बीमा विनियामक और विकास प्राधिकरण
INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY

No. IRDA/F&I/ORD/IFRS/161/09/2010 September 30, 2010

ORDER

Working Group on Convergence of IFRS

A Group consisting of the following officers under the chairmanship of Mr. R K Nair, Member, (F&I) is constituted with immediate effect:-

1. Mr. N. Srinivasa Rao, FA & CAO
2. Mr. Kunnel Prem, CSO (Life)
3. Mr. Randip Singh Jagpal, Joint Director (Non-life)
4. Mr. S. N. Jayasimhan, Joint Director (Investment)
5. Mr. S. P. Chakraborty, Deputy Director (Actuarial)
6. Mr. R. K. Sharma, Deputy Director (F&A)
7. Ms. B. Padmja, Sr. Assistant Director (F&A)

The terms of reference of the group will be as under

- Issues arising out of draft AS 30 (corresponding to IAS 39) standard brought out by ICAI
- Issues raised in the Exposure Draft of IASB on IFRS 4 and IFRS 39
- Issues arising out of Exposure Draft of IASB on IFRS 9
- Examining the other IFRS which has some impact or relevance for insurance such as segment report (Exposure Draft IFRS 8), Consolidation of the accounts and run-off companies.
- Issues which arise regarding good accounting practices which should be introduced irrespective of IFRS in the regulations governing accounting in so far as insurance companies are concerned.

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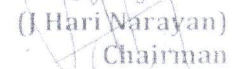
Mr. R. K. Sharma, Deputy Director (F&A), IRDA, will act as convener of the group. In order to have industry view points, the group will also have the following as co-opted members:-

1. Mr. V. K. Kukreja, Executive Director (F&A), Life Insurance Corporation of India
2. Mr. A. Sekar, GM, New India Assurance Co. Ltd
3. Mr. A. K. Mittal, DGM, General Insurance Corporation of India
4. Mr. Abhijit Chaterjee, AA, ICICI Prudential Life Insurance Co. Ltd
5. Mr. Samir Shah, CFO, HDFC ERGO General Insurance Co. Ltd
6. Mr. Rakesh Jain, CFO, ICICI Lombard General Insurance Co. Ltd
7. Mr. Satyen Jambunathan, CFO, ICICI Prudential Life Insurance Co. Ltd
8. Mr. Abizer Diwanji, KPMG
9. Mr. Ravindar Vikram, partner, Anandam & Co.
10. Mr. P. R. Ramesh, Partner, Deloitte & Touche

The Group will furnish its comments on Exposure Draft of IFRS 4 by 5th November, 2010 and will submit its report on other issues covered in terms of reference by end of March, 2011.



(J Hari Narayan)
Chairman

MINUTES OF THE 1ST MEETING OF THE STANDING COMMITTEE ON ACCOUNTING ISSUES HELD ON 15TH APR 2010 AT 11.00 A.M..- AT IRDA, HYDERABAD

Present:

1. T.S. Vishwanath, Chairman
2. Dr. A.K. Bhattacharya, Member

The chairman briefed the committee on the constitution of the committee in terms of office order reference IRDA/F&I/ORD/061/04/2010 dated 8th April 2010.

Item 1: Leave of absence

Leave of absence was granted to Mr. Amal Ganguli.

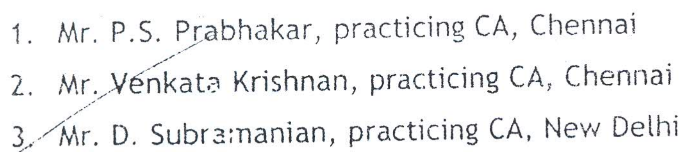
Item 2: Co-option

The following were co-opted as members of the committee

1. Mr. S B Mathur, Ex-chairman, LICI, Life Insurance Council
2. Mr. Sunil Goyal, Past President of ICAI
3. Vice President in office of ICAI
4. Mr. K.S. Gopala Krishnan, Actuary (currently the Vice President of Actuarial Society of India)
5. Mr. P.R. Ramesh, practicing CA, Hyderabad
6. Mr. Rakesh Jain, CFO, ICICI Lombard General Insurance Co

The committee also decided to invite the following to the deliberations of the committee

1. Mr. P.S. Prabhakar, practicing CA, Chennai
2. Mr. Venkata Krishnan, practicing CA, Chennai
3. Mr. D. Subramanian, practicing CA, New Delhi



4. Mr. Sunder Krishnan, Chief Risk Officer, Reliance Life Insurance Co Ltd.

Mr. S.N. Jayasimhan was requested to act as convener of the committee in order to co-ordinate with all the members and invitees on the issues to be discussed besides providing secretarial support.

Item 3: Any other matter

The committee decided that as IRDA(Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulation, 2002 was prepared some 10 years back, it would be appropriate to review in the light of experience. The office was requested to flag the issues related to accounting in this regard.

The meeting concluded with a vote of thanks to the Chair.

Date: 15th Apr, 2010

CHAIRMAN

MINUTE OF THE 2ND MEETING OF THE STANDING COMMITTEE ON ACCOUNTING ISSUES

Held on 10th August, 2010 at 10:30 AM at Head Office, LIC, Mumbai

Present

1. Mr. T S Vishwanath, Chairman
2. Mr. A K Bhattacharya, Member
3. Mr. S B Mathur, Co-opted Member
4. Mr. Sunil Goyal, Co-opted Member
5. Mr. K S Goplakrishnan, Co-opted Member

Also Present

6. Mr. P S Prabhakar, Special Invitee
7. Mr. Venkatakrishnan, Special Invitee
8. Mr. D Subramanian, Special Invitee
9. Mr. Sunder Krishnan, Special Invitee
10. Mr. N. Srinivas Rao, FA&CAO, IRDA
11. Mr. S N Jayasimhan, Joint Director, IRDA
12. Ms. Mamta Suri, Joint Director, IRDA
13. Mr. R K Sharma, Convenor
14. Mr. R Kumar, Deputy Director, IRDA

Chairman welcomed all the members, special invitees and officials of the Authority to the meeting. He briefed the members on the constitution of the committee in terms of the office order reference IRDA/F&I/ORD/061/04/2010 dated 8th April, 2010. He also informed the committee that Mr. R K Sharma will act as convenor of the committee.

