# Creation of new Insurance Distribution Channel -Motor Insurance Service Provider (MISP) - Impact on stakeholders in General Insurance Sector in India

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**ABSTRACT** *On August 31, 2017, the IRDAI (Insurance Regulatory and Development Authority of India)notified the "Guidelines on Motor Insurance Service Providers"(MISP Guidelines) to identify and regulate the role of the automobile dealers in distributing and servicing motor insurance products. The compliance of this guideline come into force from November 1, 2017. This gave birth to a new distribution channel or intermediary in non-lifeinsurance. The IRDAI with this step recognised the role of automobile dealers and aimed to give legitimacy to existing practices of solicitation and servicing of motor insurance by automobile dealers in India. The paper seeks to study what led IRDAI to create a new channel and what would be the likely impact in coming times on various stakeholders of this new distribution channel.*

***Keywords:*** *Automobile Dealers, GeneralInsurance, MISP, Motor Insurance Service Provider,IRDAI*

## Introduction

Prior to the introduction of MISP guidelines by IRDAI automobile dealers have been selling motor insurance by tying up with brokers or by setting up their own Insurance broking company. Few of them were selling motor insurance by acquiring agency licenses in the name of their family members or employees.

Automobile dealers are the first point of contact for acustomer purchasing a new vehicle. Most customers purchase insurance along with the new vehicles bought from the dealers. Motor Insurance is the major segment of general insurance Sector and contributes 40% of total general gross direct premium in India. The segment assumes importance as law mandates compulsory third party insurance. The first effort of any new insurer is to establish a foothold in Motor Insurance segment. Insurers focused on automobiles dealers simply as they got captive customers who walked in showroom of dealers for the purchase of automobiles.As dealerships,they had no legal entity. Various arrangements and incentives were given by Insurers to get customers. This led to certain malpractices and transgression of spirit of IRDAI rules and guidelines.

In view of several such undesirable market practices, in November 2015, IRDAI formed a seven-member committee to "*bring clarity and transparency in pay outs made to the auto dealers by the insurers for getting motor insurance business".*

Ultimately, on August 31, 2017, the IRDAI notified the "*Guidelines on Motor Insurance Service Providers"*(MISP Guidelines) to identify and regulate the role of the automobile dealers in distributing and servicing motor insurance products.

Briefly, the guidelines can be summed up as under

A 'motor insurance service provider' (MISP) was defined as an automobile dealer appointed by the Insurer or an insurance intermediary to distribute and/or service motor insurance policies of automobiles sold through such dealers.

The MISP is required to comply with the code of conduct prescribed under the MISP Guidelines while soliciting and servicing insurance policies.

According to the new guidelines, a dealer has to become a Motor Insurance Service Provider (MISP) through tying up with eitheran insurer or a Broker and simultaneously nominate a person (dealership employee) to sell insurance policies at thedealership.

Insurers are required to enter into a written agreement with the MISP. Further, the insurer/insurance intermediary engaging the MISP is required to upload the relevant data of the MISP on the insurance information bureau (IIB) website.

The MISP Guidelines prescribe the maximum distribution fees that can be paid to the MISP for soliciting insurance business by the insurer or insurance intermediary engaging the MISP.

The journey so far of regulations framed by IRDA for MISP's is shown as per TABLE A as under:

Table A: MISP (Motor Insurance Service Provider) - Timelineof Regulations by IRDAI

| Subject | IRDA Circular | Date |
|---|---|---|
| Constitution of Committee on Motor Dealer pay outs on Motor Insurance Business | IRDA/NL/ORD/CMT/199/11/2015 | 13.11.2015 |
| Guidelines on Motor lnsurance Service Provider | IRDA/INT/GDL/MISP/2012/08/2017 | 31.08.2017 |
| Clarifications on Guidelines issued on 31.08.2017 | IRDA / INT/ CIR / MISP /246/11 /2017 | 01.11.2017 |
| Uploading of Details of Designated Persons on IIB portal | IRDA / INT/ CIR / MISP /0245/11 /2017 | 01.11.2017 |
| Creation of Panel by Brokers and Role of OEM's - Clarifications | IRDA/ INT/ CIR/ MISP/ 05/01/2018 | 11.01.2018 |

### 2.1 Understandingthe Automobile Market and Automobile Dealers

The Automobile Market is growing at fast pace in India. Every year more than 20 million automobiles are sold in India. The passenger vehicle segment is growing 4% year on year since 2014. Though commercial vehicle sales have been stagnant in this period they have shown a growth in 2017-18. The two wheeler population is increasing rapidly every year and grew by 13%in 2017-18.

