2nd Capacity Building Seminar on INDAS for Life Insurance - IND AS 104

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IFRS 4-Phase I is "only" an interim solution

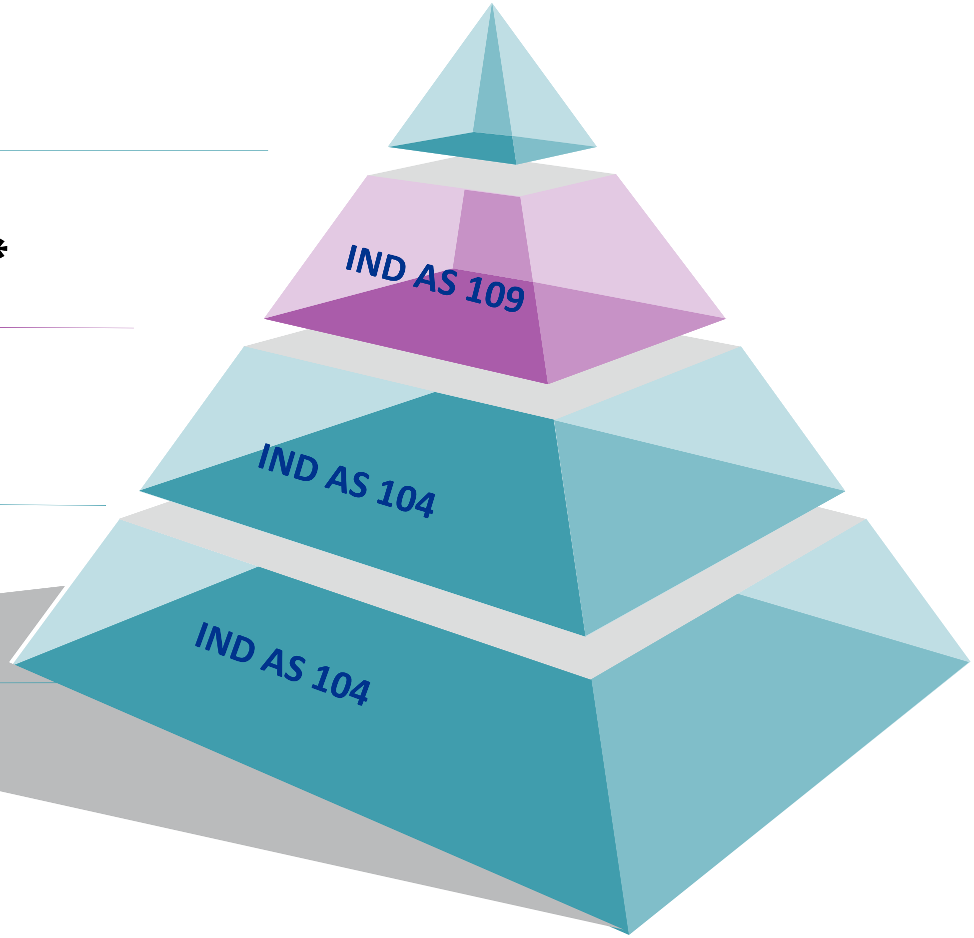
- IND AS 104/ IFRS 4 does not aim at an uniform accounting policy
- It does not provide detailed valuation requirements
- It aims pushing the accounting policy towards fair value (market value)
- It does allow to continue current accounting policy ("grandfathering")
- It introduces significant disclosure requirements
- The First Time Adapter has to decide how IFRS 4 is interpreted and accordingly introduced
- The concrete implementation of IFRS 4 is at the discretion of the insurer and his external auditor

As per IND AS 104, three different classes of contracts are distinguished

Investment contracts without DPF*

Investment contracts with DPF

Insurance Contracts



* Discretionary Participating feature

Insurance Contracts

An insurance contract is signified by acceptance of significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

Significant insurance risk	Compensation
Uncertain future event	Adverse effects on policyholder

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- **No Guidance on 'Significance'**
- **Sufficient Probability of Occurrence and magnitude of effect**
- **Contract Level**
- **Inception of the contract**

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- **Occurrence**
- **Timing of Occurrence**
- **Magnitude, given event occurred**

Investment Contracts

- Investment contracts are contracts which bear significant financial risk, but have no or no material significant insurance risk. Those contracts can be either

  – investment contracts with DPF
  or,
  – investment contracts without DPF

- Financial risk is the risk of possible change in one or more of the following:

Interest rate	Foreign exchange rate	Commodity price	Price index	Credit rating	Credit index

Examples of Insurance & Investment Contracts for Life Insurance

Insurance Contracts:

- Traditional endowments financed with single or regular premiums
- Unit-linked endowments financed with single or regular premiums
- Term insurance contracts
- Immediate Annuities
- Deferred annuities with annuity rates fixed at inception;

Investment Contracts with DPF:

- Financial products with technical interest rates and annually determined participation, but with no significant insurance risk

Investment Contracts without DPF:

- Unit-linked contracts with no significant insurance risk

Unbundling of Contracts

Scenarios

Unbundling is required if both of the following conditions are met:

1. The insurer can measure the deposit component separately without considering the insurance component; and
2. The insurer's accounting policies do not otherwise require it to recognize all obligations and rights arising from the deposit component.