Item 1: Leave of absence

Leave of absence was granted to the following

1. Mr. Amal Ganguli
2. Mr. Ramaswamy, VP ICAI
3. Mr. P R Ramesh
4. Mr. Rakesh Jain

Item 2: Confirmation of the minutes of the last meeting

The minutes of the last meeting held on 15th April, 2010 was confirmed.

Item 3: Convergence with IFRS and its time line including discussion on Exposure Draft of IRFRS-4 on Insurance Contracts

Chairman briefed the committee that IASB has issued the exposure draft (ED) on insurance contracts on 30th July, 2010 for comments. The ED is open for comments up to 30th November, 2010. According to the work plan issued by IASB, the IFRS will be issued in the second quarter of 2011. ICAI and NACAS will consider IFRS after issuance of the same by IASB and therefore the equivalent Indian Accounting Standard is likely to be issued in 2012. In view of the above, it was felt that it would be impracticable to implement the standard in India as per the current time line of April, 2012. There will be implementation issues and the impact of the implementation of Indian Accounting Standard fully convergent with IFRS should be examined before mandating the implementation of that standard. IRDA will also be required to issue implementation guidance to ensure uniformity in application of accounting principles and method stipulated in the proposed accounting standard.

After due deliberation, the committee decided to recommend to IRDA that the transition date should not be earlier than April 01, 2014.

Item 3: Review of the existing regulations

The IFRS on insurance contracts will cover only insurance and reinsurance contracts, and certain financial instruments that contain a discretionary participation. Other transactions being entered into by insurance companies are addressed by other IFRS- equivalent Indian accounting standards. The Chairman suggested that the existing regulations should be reviewed in the light of extant IFRS equivalent accounting standards because number of revisions have been incorporated in IFRSs since issuance of the accounting regulations. He was of the opinion that the review of the regulations would help the IRDA and the insurance companies to get ready to implement the new regulations convergent with Indian accounting standards fully convergent with IFRS seamlessly.

The committee decided to form a sub-committee with the following members to examine alignment of accounting regulations with IFRSs;

a. Mr. T S Vishwanath, Chairman
b. Mr. A K Bhattacharya
c. Mr. P R Ramesh
d. Mr. Sunil Goyal
e. Mr. D Subramanian, co-opted member

The sub-committee may also invite other expert to support its activities. It was also decided that Mr. RK Sharma will act as convenor of the sub-committee.

On the suggestion of Mr. N. Srinivas Rao, the committee decided that the above sub-committee may also examine the prudential norms / issues especially in relation to solvency to align the same with accounting principles.

The committee also decided that IRDA will provide information on the implementation issues arising of the current regulations to enable the sub-committee to examine them in the context of IFRS implementation.

Item 4: Review of the current accounting of the Premium Deficiency

Mr. R K Sharma brought out the need for change in the current provision on accounting for premium deficiency and the need for more disclosure and separate provisioning on individual insurance segment and sub-segments. On the basis of the presentation of Mr. Sharma, the committee decided that Mr. Sharma will prepare a background paper to facilitate review of the current accounting principles by the committee.

Item 5: Vote of Thanks

Meeting concluded with vote of thanks to the Chairman

T S Vishwanath,

Chairman

Minutes of the Standing Committee on Accounting Issues

Held on 26th July, 2011 at 11 A.M. at the Premise of the IRDA, Hyderabad

Present

1. Mr. T S Vishwanath, Chairman
2. Mr. A K Bhattacharya, Member
3. Mr. Sunil Goyal, Co-opted Member
4. Mr. P R Ramesh, Co-opted Member
5. Mr. Rakesh Jain, Co-opted Member
6. Mr. V K Kukreja, Co-opted Member
7. Mr. P Roy, Co-opted Member
8. Mr. R K Sharma, Convenor

Also Present

9. Mr. S N Jayasimhan, Joint Director, IRDA
10. Mr. P S. Prabhakar, Special Invitee
11. Mr. Venkatakrishnan, Special Invitee
12. Mr. D Subramnain, Special Member
13. Mr. Sunder Krishnan, Special Invitee
14. Mr. R Kumar, Deputy Director, IRDA
15. Ms. Uma Maheswari, Assistant Director, IRDA
16. Mr. S K Goswami, Invitee, NIC

Letter No. 441/2/F&A/SCAI/21/May-2011 and 441/2/F&A/SCAI/20/May-2011 dated 02.05.2011 nominating Mr. P Roy, DGM, National Insurance Co. Ltd and Mr. V K Kukreja, ED_F&A, LIC was placed before the Committee and taken on record. The Chairman welcomed all the members especially the newly joined Mr. V K Kukreja and Mr. P Roy.

Item 1: Leave of absence

Leave of absence was granted to the following members

1. Mr. Amal Ganguli
2. Mr S. B Mathur
3. Mr. J. N Shah, VP ICAI
4. Mr. K S Goplakrishnan

Item 2: Induction of the Special Invitees

The Committee took note of induction of the following members as special invitees

1. Mr. K Subrahmanyam, Ex-ED, IRDA
2. Mr. N Srinivas Rao, IES

Item 3: Confirmation of the minutesof the last meeting

The minutes of the last meeting held on 10th August, 2010 was confirmed. The Chairman informed the Committee that a sub-committee was formed to look into the existing accounting regulations for alignment with the IFRS. However till date no meeting could be held and it was decided that the sub-committee should submit its report on proposed amendment in accounting regulations by end of August-2011 for consideration of the Committee. Mr. R. K. Sharma was requested to prepare a background paper in the context for accounting for premium deficiency for the consideration of the Committee.

Item 3: Fund Approval Procedure

The Committee after deliberations approved the fund approval procedure as proposed subject to the following modifications:

1. Purchase of investment in bulk and segregation to different funds need be permitted;
2. Units for Unallocated Amount / Suspense need besegregated; and
3. The date of implementation of the procedure could be as under;
    a. the revised regulations will be applicable to the products to be approved by the Authority on or after 1st August, 2011;
    b. the existing funds need be made compliant with the new procedure by October 01, 2011; and
    c. the compliance certificate from the auditors be submitted along with report for the quarter ended September, 2011

Item 4: NAV Computation

The Committee recommended the NAV Computation process as proposed subject to the following;

1. Differential notional asset/ liability on account of dealing costsshould not be taken into account while computing the NAV;
2. The provision for non-performing asset (NPA) should also be taken into account in the computation of the NAV; and
3. The existing differential notional asset / liability on account of dealing cost should be treated as under:
    a. In case of net debit (Asset), the same should be made good by shareholders by charging the same to Profit & Loss Account.
    b. In case of net credit (liability), the same should not be written back and must be treated in the manner provided by the Authority for unpaid claims amount.

