### How can knowledge be propagated?

The sad reality today is that no one is willing to take the first step. Industry players worry that the people they invest in by training will be immediately picked up by a competitor for a higher package. With loyalty going out of fashion, companies investing in training are becoming happy hunting grounds for the rest of the industry. However, as they say, we need to "stop worrying about the trained guy who got away – and worry more about the untrained guy who stayed back".

There is a whole mine of untapped knowledge within the industry. While some individuals believe that hoarding of knowledge is power, this can be very detrimental to a Company. Barriers have to be broken and knowledge has to flow. Companies have to create a culture of 'Knowledge Pull'. This lies purely in the hands of the top management of the company. Techniques used by such companies include rewarding their employees who pull knowledge from internal and external sources and who contribute their knowledge to the company's database.

Training our own employees is one of the simplest ways to propagate knowledge. Training programmes need to be more interactive and case study based. Insurance products are different from banking products and require different level of expertise in underwriting skills. Insurance marketing depends more on professional approaches as the business depends on solicitation. An overall training would include the basic and legal concepts behind insurance, product knowledge, the regulatory system and how it protects the customer and an awareness of what the customer needs and what motivates him –this with a practical, case study based approach will go towards higher and more consistent sales performance. Conversely, the lack of these lead to unintentional, or even deliberate mis-selling and the industry will suffer in the long term when customers resent what they are sold and the way in which they are sold.

### Can we salvage the situation for a better tomorrow?

Certainly yes, but for this we need to take a united approach.

- First and foremost, the insurance industry itself requires a great amount of branding to be done.
- Tie-up with one or more of the universities offering risk management courses, and recruit their graduates. These young people have already been sold on the industry—hire them, and keep them. Assist in finalizing the curriculum for the university and ensure that the sessions do not just impart theoretical knowledge but you get a complete package you would require.
- Make certain you use the best possible hiring process to bring the right people on board to begin with. Hasty, poor hiring decisions made by overworked managers are among the costliest mistakes that companies make. Turnover is expensive now; it will be even more costly in the future.
- Implement a training process that will challenge and motivate young employees, exposing them to various facets of your company and the industry. Companies that develop effective strategies for hiring and keeping the best and the brightest today are going to be the success stories of the next decade.

### Conclusion

The industry is facing a critical test. It is the onus of each of the players to make his contribution to the industry by cleaning his house to begin with. Like the saying goes, "Self help is the best help". So why not each of us begin by training our own employees instead of expecting the "Others" to commence. Once each of us is committed to work towards this, there would be a growth in the knowledge within the industry, and this will not only help Customers and Insurers, but also the nation's economy. Human capital will remain the single most important force behind the growth of the industry. India needs to transform itself into a repository of talent that can feed global demands for skilled workforce.

# Gratuity Scheme : A salute to loyalty

This is one of the important features of the social welfare measures adopted by the Government of India. Since the employees work in an organization for so long, as a gratitude to their long association and service, employers pay them additional money on their exit. This is a practice across the globe. The Government of India being a welfare state has made this benefit mandatory.

Gratuity payment is a potential liability for an organization and tends to increase as the salaries and the service lengths increase. In case of large organizations, liability on account of Gratuity can become very big and if not handled properly it can affect the cash flow.

Gratuity is an effective tool not only to reward loyal employees, but can also be used to retain them by offering higher benefits than that prescribed in the Act.

Gratuity shall be payable to an employee on the following events of his/her employment after he/she has rendered continuous service for not less than five years:

(a) on retirement or resignation or termination

(b) on death or permanent disablement due to disease or accident.

In case of termination of the employment due to death or permanent disablement, continuous service of 5 years shall not be necessary. The annual contribution to the Gratuity Fund by an employer shall not be more than 8 1/3 % of the annual wage bill.

For every completed year of service, the employer shall normally pay gratuity to an employee at the rate of fifteen days' wages (Basic + DA) based on the rate of wages last drawn by the employee concerned. The amount of gratuity payable to an employee shall not exceed Rs. 350000. The formula for calculating Gratuity liability is:

15/26 * Last drawn wage* number of years served.

Example:

| | | |
|---|---|---|
| Assuming last drawn wage (Basic) | = | Rs 10000 |
| No. of years served | = | 20 |
| Therefore Gratuity is | = | 15/26 X 10,000 X 20 |
| | = | 115384 |

### How to improve the benefits

Employer may provide better benefits than statutorily provided. Example: an employer may choose to pay gratuity even if an employee has not served for 5 years or the accrued gratuity amount can be greater than Rs.350000. Employer can also improve the quotient of 15/26 to a higher quotient; say 26/26. Gratuity payment exceeding Rs 350000 becomes taxable in the hands of receiver. These changes must be incorporated in the Trust Rules and approved by the IT Commissioner.

The organization's liability of gratuity is derived after the scientific actuarial valuations are done by a certified actuary. In the case of formation of new Trust, the organization can pay the past service contribution in maximum up to 5 installments spread over 5 years.

