

46th India Fellowship Seminar

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What counts as one-off?

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Agenda

1. Case Study Overview
2. Key Issues & Next Steps
3. Q & A



1. Case Study Overview



1. Case Study Overview

Company:

- Aarambh Life Insurance (15 years old)
- Private Equity Backed, IPO in 12 months
- 30%+ APE growth in past 3 years, 2 million in-force policies

Protagonist:

- Arjun Mehta, first role as Appointed Actuary (AA), joined 8 months ago & inherited the expense model which he does not trust fully

1. Case Study Overview

Issue:

- Maintenance Expense Overrun: ₹120 crores (50% above assumption)
- CFO proposes to treat ₹80 crores as “one-off” & hence only ₹40 crores is recurring
- Arjun's concern: 3-year per-policy cost trend (flat/rising) suggests much of the ₹80 crores is recurring, not one-off
- Potential IEV Impact: ₹1080 crores - ₹1320 crores
- This one classification decision carries a ₹1000+ crore valuation impact - affecting both policyholder reserves & IPO pricing

1. Case Study Overview

Expense Analysis (3 years trend) data:

Year	Maintenance assumption (₹ cr)	Actual maintenance (₹ cr)	Overrun (₹ cr)	In-force policies (mn)	Actual maintenance per policy (₹)
Y-2	180	250	70	1.45	~1,724
Y-1	210	300	90	1.70	~1,765
Y (now)	240	360	120	2.00	~1,800

Red Flag: If past 'one-off' investments were genuinely delivering efficiency, per-policy costs should be falling - they are not

1. Case Study Overview

CFO Proposal:

- Proposal from CFO is to classify ₹80 crores as “One-Off” exclusions:

Expense Items	Cost (₹ crores)
Servicing Platform (slipped timeline twice)	₹35 crores
Operations Transformation	₹25 crores
Analytics & Persistency Team	₹15 crores
Remediation (one-off)	₹5 crores

Arjun's Concern:

- Significant portion of ₹80 crores appears recurring - only limited items clearly qualify as one-off

2. Key Issues & Next Steps



2.Key Issues & Next Steps

Six major issues to handle & next steps:

- Q1: Certification Dilemma
- Q2: Role of market practice/industry standards
- Q3: Deadline Pressure
- Q4: Unrepresented stakeholders
- Q5: Sequence of options
- Q6: Preventive Actions

Q1: Certification Dilemma



Issue Overview:

- Arjun believes the right recurring expense assumption is between ₹40 crores & ₹120 crores, yet to be concluded
- The core question: Should an AA prove a number is wrong before refusing to certify - or should they be positively satisfied it is right before they sign?
- Certification is a positive act - it carries the AA's professional reputation. The question is what standard of conviction is required when complete proof is unavailable?

Q1: Certification Dilemma

Arguments for Arjun certifying:

- Professional judgement operates under uncertainty - proof is never absolute
- CFO's view is supportable, 30%+ growth does incur genuine build-out costs
- Overstating costs also distorts best estimate – accuracy works both directions
- Partial validation possible, some items (₹5 crores remediation) are clearly one-off

Q1: Certification Dilemma

Arguments for Arjun not certifying:

- 3-year per-policy trend shows costs not reducing - this is evidence
- AA must be "satisfied" - inability to disprove is not satisfaction
- AA's primary duty is toward policyholders & future investors
- Same assumption impacts statutory reserves - not just an EV presentation choice
- APS 10: Unit costs must reflect actual experience - cannot assume savings not yet achieved

2.Key Issues & Next Steps

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Q2: Role of market practice/industry standards



Market practice “everyone does it”:

- Meridian director says “This is normal pre-IPO normalization that every company does”
- How much weight with regards to “everyone does it” should the actuarial judgement carry?
- Does market practice mean the evidence that approach is appropriate, completely irrelevant to professional standards, covers for questionable decisions?

Q2: Role of market practice/industry standards



Considerations for following market practice:

- Many actuaries have faced similar situation, this reflects overall industry wisdom
- IRDAI & peer reviewers do see many IPO valuations; if practice were inappropriate, it would have been challenged
- Investors compare multiple insurers preparing for IPO, consistent price discovery
- Actuaries must balance prudence & judgement with business viability

Market practice can be one input...