Item 5: Amendment in Investment Regulations

The Committee recommended the changes in the investment regulations subject to the following

1. The investment by insurance companies/funds in listed investee companiesshould be in compliance with SEBI Regulations.

2. The industry sector exposure limit as specified in the regulations need not be applicable to "Infrastructure Category".
3. Exposure Limit applicable to investment in promoter's group companies be limited to 5% of the total investment subject to no investments being made on private placement basis or in unlisted companies.
4. Since the definition of Debentures under the Companies Act, 1956 includes Bonds, a clear differentiation in Debentures and Bonds may be brought out in the proposed amendment.
5. A clear provision providing that Thinly Traded Investment shares are part of "other Investment" needbe brought out.
6. The time limit for the submission of quarterly returns be provided as 30 days instead of 45 days as at present.

Item 6: Any other item

Mr. R K Sharma appraised the committee about the proposed master circular on F&A related issues for non-life insurers. The Committee decided to form a group to examine the master circular and to suggest modifications, if any with the following members;

1. Mr. P R Ramesh – Chair
2. Mr. Sunil Goyal
3. Mr. P.S. Prabhakar
4. Mr.VenkataKirshnan
5. Mr Rakesh Jain
6. Mr. D Subramanian

The group will be assisted by Mr. R K Sharma

Item 7: Vote of Thanks

The meeting concluded with a vote of thanks to the Chair.

T S Vishwanath
Chairman

Minutes of 1st Meeting of **Working Group on Convergence to IFRS** held on October 23, 2010 at 11:00 AM in the premises of **IRDA, 3rd Floor, Parisarm Bhavan, Basheer Bagh, Hyderabad**

The following were present at the meeting

1. Mr. R K Nair, Chairman
2. Mr. N. Srinivasa Rao, Member
3. Mr. V K Kukreja, Member
4. Mr. A R Sekar, Member
5. Mr. Avijit Chatterjee, Member
6. Mr. Satyan Jambunathan, Member
7. Mr. P R Ramesh, Member
8. Mr. Randip Singh Jagpal, Member
9. Mr. S N Jayasimhan, Member
10. Mr. S P Chakraborty, Member
11. Mr. R K Sharma, Member- Convenor
12. Ms. Padmaja, Member

Also Present

1. Dr. R Kannan, Member- Actuary as Special Invitee
2. Ms. Mamta Suri, JD, IRDA
3. Mr. Viswanathan Narayana Swamy, Partner, KPGM

Chairman welcomed all the members and guests to the meeting. He briefed the members on the constitution of the committee in terms of the office order reference IRDA/ F&I/ORD.IFRS/161/09/2010 dated September 30, 2010.

Item 1: Leave of Absence

Leave of absence was granted to the following

1. Mr. Kunnel Prem
2. Mr. A K Mittal,
3. Mr. Rakesh Jain
4. Mr. Samir Shah
5. Mr. Ravinder Vikram
6. Mr. Abizer Diwanji

Item 2: Terms of Reference

Chairman explained the committee about the terms of the reference of the committee. He also explained that the committee has to forward its comments on Exposure Draft of IFRS 4-

Insurance Contract latest by 5th of the November, 2010. In view of the same, it was unanimously decided to take up the exposure draft first so that committee can complete task by first week of November, 2010

Item 3: Exposure Draft – IFRS- 4-Insurance Contracts:
Chairman explained that IASB has sought the view on specific 19 questions raised by them. It was decided to examine these questions first.

Questions 1 to 5
It was observed that Questions 1 to 5 were primarily related to Actuarial. In view of the same, it was decided that these questions will be first examined by the members having actuarial background. Member Convener was advised to circulate their observations to all the members so that consensus be arrived at before the next meeting.

Question 6 – Residual/composite margin :
Committee broadly agreed to the approach suggested in exposure draft. In practice, it does not make any commercial sense to underwrite an insurance contract, the outcome of which at initial stage itself is known to be negative.

In the same manner, committee agreed that composite margin or residual margin should be estimated at a level that aggregates insurance contracts into a portfolio of the insurance contract. However, whether within a portfolio, should we adopt cohort approach based on similar date of inception of the contract, by similar coverage period etc. are the issues which needs to be examined further.

In view of the same, it was decided that Mr. Avijit Chatterjee and Mr. Satyan Jambunathan will first examined the issues pointed out from (b) to (e) of the question 6. Their comments will be circulated by Member-Convener to committee members for their observations.

Question 7 – Acquisition Costs
The committee first discussed as to what would fall under the gamut of incremental acquisition costs for life and non-life insurance. It was discussed that if the incremental acquisition costs are included in the initial measurement of insurance contract, this would not burden the income statement in the first year as against the current practice followed in India. It was decided that there is nothing significant which needs to be commented by the committee.

Question 8 – Premium allocation approach

The pre-claim liability has been defined as insurer's stand ready obligation to pay valid claims for future insured events arising under existing contracts (i.e. the obligation relating to the unexpired portion of risk coverage). Thus, ***pre-claim liability*** appears to be a misnomer, going by the definition. However the General Insurance members were not too clear about the term pre-claims liabilities and measurement of claim liability. Hence, it was decided that members may forward their comments, if any, after detailed examination to the member convener.

Question 9- Contract Boundary principle

Dr. R Kannan explained the Contract Boundary principle in detail. When a life insurance policy lapses, the insurer is no longer required to give life cover for the insured, but there is still an option for revival for the policyholder in the next two years but the principle of Contract Boundary does not take this fact into account. In view of the same, it was decided that committee will make a note of revival period while commenting on **Contract Boundary Principle.**

Question 10 – Participating features

Overall the committee was convinced with the participating features being included in the Insurance Contracts standard and wanted additional guidance either from the local regulator or IASB on the management of assets in the same pool in the case of participating and non-participating policies' investments

Question 11- Definition and scope

- The definition of insurance contract was discussed point by point and in length by the members. The members also discussed the aspect of what constitutes significant risk and what the applicable threshold for determining significant risk is. The members were of the opinion that there should be guidance on threshold for determining insurance contracts and this can be even specified at local regulator level as well.