### Three ways to manage the Gratuity Scheme

**1. Pay to the employees when they leave ("*Pay-as-they-go*")**

The employer will make provisioning of the gratuity liability at the end of every year. The amount provided may be ploughed back in the business. As and when the employees leave, the payment is made. This option may work in a very small orgainsation where the gratuity liability is small. However, if the company has been in existence for long, even small number of employees may create huge liability of Gratuity as this liability is also linked with the length of service.

**2. Form Gratuity Fund Trust**

The employer can form a Gratuity Fund Trust and get it approved by the Commissioner of Income Tax as the recognized Gratuity Fund Trust under Part C of the Schedule 4 of the I T Act 1961. The organization has to pass a Board Resolution, draft the Gratuity Fund Deed and the Gratuity Fund Rules. Every Trust must have minimum 2 trustees to administer the Trust. The organization will get the actuarial valuation done and transfer the money from the current account to the Gratuity Trust Account. The contribution by the employer towards the approved Gratuity Fund Trust can be claimed as Business Expenditure U/s 36 (1) (v) of the IT Act 1961. All the income generated by way of investments by the recognized Trusts will be 100% exempted from the Income tax U/s 10(25) (iv) of the IT Act 1961. The Gratuity received by the employee will be tax free up to Rs. 350000/- U/s 10(10)D.

If the Trust fund is self managed, the Trustees have to follow Rule 67 of the Income Tax Act for the investments which makes it compulsory to invest in Govt Securities/ State Govt securities and PSU bonds etc. The scope for improving the returns will be limited here.

**3. Outsource the management of fund to a Life Insurance Company**

It makes sense to outsource it to a Life Insurance Company due to the following reasons:

a) Professional management of the fund, Better Investment avenues and hence better returns. Life Insurance companies have number of investment options which includes equity too. Life Insurance companies are not bound to follow Rule 67 of the IT Act as their investment options are approved by IRDA. This increases the possibility of maximizing the returns depending upon the market conditions.

b) Economies of scale (larger volume gets better rates). Insurance companies manage thousands of crores and hence they are in a better position to bargain better rates for investments in fixed income securities.

c) Ease in administration

d) Total Transparency

e) Annual Actuarial valuation free of cost

f) Maintaining the Books of Accounts of the Gratuity

g) Filing of Gratuity returns

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## Gratuity Scheme : A salute to loyalty........ *contd. # 3*

h) Life Insurance Companies can also provide Life Cover as well as Future Gratuity Cover (anticipated Gratuity earned by the employee till his/her retirement) along with management of Gratuity Fund

i) Better claims management: In case of exit of an employee, the employer informs the insurance company in writing and the insurance company issues the claim (liability amount) within the turn arround time limit.

### Indian Scenario – Outsourcing of Fund Management

Before privatization, LIC used to rule the roost in the outsourced market, but today more than 10 Life Insurance companies in India have launched this product. Majority of the corporate clients have restructured their Group Gratuity schemes and are selecting an insurance company for managing this scheme based on the annualised returns generated, types of investment options, assets under management, fund management charges and, obviously, the service levels. The Clients are under no obligation to stay with any one insurance company for ever for managing this scheme. The funds can be shifted from one insurer to another. Private Life Insurance companies went overboard in launching innovative products for investment, viz Unit Linked, forcing LIC to launch their Unit Linked plan called Gratuity Plus. Unit Linked product is a major hit today under Gratuity scheme as clients have earned very decent returns. A good return this year helps the client is paying less contribution next year. Therefore clients are shifting their money from the traditional mode of investments to Unit Linked schemes. The market has witnessed thousands of crores of money being shifted not only from the private corporates but also from the Public Sector Undertakings.

### Increasing role of Insurance Brokers

Unlike other insurance policies, there is no need of comparing premiums (referred to as "contribution" in this scheme) while selecting the life insurance company. Whether you pay more or less money to the insurance company as contribution, it is your money only and the insurance company is only working as the Fund Manager.

What need to be checked are the following:

- the FMCs (Fund Management Charges),
- the actuarial valuations,
- Asset Under Management (AUM) and
- the past track record.

Another very important factor not to be forgotten is the approval from the Commissioner of Income Tax as the approved Gratuity Fund Trust.

A professional intermediary (like an Insurance broker) can provide immense help to the clients in managing this exercise end-to-end.

An Insurance Broker has a major role to play on behalf of the client while selecting an insurance company and the plan. The FMCs are open for negotiation. It is negotiated based on the size and the type of the fund. Future Service Gratuity (FSG) is a very modern concept to provide life cover to all the members of the Gratuity Fund Trust. It can be offered through a Term Life policy.

### Need of the Hour

Every organization whether big or small, should form Gratuity Fund Trust and start contributing money every year based on the actuarial valuation done by a certified actuary. This will be a prudent financial management tool to save the organizations from jolts of sudden cash outflow. Investment of funds is a highly technical job and it must be given to the professional fund managers to do justice with the fund instead of managing by self.

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