

# 46th India Fellowship Seminar

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Group 5

## Appointed Actuary and Bonus Cuts (Professional Case Study)

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# Case Study



You have recently joined a large life insurance company in India as its Appointed Actuary. The Company has been selling predominantly traditional participating business for the past 25 years. Since inception of its participating fund, the Company has consistently declared the same level of bonuses on its policies as were supportable based on the bases adopted in the original point-of-sale illustrations issued to the policyholders. This has been the practice of the Company, despite several structural shifts in the interest rate regimes over the past 25 years; the impact of global financial crisis; as well as other events such as demonetisation and Covid-19 pandemic.

Having investigated the bonus supportability (how has this changed from previous investigations), you have concluded that the current level of bonuses is not supportable and the rates need to be lowered by around 15% to 25% across different cohorts of business.

# Case Study

Discuss the following –

1. What professional considerations would you have adopted in arriving at the conclusion about the bonus cuts?
2. What professional considerations would you adopt in responding to each of the comments (highlighted later in the presentation) raised during management discussions?
3. If the management declines to approve your proposal, what would be your next course of actions?
4. If the management approves your proposal, what professional considerations would you adopt in actually effecting the cuts in the bonus rates?



# Regulatory Framework considered



- IRDAI Actuarial, Finance and Investment Functions of Insurers Regulations, 2024 (AFI)
- Master Circular on Actuarial, Finance and Investment Functions of Insurers
- Guidance Note 6
- Professional Code of Standards (PCS)
- The Actuaries Act, 2006
- APS 1: Appointed Actuary and Life Insurance Business
- Master Circular on Protection of Policyholders' Interests, 2024 (PPI)
- APS 5: Appointed Actuary and Principles of Life Insurance Policy Illustrations
- APS 34: General Actuarial Practice Standard
- APS 4: Peer Review of Appointed Actuary's work in Life Insurance

# Case Study

Discuss the following –



1. What professional considerations would you have adopted in arriving at the conclusion about the bonus cuts?
2. What professional considerations would you adopt in responding to each of the comments (highlighted later in the case study) raised during management discussions?
3. If the management declines to approve your proposal, what would be your next course of actions?
4. If the management approves your proposal, what professional considerations would you adopt in actually effecting the cuts in the bonus rates?

## Professional Considerations

- Guidance from IRDAI
- Policyholders' reasonable expectations (PRE)
- Bonus Earning Capacity of the fund
- Sustainability of current bonus rates over the term of the policies

## Guidance from IRDAI/ IAI

- Professional Conduct Standards (PCS)
- Previous With Profit Committee Reports (WPC) and Principles and Practices of Financial Management (PPFM) documents, asset share documents
- Guidance note 6
- APS 34

## Professional Conduct Standards

- Section 1.3 of PCS that states, “A member who has any doubt about the interpretation of professional guidance or its application in particular circumstances should normally seek advice from an actuary who has relevant experience in the first instance. If this would be inappropriate or if, having consulted such an actuary, the member has residual doubts about the course of action to be taken, the member must seek guidance from the professional body.”
- Due guidance and relevant information has been taken after discussions with the previous Appointed Actuary/ With Profit Actuary/ Independent Actuary/ seniors/ Independent consultant who have significant experience and can aide in exercising professional judgement on matters related to bonus declaration.

## Previous WPC and PPFM

- Previous WPC reports, past minutes of meetings and PPFM were referred to for understanding the company's existing practices regarding calculation of asset share, method to ascertain bonus earning capacity, sensitivity analysis of bonus rates, Policyholder Reasonable Expectation (PRE), treatment of FFA and other matters pertaining to participating business.

## Guidance Note 6

- GN6 provided recommended practices for the management of participating life insurance business with reference to distribution of surplus.
- We have abided by the recommendations of GN 6 by:
  - Grouping policyholders into homogeneous cohorts for the purpose of asset share calculation.
  - Calculation of asset share
  - Assumption setting & Expense allocations
  - Policyholder reasonable expectations and treating customers fairly

## Policyholders Reasonable Expectations (PRE)

- PRE is set by marketing literature, benefit illustrations, company's past and current practices, past bonus declarations and communications to the policyholders.
- While the benefit illustration and other marketing material provide a projection of future bonus rates, it is well communicated to the policyholders in the marketing literature that the bonus rates are linked to the financial performance of the insurance company and may change basis the insurer's discretion.

## Policyholders Reasonable Expectations (PRE)

- Section 4.3 of APS1 states, “Appointed Actuary must take all reasonable steps to ensure that new policyholders are not misled with regard to their expectations, e.g. in connection with illustrations at the point of sales.”
- Declaring current bonus rates to new policyholders may set a PRE that the company may not find sustainable for a prolonged period of time.