  The committee was in agreement with the insurance definition, however wanted the regulator or IASB to determine the significant risk threshold. The scope exclusions were felt appropriate as those were specifically covered under other standards and the committee did not want to comment on financial guarantee contracts whether to be included in the purview of insurance contracts.

Question 12- Unbundling

The members first discussed about the applicability of the unbundling was only to life insurance contracts and there were no such specific features in products sold in general insurance which would currently attract unbundling.

As per the definition about unbundling, requirement would be attracted for those insurance contracts which have investment component or a service component. Currently in India Unit Linked Products and Pension products contain both insurance and investment feature. However, the exposure draft provides that an insurer shall not unbundled components of a contract that are **closely related to the insurance coverage specified in the insurance contract**.

Committee observed that "closely related to the insurance coverage" is a vague term. It was agreed to suggest the following which are more relevant

a. Unbundling is only mandatory if the deposit / service component can be measured separately. If it cannot be measured separately, then unbundling should not be permitted.
b. In the similar manner, if the insurer's accounting policies require to recognize all obligations and right from the deposit (other than insurance) component, then unbundling should not be mandatory.

Question 13 – Presentation

The following is agreed

a. the clause 71(a) of the ED requires to present the pool of assets underlying *unit linked contracts* as a single line item, and not commingle it with the insurer's other assets.
   Committee observed that pool of assets underlying unit linked contract should be disclosed for each portfolio of unit linked contracts. This will give a better idea about the performance of different funds.
   The actuarial members were of the opinion that the presentation format will not be understood by most of the readers, including analysts. The presentation format mentioned in the exposure draft would be only best understood by an actuary, which is not the purpose of the standard.

Question 14 – Disclosures

- Clause 92 (i) provides for the sensitivity to show any material effect on profit or loss and equity to insurance risk in relation to its effect on profit or loss and equity. The sensitivity to insurance risks in relation to its effect on profit or loss and equity. However, it does not talk about the impact on Unit Linked Fund.
- There should be a separate disclosure for Asset Liability Matching (ALM).
- Moreover most of the disclosures are linked to the financial statements presentation, which in-itself is complicated to understand and hence the members were of the opinion

that the disclosures will not be useful to the readers of financial statements as they would be too technical.

Question 15: Unit Linked Contract

Committee observed that disclosures are in order except that it should be made on portfolio basis instead of making a single line disclosure.

Question 16 : Reinsurance

It was agreed that Mr. A R Sekar and Mr. Randip Singh Jagpal will examine the issues. These issues will be circulated to Members before the next meeting.

Question 17 : Transition and Effective Date

The BC 248 makes it clear that IFRS 4 does not cover insurance contracts which are already in-force before the applicability. However, this fact has not been mentioned in the Exposure Draft.

Secondly, it specifies that no residual margins will be recognized as income for any subsequent period on such contracts.

Other Comments

1. It excludes weather based insurance products. This should not be excluded.
2. It does not provide for accounting of subrogation right for non-life insurer which is utmost important in case of non-life insurance contract.
3. Dr. R. Kannan indicated that he had prepared a draft response to all the questions which would be circulated for suitable consideration.

Minutes of 2nd Meeting of **Working Group on Convergence to IFRS** held on November 20, 2010 at 11:30 AM in the premises of **Life Insurance Council, 4th Floor, Jeevan , Mumbai**

The following were present at the meeting

1. Mr. R K Nair, Chairman
2. Mr. N. Srinivas Rao, Member
3. Mr. Kunnel Prem, Member
4. Mr. V K Kukreja, Member
5. Mr. A K Mittal, Member
6. Mr. Rakesh Jain, Member
7. Mr. Samir Shah, Member
8. Mr. Avijit Chatterjee, Member
9. Mr. Randip Singh Jagpal, Member
10. Mr. S N Jayasimhan, Member
11. Mr. S P Chakraborty, Member
12. Mr. R K Sharma, Member- Convenor
13. Ms. Padmaja, Member

Also Present

1. Mr. Suresh Mathur, JD, IRDA
2. Ms. Mamta Suri, JD, IRDA
3. Mr. Shrawan Jalan, Parnter, E&Y
4. Mr. Viswanathan Narayana Swamy, Manager, KPGM
5. Mr. Gopal Balchandran, ICICI Lombard General Insurance Co. Ltd

Chairman welcomed all the members and guests to the meeting. Chairman briefed the group about the deliberation that had taken place in last meeting on questions 6 to 17 of the Exposure Drafts. The issues covered in question 1 to 5 are mainly on actuarial issues. Hence, it was agreed upon to first examine these issues by the members having actuarial backgrounds.

Item 1: Leave of Absence

Leave of absence was granted to the following

1. Mr. A Sekar, Member
2. Mr. Satyan Jambunathan, Member
3. Mr. P R Ramesh, Member
4. Mr. Ravinder Vikram
5. Mr. Abizer Diwanji

Item 2: confirmation of the meeting of the first meeting

The minutes of the first minutes was confirmed by the group. However, group observed that some of the questions may be deliberated again. It was decided to take them as a separate agenda item.

Item 3: Exposure Draft – Recommendation on question 6 of ED

As decided in the last meeting, the inputs given by Mr. Avijit Chatterjee, Mr. Satyan Jambunathan and Mr. S P Chakravotry on 6(b) to 6(e) were deliberated further and the follwing are agreed upon

- 6(a) :It is reasonable to require that profits are recognized over the term of the contract. However, as a consequence, arguably, the liabilities are not reported on a true and fair basis. Clearly, a company would not in general write business that is not intended to be profitable on some reasonable basis. The group may infer from this, that in any case, the liabilities are not being valued on a realistic basis that is designed to reveal their 'economic substance', be it fulfilment value, exit value, fair value, etc.

  However, while it is reasonable to match the profit recognition to the risk coverage of the contract, and so not to recognize a profit at inception, group would suggest that it is illogical to report a loss where, in economic substance, a contract is expected to be profitable. The amortization pattern of the residual margin in particular should be clarified so that such an untoward outcome does not arise.