In terms of insurance sales, the private car segment is most lucrative area for general insurers. Over5000 car showrooms spread all over India and more outlets opening every year, the potential is enormous.Insurers had been selling traditional package or comprehensive insurance policies for years. This segment has seen the introduction of add on covers which provide additional benefits to customers and insurers can charge additional premium for such benefits from customers. There is increasing customer preference of customers buying these add on covers this gives a cushion to insurers and leads to a lower loss ratio.

However, this is not the case with commercial vehicle insurance which has high third party premium in comparison with other class of vehicles and since dealer is not paid commissions on third party (TP) portionon buying package policies, the segment is not as attractive for insurance sales as of private car.Commercial Vehicle Insurance, which comprises of primarily buses and trucks gives rise to third party claims where unlimited liability exists as per Indian law.

Two wheeler insurance is characterised by low-ticket premiums, which makes the cost of procuring business unviable. Recently IRDAI allowed long-term cover for 2 wheelers to increase coverage and increase ticket size. The loss ratios for two wheelers are lowest among all category of vehicles.

Let us look at the growth of the market and its composition by way of TABLE B and TABLE C as under:

TABLE B: Domestic Vehicle Sales – 2012-2018

| Category | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Passenger Vehicles | 26,65,015 | 25,03,509 | 26,01,236 | 27,89,208 | 30,47,582 | 32,87,965 |
| Commercial Vehicles | 7,93,211 | 6,32,851 | 6,14,948 | 6,85,704 | 7,14,082 | 8,56,453 |
| Three Wheelers | 5,38,290 | 4,80,085 | 5,32,626 | 5,38,208 | 5,11,879 | 6,35,698 |
| Two Wheelers | 1,37,97,185 | 1,48,06,778 | 1,59,75,561 | 1,64,55,851 | 1,75,89,738 | 2,01,92,672 |
| **Grand Total** | **1,77,93,701** | **1,84,23,223** | **1,97,24,371** | **2,04,68,971** | **2,18,62,128** | **2,49,72,788** |

Source: SIAM (Society of Indian Automobile Manufacturers)

TABLE C: Domestic Sales (Vehicle Wise –Market Share)

| Type of Automobile | Market Share (2017-18) |
|---|---|
| Two Wheelers | 81% |
| Passenger Vehicles | 13% |
| Commercial Vehicles | 3% |
| Three Wheelers | 3% |

**Source: SIAM**

**TABLE D**: **Revenue Streams for Dealers**

| Source of Revenue | Percentage of Income Earned % |
|---|---|
| Servicing/Repair of Vehicles through Dealers Workshop | 35% |
| New Vehicles Sales | 30 % |
| Sales of Spares | 15% |
| Insurance and Car Finance | 20% |

As is evident from the above TABLE D, I\insurance Income is sizable chunk of dealers business.
Servicing and repair of vehicles earns dealers more than actual income from sales of vehicles. It will not be out of place to say that the margins in sales of vehicles are not as attractive as servicing of vehicles and selling insurance.

## 2.2 Issues prior to introduction of the MISP channel

**High Loss Ratios of Automobile Dealers**

Motor Business continues to show high loss ratios for most insurers. Loss Ratios on an average range from 70 to 75 % after adding to them the costs of acquiring business (COA) paid as commissions and management expenses, combined operating ratio (COR) runs for dealers in the range of 115-145 %. COR varies from insurers to insurer and across geographies. Overall sourcing insurance has not been profitable for insurers from the dealer channel except shoring up the turnover.

**High Claim Costs through Dealers Authorised Service Centres**

Since Dealers run their own workshops as discussed above for repair of vehicles. Many workshops or authorised service centres are known to inflate repair bills. One areas is replacement of spares used in repair of vehicles. Dealers push OEM built spares only during repairs for replacement as get earn more margins on such spares. Labour Cost is another area where is no standardisation of costs. It has been found that repairs costs done outside these authorised service centres results in lower bills but since the automotive OEMs's influence the customers indirectly to go through authorised dealers workshops only. Bulk business of accidental repairs in own damage claims is done through these authorised workshops only. Insurers tried having preferred network of garages/workshops outside these authorised service centres but this had limited success with customers.