## Sustainability of Bonus Rates

- The par fund has been impacted adversely due to certain events such as global financial crisis, structural shift in interest rate regimes, demonetization and COVID-19.
- Declaring the same levels of bonus may lead to pressure on FFA, cross subsidy to various generation of policyholders. This may go against the principle of fair treatment of customers which asks equitable distribution of surplus amongst all policyholders.
- Having a cautious outlook for future events, the current bonus rates may not be sustainable over a prolonged period of time

## Bonus Earning Capacity (BEC)

- The asset share is calculated as at the valuation date on retrospective basis taking into account the actual experience and using the declared RB/CB rates.
- The asset share is compared against the maturity benefit payable to determine the bonus affordability of the participating fund by either projecting the asset share till maturity or by discounting the value of future benefits payable to valuation date.
- This is in lines with bonus philosophy of the company and recommendation for the method of calculation of bonus rates as per Guidance Note 6.

## APS 34

- Section 2.2 of APS 34 states that, "The actuary should have or obtain the knowledge and understanding of the data and other information available, including the relevant history, processes, nature of the business operations, law and business environment of the subject of the actuarial services, to be appropriately prepared to perform the actuarial services required by the assignment.
- Appropriate understanding about the data, relevant history and other concerned subjects have been taken from various documented material like previous WPC report, PPFM and from discussions with relevant actuaries.

# Case Study



Q2. What professional considerations would you adopt in responding to each of the comments raised during management discussions?

- “Are you saying the previous Appointed Actuaries didn’t do their job properly?”
- “We have been selling dreams and by cutting the bonus rates, you would be shattering those dreams”
- “Surely, if the Company has been able to sustain declaring these bonus rates for 25 years, we can do that in the future too”

i] “Are you saying the previous Appointed Actuaries didn’t do their job properly?”



*As per IRDAI Actuarial, Finance and Investment Functions of Insurers Regulations, 2024, Part II- Appointment of an Appointed Actuary, Powers, duties and obligations of an Actuary:*

- An Appointed Actuary is a qualified professional designated by the Competent Authority.
- All the reports and decisions had been reviewed by the management, Independent Actuary and Board. All past data checks and assumptions have been duly reviewed in accordance with the prescribed regulations.
- The previous Appointed Actuaries have performed due diligence and made decisions in line with the professional framework.

i] “Are you saying the previous Appointed Actuaries didn’t do their job properly?”

- Past bonuses had been approved by With Profits Committee. Prior studies had been thoroughly reviewed by the Peer Reviewer.

*As per APS 1 Section B.5, there is room for differences of opinion with regard to actuarial advice and judgement, they should always take care to respect the status of the Appointed Actuary.*

- The circumstances in which the previous Actuaries were operating versus the current circumstances have changed. These would have led to different decisions. Different conclusions do not imply misconduct. Different opinions are correct due to change in circumstances.

i] “Are you saying the previous Appointed Actuaries didn’t do their job properly?”

- The latest findings represent the fund's current position as assessed under the existing methodology, with a view to ensuring its long-term sustainability, fair and equitable treatment of all policyholders.

*As per PCS 6.1, Actuaries must ensure that their professional judgement is not compromised, and is not seen to be compromised, by any bias, conflict of interest or the undue influence of others.*

- An independent investigation has been performed by the current Actuary to ensure professional judgement is not compromised.

ii] “We have been selling dreams and by cutting the bonus rates, you would be shattering those dreams”

- The Appointed Actuary has to ensure financial viability of the product.
- If the correction is delayed, it will have significant financial implications on the company.

*As per APS5 Section C Point 9, the illustration of non-guaranteed or variable benefits shall be based on assumptions about future experience.*

- In case of a participating product, the insurance company sells both guaranteed and discretionary benefits. To ensure financial supportability and reviewing the change in current circumstances, the Appointed Actuary continues to maintain professional framework while ensuring the bonus reduction.

ii] “We have been selling dreams and by cutting the bonus rates, you would be shattering those dreams”

*As per APS 1 Section 4.2, if a significant change is likely, the Appointed Actuary must make sure that the company appreciates the implications of this on its policyholders’ reasonable expectations.*

- Policyholder reasonable expectations need to be aligned in accordance with financial supportability.