Q2: Role of market practice/industry standards



Considerations for not following market practice:

- Consider rationale of the market practice
- Comparability cannot be assumed just from board comment; other companies may have better data or substantiation
- Pre IPO periods creates pressure & optimism & may lead to systemic risk
- Each appointed actuary must exercise independent judgement; Professional standards needs to be maintained

...but cannot cover for questionable decision & own reality

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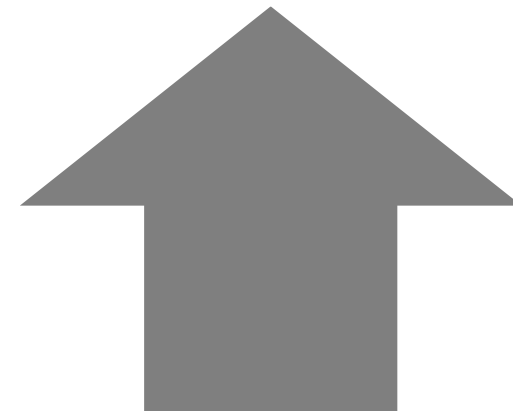
Q3: Deadline Pressure



Should an immovable deadline change what an actuary is willing to certify?



Should we change the deadline?



Practical necessity vs Professional integrity

Q3: Deadline pressure

Importance of IPO deadline

- IPO windows are time-sensitive; delay = lost opportunity
- All teams accountable for missing deadline

Professional Integrity & Statutory duties

- Time pressure is not a professional defence
- Deadlines must accommodate professional requirements; cannot bend for business deadlines
- AA cannot certify what cannot be substantiated
- Focus scrutiny on high impact expenses
- Finance to provide inputs on priority so that AA can substantiate information in available window

**Deadlines are important but cannot compromise statutory duties;
Strict timelines cannot justify lower standards of proof**

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Q4: Unrepresented stakeholders

Who is in the room?	Who is not in the room?
<ul style="list-style-type: none">➤ CFO; Preferably wants high IEV for IPO➤ PE nominated directors; eager on getting exit at high valuation➤ Management; is under pressure to deliver	<ul style="list-style-type: none">➤ Future IPO investors; who will rely on IEV disclosures➤ Future policyholders; who would want that their obligations are met timely

Q4: Unrepresented stakeholders

Who bears the consequences?

- Future IPO Investors: Overpay for shares based on inflated IEV. They rely on disclosed IEV, & trust AA certification
- Policyholders: Solvency Risk, Benefits at risk. They rely on AA for certification, cannot assess reserves & cannot exit easily
- CFO/Management: Temporary embarrassment if corrected later & they do have information so they can manage themselves
- PE Sponsor: Already exiting at high valuation, so no ongoing risk
- To conclude, those not in the room bear all the risk while those in the room bear no risk or limited risk

Q4: Unrepresented stakeholders

Ways to represent the unrepresented?

- Explicitly ask yourself if IPO investors would accept ₹80 crores exclusion if they knew facts & whether policyholder's interests are protected fully with this assumption, to initiate decision making
- Reverse the information asymmetry & evaluate what would AA certify if investors were in the room
- When in doubt over multiple stakeholders, favor the one's who cannot protect themselves
- Consider long term reputation of profession
- Require additional disclosures so investors know what they are buying

Q4: Unrepresented stakeholders

Next Steps:

- In conflicts between represented & unrepresented parties, Arjun must favor the unrepresented
- As per APS 1, Arjun has responsibility to protect interests of policyholders, to also enable the company to meet its liabilities to policyholders
- Policyholders need adequate reserves so he should favor conservative assumptions
- Arjun is the only voice in the room for unrepresented stakeholders, if he does not represent, no one will

2.Key Issues & Next Steps

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Q5: Sequence of Options

Least to Most Disruptive:

- **Option 1:** Accept CFO's proposal - To be executed if AA is still fine to proceed
- **Option 2:** Request additional time for analysis - Can be explored when more evidence & analysis is needed & to be opted for when current information is not enough
- **Option 3:** Propose middle ground (₹15 crores - ₹20 crores as one-off) - Recommended starting point & if CFO is willing to negotiate
- **Option 4:** Certify with documented reservations to board, audit committee - If CFO shows flexibility on unsupported ₹80 crores, then can be executed