- 6(b) group agreed that the residual margin should have a floor of zero. This would appear consistent with normal accounting concepts of prudence.

- 6 (C) : The primary issue is whether, in the estimation of the margin, the portfolio should be segmented into cohorts defined by similar dates of inception. By so doing, the expected profitability of each cohort of new business may be reported as it is written. In particular, if a cohort is expected to be loss-making, its negative residual margin may not be offset against any positive margin brought forward. Group believes that this will add to the transparency of the reporting, and so we support the segmentation of the portfolio into cohorts.

  Another issue appears to be whether positives and negatives at policy level may offset each other within a cohort of similar policies, or whether negatives should be eliminated policy-by-policy. The residual margin broadly represents the expected value of future profits. As an expected value, it acquires meaning only when it is an aggregate of a large number of policies. In practice, inevitably, some of these policies will generate profits and some will generate losses. The expected profitability is in any case an average of these. To introduce a floor at policy level so that the expected profit may not be negative would appear to be unnecessary and a distortion. Group recommends therefore that a portfolio approach be adopted.

Further, group suggests that to eliminate negative margins policy-by-policy would introduce a level of prudence inappropriate to financial statements.

- In accordance with BC 125 and 126, it appears that non-incremental acquisition costs can be recognized in the amortization pattern. In particular, BC 125 refers to:
    - Compensation for the cost and effort of originating the contracts;
    - Compensation for ancillary services that are not unbundled; and
    - Compensation for product development.

  Group would assume from these that non-incremental acquisition costs may be part of the amortization pattern of the residual margin. However, Paragraph 50(b) of the Exposure Draft refers only to expected claims and benefits. Group support the approach proposed in the Basis for Conclusions rather than in the proposed Standard.
- 6(f) : Since, the residual margin will reflect the present value of future profits, as calculated at inception, it must unwind at its discount rate over time. It must therefore accrete interest.

Item4 : Question 7 – Acquisition costs :

On inception, non-incremental acquisition expenses are to be expensed (Paragraph 39b). Incremental acquisition costs are to be included in the fulfillment cash flows. Hence, they will serve to reduce the residual margin, since:

Max(0, Premium - fulfillment value)= residual margin (Paragraph 40)

The proposal will give rise to new business strain in respect of non-incremental acquisition costs. New business strain would give a misleading picture of the profitability of new business. To recognize a profit of zero at inception may be reasonable on grounds of prudence. But to mandate recognition of a loss, even in respect of contracts expected to be profitable, would appear to have little justification. To avoid new business strain in respect of profitable business, group suggests two alternatives:

1. The non-incremental acquisition costs may be recognized in the amortization pattern of the residual margin. (See response to Question 6(d) above.)
2. The non-incremental acquisition expenses may be included in the fulfillment cashflows.

Item 5: Question 8 – Premium allocation approach

Group discuss the pre claim liability once again and broadly agreed to the proposed approach.

Item 6: Question 9- Contract Boundary principle

The group broadly agreed that the principle is reasonable but guidance is required as to the treatment of policies where the premium is reviewable subject to regulatory approval. Is the point of review a contract boundary? Paragraph BC58 would imply that such a restriction would not be a boundary.

Item 7: Question 10 – Participating features

The following was agreed by the group

- 10(b) Typically, pensions and some investment contracts with discretionary participation features (DPF) have minimal risk cover. However, to treat them differently from life insurance business with DPF, which does have significant risk cover, would introduce more inconsistency than consistency. DPF rather than risk covers, even where they are significant, are usually the predominant features of such business, and so, group recommended that financial instruments with DPF written by insurance companies be included within the scope of IFRS 4.

- As a consequence of BC 201, where there is a regulatory requirement to separate business with discretionary participation feature (DPF) into two funds, one for pensions which would not have significant insurance risk, and one for life insurance which would have significant insurance risk, group understands that the pensions business would not be treated under IFRS 4. Group does not agree with this proposal.

It appears that the possession of DPF is, in principle, sufficient to confer the status of insurance on a product. Otherwise, the inclusion of financial instruments with DPF within the scope of IFRS 4 would not arise. Once this is admitted, the precise constitution of the profits in which the contract participates appears irrelevant to its categorization. In particular, the right to participate in mortality profits should not be deemed to confer the status of being contingent on human life on a policy; for a policy to be so deemed, the life in question should be the life assured.

Further, the proposal could give rise to significant inconsistencies between companies that write essentially the same business, but where one maintains separate participating funds for pensions and life business, and the other aggregates the funds, or where one writes only pensions business and the other writes life and pensions in the same fund.

Item 8: Question 11- Definition and scope

The group agreed with the definition. However, the group would expect detailed guidance of IASB and prescription by the local regulator to enable a consistent interpretation of 'significant insurance risk.'

In response to question 11(c): Group suggested that financial guarantee contracts written by insurance companies be within the scope of IFRS 4.

Item 9 : Question 12- Unbundling

As per the definition about unbundling, requirement would be attracted for those insurance contracts which have investment component or a service component. Currently in India Unit Linked Products and Pension products contain both insurance and investment feature. However, the exposure draft provides that an insurer shall not unbundled components of a contract that are **closely related to the insurance coverage specified in the insurance contract**.

Committee observed that "closely related to the insurance coverage" is a vague term. It was agreed to suggest the following which are more relevant

a. Unbundling is only mandatory if the deposit / service component can be measured separately. If it cannot be measured separately, then unbundling should not be permitted.

Item 10: Question 13 – Presentation

The following is agreed

- 13 (a) the group felt that the presentation, while illuminating to experts, will prove extremely difficult to understand for most users. There is an expectation of and familiarity with items such as premiums, expenses, claims, etc. in the financial statements. The absence of such items will require extensive explanation and substantial supplementary disclosure.

  Further such outputs typically arise from actuarial, not accounting, models. For these to form primary reporting will require significant re-engineering of accounting and actuarial processes and software.

Item 11: Question 14 – Disclosures

- There should be a separate disclosure for Asset Liability Matching (ALM).
- Moreover most of the disclosures are linked to the financial statements presentation, which in-itself is complicated to understand and hence the members were of the opinion that the disclosures will not be useful to the readers of financial statements as they would be too technical.

Item 12: Question 15 : Unit Linked Contract

The group broadly agreed with the proposed approach.