*As per APS 1 Section 4.3, the Appointed Actuary must take all reasonable steps to ensure that new policyholders are not misled with regard to their expectations, e.g. in connection with illustrations at the point of sales.*

- The Appointed Actuary needs to ensure that new policyholders are not misled in terms of illustrations. Realistic policyholder reasonable expectations need to be set.

ii] “We have been selling dreams and by cutting the bonus rates, you would be shattering those dreams”



- *Circular on Protection of Policyholder interests, 2024 states that under a benefit illustration for non linked par life products:*

*If your policy offers variable benefits, then the illustration on this page will show two different rates of assumed future investment returns of 8% p.a. and 4% p.a. These assumed rates of return are **not guaranteed and they are not the upper or lower limits** of what you might get back, as the value of your policy is dependent on a number of factors including future investment performance.*

iii] “Surely, if the Company has been able to sustain declaring these bonus rates for 25 years, we can do that in the future too”



- Past bonus reflects the past performance of the company. It is not a guide to the future performance. The allocation of bonus should be in accordance with the experience of the company.

*As per APS 1 11.4, The Appointed Actuary must discuss how the proposed allocation relates to the relevant experience. Also the Appointed Actuary must indicate whether continuation of the distribution policy is consistent with that proposed, will be sustainable. If it will not be, the Appointed Actuary needs to explain how this could be appropriately dealt with.*

iii] “Surely, if the Company has been able to sustain declaring these bonus rates for 25 years, we can do that in the future too”



- The participating fund has seen increased volatility in recent years due to a series of one-off events. Although episodic, such events are likely to recur and, owing to recency bias, exert a disproportionate influence relative to the company's 25-year track record. A recalibration of discretionary payouts is therefore necessary to ensure the company's long-term financial stability.

iii] “Surely, if the Company has been able to sustain declaring these bonus rates for 25 years, we can do that in the future too”



*As per APS 1 10.1, if, however, the solvency of the company is involved, then the Appointed Actuary must apply much more rigorous standards.*

- Rigorous actions of reducing bonus need to be taken to ensure stability of the company. Decreasing asset share leads to estate depletion eventually impacting solvency.
- The Appointed Actuary would also need to consider the extent to which smoothing may be applied to investment returns. As per Section C of GN6, the Appointed Actuary to continually look for ways to refine the way in which the asset share is being determined for each policy grouping, to ensure equity and fairness to policyholders and that the calculation method is robust.

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# Next Steps if management declines proposal



## Assess if situation threatens solvency

- It is the duty of Appointed Actuary to ensure that required level of solvency margin is maintained (Reference to 7(5) of Part II of Schedule I of IRDAI (Actuarial, Finance and Investment Function of Insurers) Regulations, 2024).
- The Appointed Actuary must assess whether the continued declaration of pricing level bonus rates materially threatens the solvency of the company

# Next Steps if management declines proposal



## Re-engage with management with data supplement

- Supplement the results of bonus supportability information
- Provide management with a view of future financial position in the scenarios-
  - i. Where existing level of bonus rates are declared
  - ii. Where the bonus rates are reduced
- Also provide them with a view of estate levels in both scenarios
- This might help executive management to better understand and evaluate the situation

# Next Steps if management declines proposal



## Re-engage with management with data supplement

- Present management with results of stress testing/ scenario testing and the resultant impact on various metrics.
- Demonstrate management through these analysis that sustained declaration of high bonus rates will lead to continued strain on estate, leading to estate run off and may eventually impact shareholder account.

# Next Steps if management declines proposal



## Re-engage with management with data supplement

- To explain management consequences of existing level of bonus rates-  
While it may help to meet Policyholders Reasonable Expectations, it might set an unsustainable PRE for future which will ultimately comprise with their interest and security.
- As per Section 7.12(vii) of Schedule I of IRDAI (Actuarial, Finance and Investment Function of Insurers) Regulations, 2024, it is duty of the Appointed Actuary to submit the actuarial advice in the interests of the insurance industry and the policyholders.

# Next Steps if management declines proposal



## Alternative Proposals

- Try to establish a common ground for bonus proposal
  - A gradual reduction every year which may be more sustainable than the current rates
  - Should be more agreeable to both management and policyholders
  - Maintains compliance with professional standards in respect of PRE
- Propose launch of new Par product where bonus rates reflect all experience changes. This will reduce the strain to the extent of future new business and participating fund.
- Optimize the Reversionary bonus and terminal bonus ratio in accordance with PRE

# Next Steps if management declines proposal



## Discuss with With-Profit Committee

- An independent actuary will be part of the With Profit Committee who will provide an independent opinion on the bonus rate declaration by assessing the existing level of funds and expected experience
- It is likely that independent actuary would have approved the calculation before Appointed Actuary went to management. If this is not done, the decision will be reviewed, and Appointed Actuary will have to justify the decision to Independent Actuary
- Hold a meeting of With Profit Committee and discuss the situation

# Next Steps if management declines proposal



## Decision and Documentation

- It is required by the master circular that in case any material differences remain unresolved between Appointed actuary and other members of With Profit Committee, the same should be documented in With Profit Committee report.
- The Appointed Actuary retains entire responsibility for his or her work in compliance with the Part-II of Schedule-I of IRDAI (Actuarial, Finance and Investment functions of insurers) Regulations, 2024 and in conformity with the provisions of the Actuarial Practice Standards/ Guidance Notes and Professional Conduct Standards of the IAI.