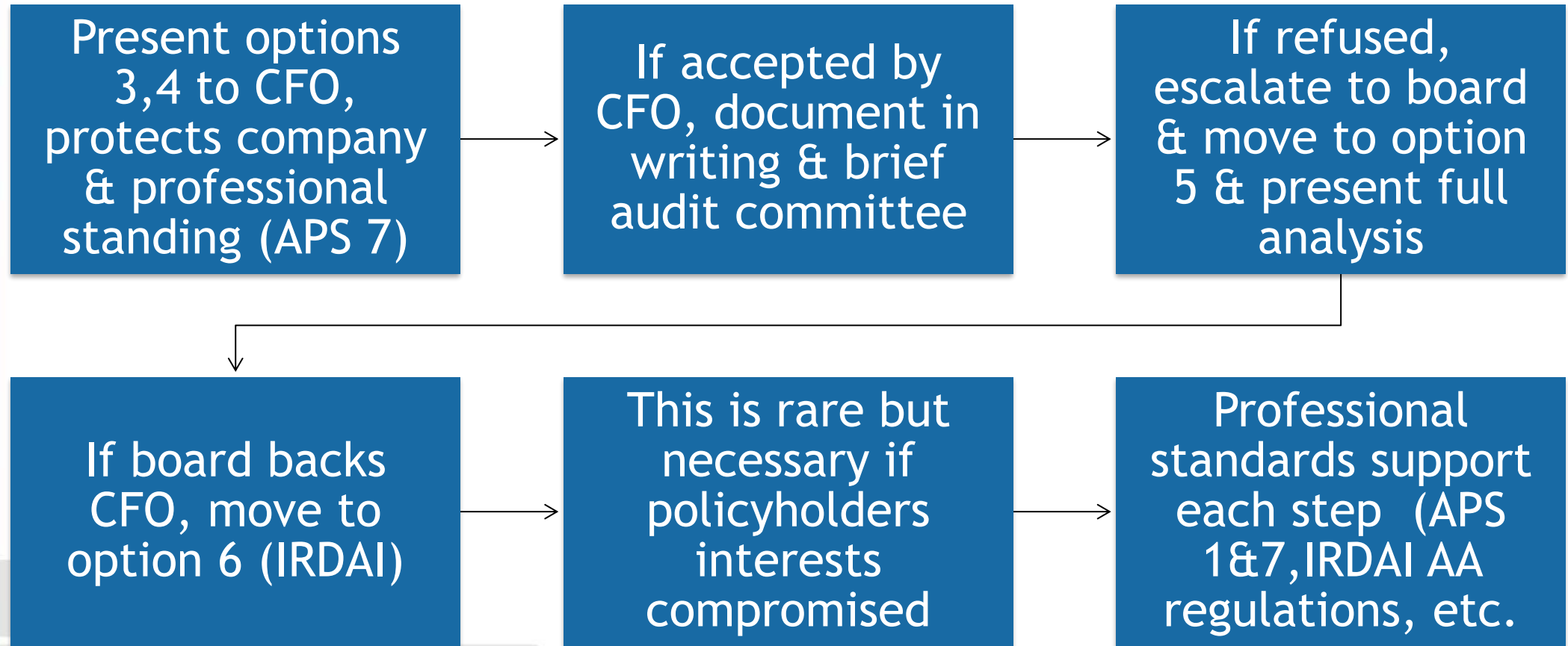
Q5: Sequence of Options

Least to Most Disruptive (Continued):

- **Option 5:** Refuse to certify & escalate to board, audit committee - If CFO shows no flexibility on unsupported ₹80 crores, then can be executed
- **Option 6:** Report to IRDAI - If policyholder's interests are compromised, board fails to acknowledge & address the same while supporting management despite clear evidence
- **Option 7:** Resign - If forced to certify inappropriate numbers by board &/or threatened to be replaced if not compliant as per management expectations

Q5: Sequence of Options

Next Steps:



2.Key Issues & Next Steps

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Q6: Preventive Actions

Arjun's Situation:

- First AA role
- A company on an IPO trajectory
- Inherited expense model built by his predecessor
- Had reservations about the allocation methodology
- Admitted concerns to team privately
- **Did not do anything to address this**

Q6: Preventive Actions

Immediate Steps for next 90 days:

Model & Data Integrity

- Independent audit of inherited expense model
- Formally flag inadequate cost-pool tagging as a governance deficiency

Documentation

- Request handover documentation from the consultants who built the model (APS1 sec2.2)
- Document gaps, concerns in the model formally from day one

Q6: Preventive Actions

Immediate Steps for next 90 days (continued):

Communication

- Formally notify Audit Committee on gaps in inherited model
- Request support for adequate resources/time to address this early

Stakeholder Relationships

- Build direct relationships with the Audit Committee, independent Board members
- Establish clear expectations with the CFO on all actuarial matters from day one
- A direct reporting line to the Audit Committee

Q6: Preventive Actions

Subsequent steps for next 4-8 months:

Strategic Preparation

- Review 2-3 years of prior expense analyses
- Establish a clear framework for expense categorization; align CFO in advance
- Review last year's IEV disclosures & the one-off exclusions claimed

Engage Peer Reviewer & Auditors Early

- Obtain peer reviewer's written view on one-off classification criteria
- Brief statutory auditor's actuarial specialist on model limitations in writing

Q6: Preventive Actions

Subsequent steps for next 4-8 months (continued):

Strengthen independence structure

- Propose formal Board policy on AA independence
- Seek Board sign-off on AA's actuarial assumptions independently of management

Guidance & Support

- Consult senior Fellows who have navigated similar commercial pressure scenarios

3. QnA



Thank You!



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