Item 13: Question 16 : Reinsurance

The following was agreed

- 16(b) group noted that the effect of the proposals on the ceding company would be to recognize a profit on inception of reinsurance where the contract is expected to be profitable, but to defer recognition of the loss where it is expected to be loss-making. This would appear to internally inconsistent, inconsistent with the treatment of directly written business and potentially imprudent.

  The group suggested therefore that the treatment proposed in Paragraph 45(b) be applied irrespective of whether or not a contract is expected to be profitable. Expected profits or losses may both then be recognized at inception.

  As a minimal alternative, group suggested that expected losses be recognized at inception.

Item 14: Question 17 : Transition and Effective Date

The following was agreed by the group

- 17(a) : The group did not support the proposed transition arrangements. They would result in an enormous acceleration of the emergence of surplus: expected future profits at the point of transition would be transferred to equity. Subsequently, for several years, profit flow would be depressed as only variances from expectations in respect of this book would emerge. Thus, the profit flow even for a stable-state company would be extremely volatile.

  The group recommended instead that as a one-off calculation, the residual margin of the existing business at point of transition be estimated, as if the standard had been in force since inception of the business, and that this be held as a liability. Alternatively, the expected future profits immediately before the point of transition may be estimated, held as a residual margin and amortized in line with the expected emergence of those profits.

Item 15: Question 1 – Relevant information for users (paragraphs BC13–BC50)

The following was agreed

- It is unlikely that economic decisions are based solely on the accounting representation, whether current or proposed. The key items that are likely to be overlaid with the financial statements in making economic decisions by the management or shareholders under the proposals are
  - Regulatory constraints such as distribution of surplus and solvency considerations
  - Expected returns from investments as opposed to just the risk free expectation under the proposed standards

  As regards usefulness to any other user, the key objective would be consistency across companies and consistency over periods. To achieve this objective, given that proposals are principles based, it would be desirable for the local regulator to provide further guidance or specify parameters. Some of the areas that would require guidance or prescription are:

  - Discount rates
  - For the purpose of the risk margin:
    - Economic Scenario Generators, including parameterisation
    - Models of non-economic parameters for risk margins
  - Setting of liquidity premiums
  - Setting of scenarios for sensitivity disclosures

Other comments:

The group presumes that the risk margin would be in respect of non-hedgeable risks only, since market consistent valuation would provide for the fair value of hedgeable risks.

Item 16: Question 2 – Fulfillment cash flows

The following was agreed by the group

To the extent a fulfillment value reflects the insurer's own circumstances, specifically expenses, it is an improvement on exit value. Also conceptually it is an improvement since the liability is long-term and should not be assessed at its traded value.

The group would however distinguish between the expected present value of future cashflows, as described in Paragraph 17, and the present value of expected cash flows. The (draft) standard may be taken to imply that:

- Probability density functions be postulated at least for all significant parameters, which may include demographic as well as market factors;
- Given these density functions, simulations of the future cashflows be made;
- The fulfilment value be calculated in each simulation; and
- The mean of the these fulfilment values be calculated. This mean could then be adjusted in accordance with Paragraphs 35 – 37 to reflect the risk margin.

However, the usefulness of such an approach in relation to non-hedgeable risks would be debateable, e.g. no plausible stochastic model in existence has proven capable of predicting observed longevity improvements in the developed economies. Also, a stochastic model of, for example, policyholder persistency, is liable to be specious. It is challenging in many such circumstances to predict the mean, let alone the entire distribution. In the context that fitting distributions to some of these parameters may not be possible, the standard would require that probabilities be assigned to each outcome, which would be an extremely subjective assessment that could result in significant inconsistencies across companies.

Furthermore, the risk margin, we presume, is designed to provide for these uncertainties. Given the presence of this margin, it would appear superfluous to require an assessment in the base cashflows of the non-hedgeable risks.

The proposed approach would also lead to significant implementation challenges and the level of complexity will be reflected in reporting timescales.

The group noted that Paragraph 17 refers to the present value of outflows less inflows, whereas Paragraph 23 refers to incremental cash inflows and cash outflows. We presume that in the latter case, 'incremental' applies only to the inflows, these typically being premiums, and not to the outflows, which would include both incremental and non-incremental expenses, except for acquisition expenses which are addressed in Paragraph 39.

Item 17: Question 3 – Discount rate

- 3(a) : The group did not agree that this is a theoretically correct approach. To discount the liabilities, one requires the risk-adjusted yield on the backing assets. This would be equal to the risk-free yield only if the behaviour of the capital markets were perfectly rational. However, the proposed approach, would provide for some level of consistency, if
  - the treatment of liquidity premiums were prescribed;

- the definition of risk-free returns were prescribed; and
- the method of extrapolation of the yield curve were prescribed, in circumstances where the liabilities are longer than available risk-free assets.

Additional guidance from IASB would be welcome in these areas. Group did agree that given these further steps, the proposed approach would be fit for purpose.

- 3(b) While theoretically reasonable, this approach depends on an observable liquidity premium. However, in respect of liabilities that are inherently illiquid, such as conventional immediate annuities, quite clearly, no liquidity premium can be observed. To provide for consistency, the approach to this risk premium will require guidance from IASB. Specifically, clarity will be needed on whether the liquidity premium will be based on the insurer's underlying assets or on a standard assumption.
- 3(C) Risk of non-performance should not be reconsidered. Allowing for the risk of non-performance would in effect depress liabilities for weak companies. The concerns that the MC approach may misrepresent the economic substance of a contract are valid.
    - The liabilities are not liquid. To use theory applicable to liquid markets, which is implicit in the choice of market parameters, is in principle inappropriate. Further, where there is little or no prospect of a liquid market's development, the exercise appears futile.
    - Liabilities are not marked to market in this approach; they are marked to model.
    - Liabilities are long-term and today's market price is not relevant unless the liability is traded.
    - To mark options and guarantees to market can have untoward macroeconomic effects, e.g. where there is an embedded put option in the liabilities, as in UK-style with profits business, mark to market will encourage a matching asset strategy, including implicit or explicit delta hedging. This will result in insurance funds' shorting of a risky asset as it falls and vice versa. This will increase market volatility, which is undesirable.
    - The group recognized that for contracts with DPF, the valuation rate may reflect actual assets held. But it would appear that embedded derivatives would still be valued as a replicating portfolio. In fact, given BC97, the asset share should also be valued as a replicating portfolio. So the purpose of exempting business with DPF from a valuation rate independent of the backing assets is unclear.