Automobiles Dealers want settlement of these claims at their terms and link it with selling insurance for an insurer. In some cases dealers dealers stop insurance business from an Insurer unless there pending repair bills are cleared by the insurer on their terms. Insurers in need to shore their topline meet this demand of dealers in most cases.

**Payment of High Commissions to dealers**

Since dealers are the first point of contact with the customer, Insurers thought it was in their interest to reward the dealers to sell insurance. Car dealer with his showroom was a point of sale and was in an ideal situation to sell insurance to a captive customer.

Due to competition among various insurers for the same customer. Insurers started paying more business than competition to divert business to them. 30% to 50% commission on own damage premium was being paid to dealers. Dealers used to place business with insurers who offered them the maximum pay-outs. The customers were offered limited choice of insurers.

IRDAImandated maximum remuneration to intermediaries of maximum 15 percent for motor business was not adhered to by most insurers. IRDA was aware of breach of the same but found it difficult to monitor and enforce compliance of the same.

**Payment of Incentives over and above commissions.**

Since Insurers were fully dependent on dealers to push insurance. With multiple insurers wooing dealers for business dealers started dictating terms to insurers taking full advantage of their dependency.

Cost over and above commissions were paid in form of infrastructure expenses ,marketing expenses, advertising expenses, documentation charges, legal fees, advisory fees etc..

In some cases, these were paid to escape scrutiny by paying the mandated commissions as decided by IRDAI and anything above under the above categories.

**Higher Insurance Premium charged by Dealers**

Since the cost of acquisition was high for insurers for selling insurance through dealers. Also was no discount or price reductions weregiven in premium for policies sold to customers by dealers. This translated into huge difference between prices of insurance policies sold by other intermediaries and that sold by dealers. Customers most of the time unaware of the same and were the losers.

**Denial of cashless claim settlements to customers**

Cashless facility is provided to customer where he gives his vehicle for repair at the workshop of the authorised dealer and does not make any upfront payment on completion of repairs. Insurer pays the amount to dealer post repair. There were frequent complaints by customers where they were forced to buy insurance from the dealers on the premise that in case they buy insurance from intermediaries other than the dealer himself they will not be entitled to cashless facility but a non-cashless one where they have to pay first and claim later. This was against the basic spirit of fair play and a restrictive trade practice to thwart competition.

**2.3Tie ups by OEM's-vehicle manufacturers with insurers.**

OEMs are out of the purview of the insurance regulator IRDAI. IRDAIwas not able to take action against malpractices of OEM's that led them to influence dealers to sell insurance of selected insurers only.

India enacted Competition Act in 2002, relating to anti-competitive agreements and abuse of dominant position in business and trade.

Manufacturers were tying with up with Insurers to indirectly influence sale of insurance to certain preferred insurers by creation of a panel of such preferred insurance companies. This also involved influencing brokers who had tied up with dealers.

Due to these arrangements, the dealers were only offering insurance services of only these selected companies to the end-consumers. The OEM's are in dominant position of strength due to mere nature of their relationship of principal and agent which exists between them and dealers.

This left the end-consumer with limited options for procuring insurance. In addition, incentives were given by OEM's to customers if they took insurance through dealers only rather than buying from any other intermediary which gave them the best deal.

The option of cashless accidental repair services was not provided where a customer bought insurance froman insurer outside the panel of preferred vendors empanelled with a broker.

**2.4 Impact Post creation of MISP channel on various Stakeholders**

**Impact on Various Stakeholders**

**Customers:**The most obvious benefit for customers is greater choice of insurers to purchase insurance. Secondly, since the distribution fees or commission paid to dealer stands reduced. The Insurers are in a better position to offer discounts to customers in own damage section of policies due to increased margins. Thirdly, MISP as a channel would now come under the purview of IRDAI, availing cashless service at any automobile dealer cannot be refused to customers and the practice of discriminating customers by refusing cashless service on grounds of not buying motor insurance from them but from other intermediaries will come to an end.Lastly, Insurers will now be doing pricing in motor policies according to customer profiling on various parameters like usage of vehicle, occupation age etc. Overall creation of new channel MISP is customer centric and benefits them the most.