# Next Steps if management declines proposal



## Decision and Documentation

- The Appointed Actuary must therefore retain the final say on whether or not any element of his or her work needs to be changed as a result of the With-Profit committee report.

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# Professional considerations in effecting the cuts post management approval



- Approval does not change the professional duties – it moves the Appointed Actuary from advisory to implementation mode
- Appointed Actuary's professional and regulatory obligations encompass all stages from the approvals to policyholder communication to regulatory filings (PCS / APS1 / GN6/ WPC / AA Certification)
- Appointed Actuary shall consider additional independent review(s) given the materiality of the proposed changes
- Documentation & Audit Trail: Maintain robust evidence supporting advice, decisions, professional judgement, PRE considerations and fairness between policyholder cohorts.
- Ensure the changes reflect into future assumptions (Best Estimate assumptions & MADs) & disclosures (e.g. L42)

# Governance



- Detailed Impact Assessment: Shall be carried out prior to final board approval & implementation; shall fully capture & reflect
  - the dynamics and nuances of the extent of bonus reduction (across RB/TB, cohorts, phases) versus the corresponding supportability assessment; at-least the following
    - Financial (including full scale projections of Solvency, Estate, VNB, EV etc.)
    - Policyholder behavior (Impact/stresses on persistency)
    - Strategic implications (any changes in the product strategy & likely impact on business volumes for business plan; reputational implications and competitive positioning)
    - Include relevant stress/scenario analysis to provide the complete future view

# Governance



- Internal Governance: The implementation will be subject to review and approvals by internal management committees as applicable including Risk Management Committee (RMC), Product Management Committee (PMC) forums
- Board Approval: Formal approval of bonus rates and consideration of policyholder, solvency, PRE and communication implications.
- Product Governance: Assess whether revised filings or notifications are required under Product Regulations and applicable IRDAI circulars. Check compliance with the conditions in the Product Regulations 2024 e.g. For Non-Linked Savings Products - *“maturity benefit shall result in at least non-zero positive return”*. Assess BIs, sales material and disclosures to reflect revised bonus assumptions.

# Governance - Operational Implementation



- Ensure Bonus rate updates (including Interim Bonus) are carried out in consistent manner in different systems ( policy admin systems/claims management etc.)
- Ensure impact is flowing correctly to all the dependent benefits
- Perform appropriate UAT and independent validation before implementation; Reconciliation of sample policies before and after implementation.
- Ensure checks in place to eliminate the possibility of old bonus rates/BIs being furnished in the system post effective date
- FAQs and escalation protocols should be prepared before communication launch
- Grievance redressal system must be live before any communication is dispatched

# Governance - Policyholder Communication



- Ensure policyholder communication is Accurate, Clear, Fair, Timely, Individualised and Not Misleading, and compliant with applicable Policyholder Protection and PPHI requirements
- Provide an appropriate explanation of the factors leading to the bonus revision, in language understandable to policyholders; distinguish guaranteed and non-guaranteed benefits; explain that future bonuses remain subject to future experience; and accurately disclose the policy-specific impact (not a generic statement), where appropriate, illustrate the impact on key policy benefits (maturity, death and surrender).
- Content should be reviewed and approved by relevant actuarial, legal, compliance and business functions prior to release; all customer-facing materials must be consistent
- Distribution channels must be briefed, trained

# Additional considerations for Future Risks



- **Discontinuance & Liquidity Risk:** Assess potential impacts on lapses, surrenders, liquidity, ALM and Expenses of Management (EOM) through stress and scenario testing; Document material impacts on solvency, liquidity and surplus emergence; develop contingency plans where appropriate.
- **Mis-selling & Distributor Conduct Risk:** Monitor post-implementation persistency, lapse and surrender experience; Investigate material deviations and ensure distributor communications and monitoring remain appropriate.
- **Complaints & Regulatory Scrutiny:** *Establish enhanced monitoring of complaints, Ombudsman cases and social-media/reputational indicators;* Significant complaint volumes may attract increased regulatory scrutiny. *Review communications and policyholder treatment where material complaint trends emerge.*

**Thank You**