However, the intention of revealing the 'economic substance' is probably unachievable. The aim of the standard should be to create a transparent framework that is applied consistently, and not one that reflects "economic substance". For that, more rules are needed, to interpret the principles.

Furthermore group noted that in any case, the incorporation of a residual margin in the liabilities is a departure from the notion of economic substance. If the intention were to reveal the economic substance of the liabilities, such a margin should not be required.

Item 18: Question 4 – Risk adjustment versus composite margin

The following was agreed by the group

It would be reasonable for the amortization of the residual margin to reflect the emergence of gross profit. The risk margin should be run off as the risk exposure is run off. The group noted also that it is quite possible for the risk profile of a portfolio of existing business to change over time, and not just because it is running off. For example:

- A conventional immediate annuity portfolio backed by bonds might have appeared more risky during the credit crunch than at other time; and
- A term assurance portfolio would have appeared more risky after the discovery of AIDS than before.

Recalculation of the risk margin will reveal these effects, whereas a composite margin would not.

Furthermore, the concept of a risk margin is quite consistent with the market consistent methods underlying the fulfillment value. If the liability cash flows are to be valued using parameters consistent with those observed in the capital market, it appears consistent to apply the same treatment to the risk inherent in the liabilities.

Item 19: Question 5 – Risk adjustment

The following was agreed

- 5(a) This will be impossible to calibrate since liabilities are not traded on a liquid market. Specifying a method does not help in this regard since, for example, the tail of the distribution used for estimating the conditional tail expectation (CTE) may vary among companies even if the methods are identical. Also, guidance is required over how to assess and project the required capital if a cost of capital approach is taken. Further, what would the marginal cost of capital be? Lastly, guidance would be required on an acceptable confidence interval if a confidence interval is the chosen method.

  In addition to guidance from IASB, prescription of the models used and the key parameters, perhaps by the local regulator, would be required. In the absence of such prescription, inconsistency would result.

  It is presumed that the risk margin will be calculated in respect of non-hedgeable risks only, as hedgeable risks will have been valued at their fair value. We recommend that in the interest of consistency, guidance be given by IASB on the development of methods of deriving the risk margin, and that local regulators be encouraged to prescribe methods and bases.

  Group noted also that while market risks are typically considered to be hedgeable, in practice, they may not be. Further, there will be considerable risk in the adoption of specific parameters for any ESG, given the absence of deep and liquid markets in insurance liabilities. The risk arising from this should presumably be allowed for in the risk margin.

Group noted that the risk margin is explicitly not supposed to represent the amount that would provide a high degree of certainty that the insurer would be able to fulfil the contract. (BC110 b) But that is precisely what a CTE, a confidence interval or the required capital in a cost of capital will reflect. We confess to being somewhat puzzled by this.

- 5(b): the group suggested that allowing discretion will lead only to inconsistency and lack of comparability, and that IASB should mandate a single method. The confidence interval and CTE appear to be in the nature of capital requirements, in that they give assurance of meeting the liability given some extreme events. However, the cost of capital approach appears to be more in the nature of a liability, since it is effectively the present value of the cost of providing the risk-based capital that would be required if the portfolio were to run off. We therefore support the cost of capital method.
- 5(C) : Disclosure may follow analysts' enquiries; to mandate it would be superfluous. Further, in isolation, it is a meaningless number since the confidence interval for any such extreme percentile of any of the significant random variables will be very wide. It would be desirable for the local regulator to prescribe the desired percentile.
- 5(D) : The risk margin may be assessed by considering together, and taking diversification benefits in respect of, pools of liabilities that may be managed separately but whose surpluses are fungible. Given fungible surpluses, it would illogical to assume that, for example, surpluses from health business would not offset deficits in term assurance business, even though the two portfolios might be managed quite separately.

Item 20: vote of thanks

The meeting concluded with vote of thanks to the Chairman.

Minutes of 3rd Meeting of **Working Group on Convergence to IFRS** held on January 29, 2011 at 11 AM in the premises of **IRDA. IRDA, 3rd Floor, Parisarm Bhavan, Basheer Bagh, Hyderabad**

The following were present at the meeting

1. Mr. R K Nair, Chairman
2. Mr. N. Srinivas Rao, Member
3. Mr. Kunnel Prem, Member
4. Mr. V K Kukreja, Member
5. Mr. A Sekar, Member
6. Mr. A K Mittal, Member
7. Mr. Samir Shah, Member
8. Mr. S P Chakraborty, Member
9. Mr. R K Sharma, Member- Convenor
10. Ms. Padmaja, Member

Also Present

1. Mr. Suresh Mathur, JD, IRDA as Special Invitee

Chairman welcomed all the members and guests to the meeting. Chairman briefed the group about the development taken place since last meeting. He explained that Authority, based upon the group's report has sent its response on exposure draft on insurance contracts to IASB. The response of the Authority are broadly in agreement with the group recommendations except on two issues viz residual margin approach and modified premium approach.

Item 1: Leave of Absence

Leave of absence was granted to the following

1. Mr. Randip Singh Jagpal, Member
2. Mr. S N Jayasimhan, Member
3. Mr. Rakesh Jain, Member
4. Mr. Avijit Chatterjee, Member
5. Mr. Satyan Jambunathan, Member
6. Mr. P R Ramesh, Member
7. Mr. Ravinder Vikram
8. Mr. Abizer Diwanji

Item 2: confirmation of the meeting of the 2nd meeting

The minutes of the first minutes was confirmed by the group.

Item 3: Draft Circular on accounting and financial presentation of non-life insurance companies

Chairman explained that the second term of reference given to the group is to examine issues which arise on good accounting practices which should be introduced irrespective of IFRS in the regulations governing accounting in so far as insurance companies are concerned.

He also explained that so far Authority has issued 55 circulars on the various accounting aspects of the non-life insurance companies. All these circular have been compiled and have been given the shape of "MASTER CIRCUALR'. He sought the views of the group on the present relevance of these circular and improvement, if any, required in these circulars. He explained that this issue being discussed in keeping with the terms of reference and also in order to make it easier for the insurers and the regulator.