**Insurers**

Before we go into what the MISP guidelines mean for the Insurers. Let us examine the new commission structure now termed as distribution fees by IRDA

TABLE E: Maximum Distribution Fees Payable to MISP's

| **Category of Vehicles** | **Maximum Distribution Fees % of OD Premium** |
|---|---|
| 2 Wheelers | 19.5 % |
| Other than 2 Wheelers (viz Private cars, Commercial Vehicles – PCV,GCV and Miscellaneous) | 22.5 % |

As is clear the most obvious benefit to an Insurer is its COA (cost of acquisition) coming down. Earlier where insurers were offering commissions in range of 30-40% to procure business a substantial saving is possible now which would to a lower combined ratio.

Now Insurers compete in terms of overall service level and satisfactory claim settlement rather than competing on commissions alone.

Combined Operating Ratio (COR) which is very high for Motor Insurance business overall and even higher for dealer business will come down. This will be good for profitability of the general insurance sector.

**Auto Dealers (MISP's)**: They have suffered the maximum among all stakeholders with these guidelines. With commissions shrinking, they have to do more volumes to maintain the same income selling insurance. They have come within the purview of audit and scrutiny by IRDA now. This means engaging more people to keep up with compliance issues required by IRDA. Also as per the guidelines, they cannot sell motor Insurance to customers other than those who buy vehicles for them. This restriction limits their insurance income. The only benefit they have is now they are recognised legal entity under purview of IRDA and dispute resolution mechanism with insurer is clearly spelt out in the guidelines.

**OEM's (Original Equipment Manufacturer's):**

IRDA cannot initiate action against practices of OEM's, as they do not come its purview. OEM's have run insurance contests or programmes through their dealers to increase insurance business. Dealers are channel partners or intermediaries for OEM's. By very nature of theirrelationship, OEM's are in a more dominant position and they are able to exercise influence on them and dictate terms to them. Setting up an automobile dealership requires sizable investment on part of Dealer in real estate and other infrastructure. Dealers have to submit the wishes of OEM's and they have the powers to terminate them as their intermediaries.

OEM's have been tying up with specific preferred insurance brokers and creating apanel of preferred insurance companies with which dealers are dictated to do business exclusively. Taking action against malpractices of OEMs's is difficult task for IRDA. Under MISP guidelines dealers are required to offer products of all insurers to customers without influencing them to choose a particular insurer. Inan additional circular released by IRDA on January 11, 2018, to motor insurance service providers (MISP's), IRDAI said that no MISP or insurance intermediary can enter into an agreement with the OEM that has an influence or bearing on the sale of motor insurance policies. If MISP guidelines are implemented in, their right spirit this practice should stop over a period of time.

**Other Insurance Intermediaries**

One fallout of MISP guidelines has been on the individual agency business. Due to capping of MISP commissions. Agent Commission has also been capped. Lot of Agents who were mere aggregators of business from freelancers or other lead providers have shut shop. They were getting commissions in the range of 25-30 percent for Motor Business, now it is unviable for them to operate at lower pay-outs. Therefore, MISP guidelines have also have shaken up agency channel. The bigger agents have no advantage overall small agents now with MISP channel coming into being.

## Conclusion

Overall, the creation of MISP channel will be positive for General Insurers. The cost of distribution will come down due to capping of distribution fees. High Combined Ratio, which has been the bane for General Insurers, is expected to come down with the arrival of MISP channel. MISP channel gives all players a level playing field in the market. The customer gains the most in the process. Now the challenge is to satisfy the customer by better service levels. With passage of time, the full impact of this change would be known completely. That is because the insurance regulator has capped the fees for selling motor covers and brought automobile dealers on a par with other distributors to bring uniformity and check arbitrary pay-outs. However, whether this will not be breached by some players in future is to be seen. Experience has shown a number of players violated IRDAnorms on agent commission earlier.

Pay-outs in Health Insurance business are still not paid as per laid down guidelines. Also new players are at a disadvantage because of low brand recall among customers of their brand names. They will have to invest more in their brands to be chosen by customers. Only time will tell whether OEM's will stop dictating dealers about choosing insurers on their panel, as thispractice is continuing in the market. Finally, whatever be the challenges creation of MISP is a step in the right direction. If the guidelines are followed in, letter and spirit by all stakeholders both motor insurance as a segment and non – life insurance sector can look for steady profitable growth in years to come.

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