The following were the suggestions made by the Members.

- Cash Flow Statement :
  - Mr. A K Mittal explained that in reinsurance, most of the settlements are done on net basis. Thus, it is very difficult for a reinsurance company to follow direct method for preparation of the cash flow statement. He emphasised that reinsurance company should not be mandated to prepared the cash flow statement on direct method. Even foreign reinsurer like Swiss Re prepares cash flow using the indirect method.
  - Mr. A R Shekhar explained that since, preparation of cash flow statement does not differentiate between the foreign and domestic operations, hence they need to prepare the cash flow on global basis i.e. including their foreign operations. This makes it very difficult for them to prepare the cash flow on direct method especially given the fact that New India has operation in 23 foreign countries.
  - However, members broadly agreed that direct method of cash flow is more exhaustive and causes no issues if it is mandated only for the Indian operation of a non-life insurer.
- Segment Reporting (AS 17) :
  - At present the accounting regulation for non-life insurance companies provide for the following segments
    - Fire,
    - Marine further segregating into Marine Cargo, Marine-Other
    - Miscellaneous further segregating into Motor, Workmen's compensation, public / product liability, Engineering, Aviation, Personal Accident, health Insurance and other

It was discuss that there should be a requirement of showing a separate sub-segment under Miscellaneous class of business in case the premium from the said segment contributes more than 10% of the miscellaneous.

- **Allocation of Operating Expense:** It was discussed that the present regulation or the circular issued there–under does not provide the mechanism to be followed for allocation of the operating expense to various segments. Due to which, different methods for allocation of operating expense are being followed by the insurers.

  It was suggested that Authority, in order to bring uniformity and transparency, may mandate that allocation of operating expense will be on net premium basis.

- **Actuarial valuation of Claims payment for more than 4 years:** The Regulations for preparation of financial statements require all insurers to furnish the particulars of the claims made in respect of contracts where the claims payment period exceeds four years. it was decided to examine the said provision in greater detail with actuarial inputs so that more clarity may be brought in the said regulations.

- **2.1.5: Treatment of Premium Deficiency** : The present regulations mandates that premium deficiency shall be recognised if the sum of expected claim costs, related expenses and maintenance costs exceeds related reserve for unexpired risks. However, circular issued by the Authority mandates that premium deficiency shall be recognized on three major segments viz fire, marine and miscellaneous and provides for disclosure of the premium deficiency of above 10% of the premium for sub-segment.

The following was recommended by the group

- The word "maintenance cost" is not clearly defined. Authority may clearly replace "maintenance cost" with operating expense.

- The yardstick to be followed for recognition of the premium deficiency may be specified by the Authority. It was recommended that average incurred claim for last three years should be a good indicator of the deficiency of the premium. The same may be specified.

- Instead of disclosing of the premium deficiency for sub-segment, the same may be made mandatory to account for.

- 2.1.6 : On approval of the Authority for appointment of Chairman-cum-managing director or whole time director of Public Sector Insurance Companies, Chairman suggested that issue may be examined in greater detail.

- **2.1.7. Unallocated Premium :** Unallocated premium refers to premium which has been received but not allocated to any of the risks. It was agreed that there is a very thin

difference between the premium received in advance and unallocated premium. It was recommended that unallocated premium may be renamed as **"Cash deposit"**.

- **2.4.9. Allocation of Depreciation Expenses:** IRDA/CIR/F&A/088/March-05 dated March 30, 2005 provides for allocation of Depreciation expense between the Revenue/Profit & Loss Account based on the "use" of the assets by the insurer.

  It was discussed that the present requirement may be dispensed with as it is very difficult to ascertain the usage of the assets for policyholders and shares holders. In absence of which it is very difficult to practically follow the said method. It also has no relevance in view of the fact that separate of shareholder funds and policyholder funds in non-life insurance sector is not necessitated in view of the differing nature of non-life insurance business. A policyholder has no stake in the funds of the insurer except for claim if incurred, unlike life insurance companies. Instead, the depreciation expense may specify as a part of the operating expense.

- 3.1 **Guidelines on Prudential Norms for Income Recognition, Asset Classification, Provisioning and Other Related Matters in respect of debt portfolio** : some of the members pointed out that the said circular does not cover all areas and the circular needs to be amended in view of the revision in parameters carried out by the RBI.

  It was agreed to examine this issue in greater detail. However, Chairman advised the members to furnish their comments on the same within 15 days so that necessary changes in the present circular may be recommended by the group.

Further, group suggests that to eliminate negative margins policy-by-policy would introduce a level of prudence inappropriate to financial statements.

- **4.3.1 Disclosures under Section 31B(2) of the Insurance Act, 1938** : the members representing industry were of the view that the threshold limit of ₹1lakhs is too low. The return to be furnished will be voluminous and furnishing of such voluminous information within 30days from the end of the financial year will be extremely difficult. It was decided to examine the issue in greater detail so and if need arises, the threshold limit of reporting may be increased to a reasonable level to be decided after receiving comments from the Members. Ms. Padmaja and Mr. R K Sharma will review the returns furnished by the insurers and will update the group in next meeting.
- **Treatment of the sum pertaining to the Insured /unclaimed claims:** Insurers especially representative of PSUs insurers express their difficulty in compiling the information. However, they were explained the concerns which gave rise to this stipulation and advised to examine the issue in greater detail and come back with their comments, if

any. It was decided that practices prevailing in other financial sectors would be studied and the issue would be reviewed.

- **Public Disclosures:** it was pointed that definition of the some of the key analytical ratios needs to be reviewed.
- In case of disclosure of 'Ageing of Claims' under management report the starting slab of 30 days to be removed.

Item 04: Sub-group for reinsurance accounts

It was observed that all the above said circulars which are applicable to non-life insurance companies are equally applies to Reinsurance Company too. Though, there are some practical difficulties in applying the same to a reinsurance company.

In order to review the applicability of the said circulars and accounting regulations on reinsurance companies, a sub-group comprising of Mr. Suresh Mathur, Mr. A R Shekhar, Mr. A K Mittal and Mr. Samir Shah was formed. The sub-group was advised to submit its report on or before the next meeting of the working group.

Item 05: vote of thanks

The meeting concluded with vote of thanks to the Chairman.

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