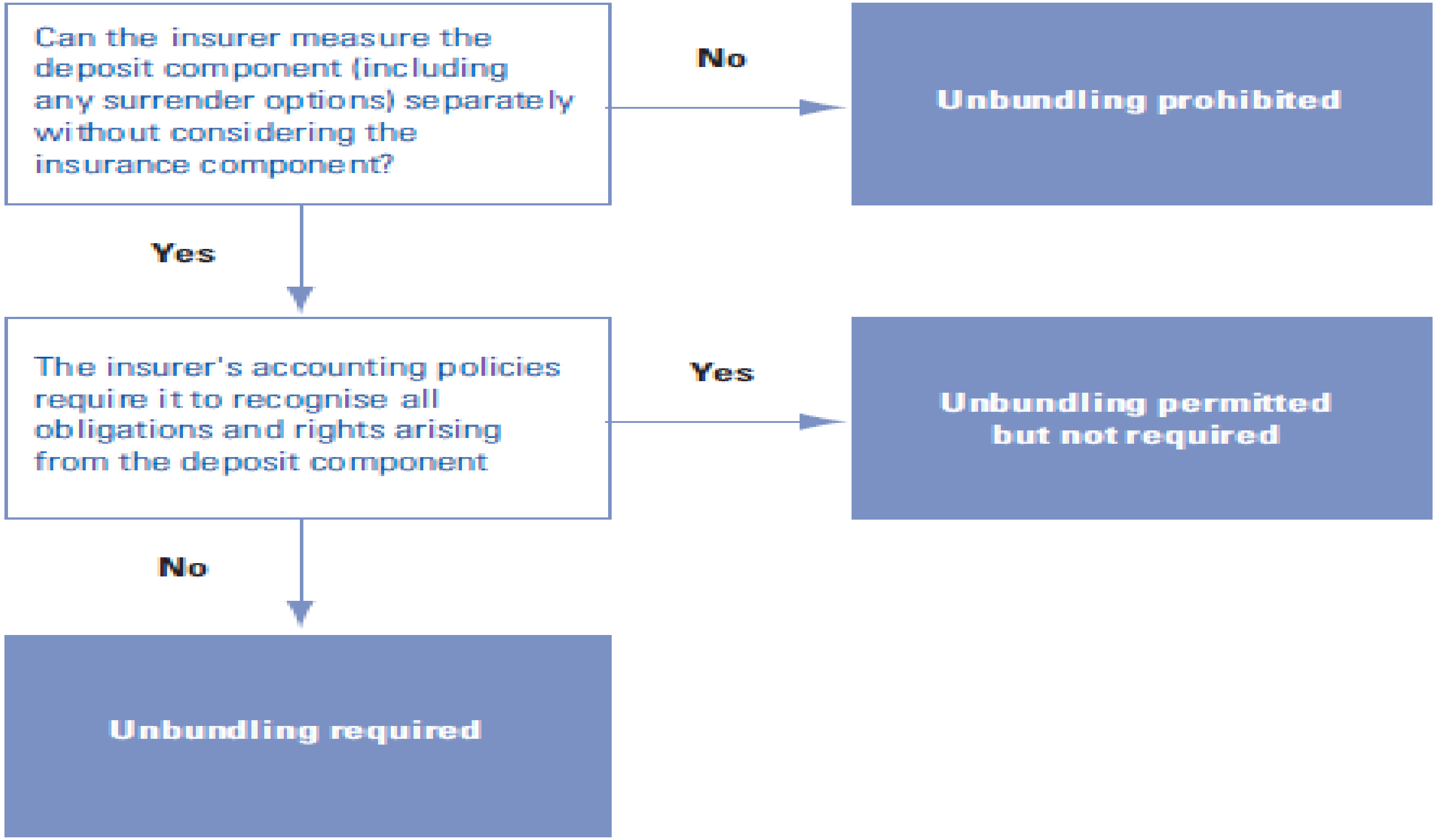
Unbundling is permitted (but not required) if:

1. The insurer can measure the deposit component separately from the insurance component, but its accounting policies already require it to recognize all rights and obligations arising from the deposit component

Unbundling is prohibited if:

1. The insurer cannot measure the deposit component separately.

Decision Tree



Embedded Derivative

Embedded Derivative

An embedded derivative shall be separated from the host contract and accounted for as a derivative under IAS 39 if, and only if:

1. the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;
2. a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
3. the hybrid (combined) instrument is not measured at fair value with changes in fair value recognized in profit or loss

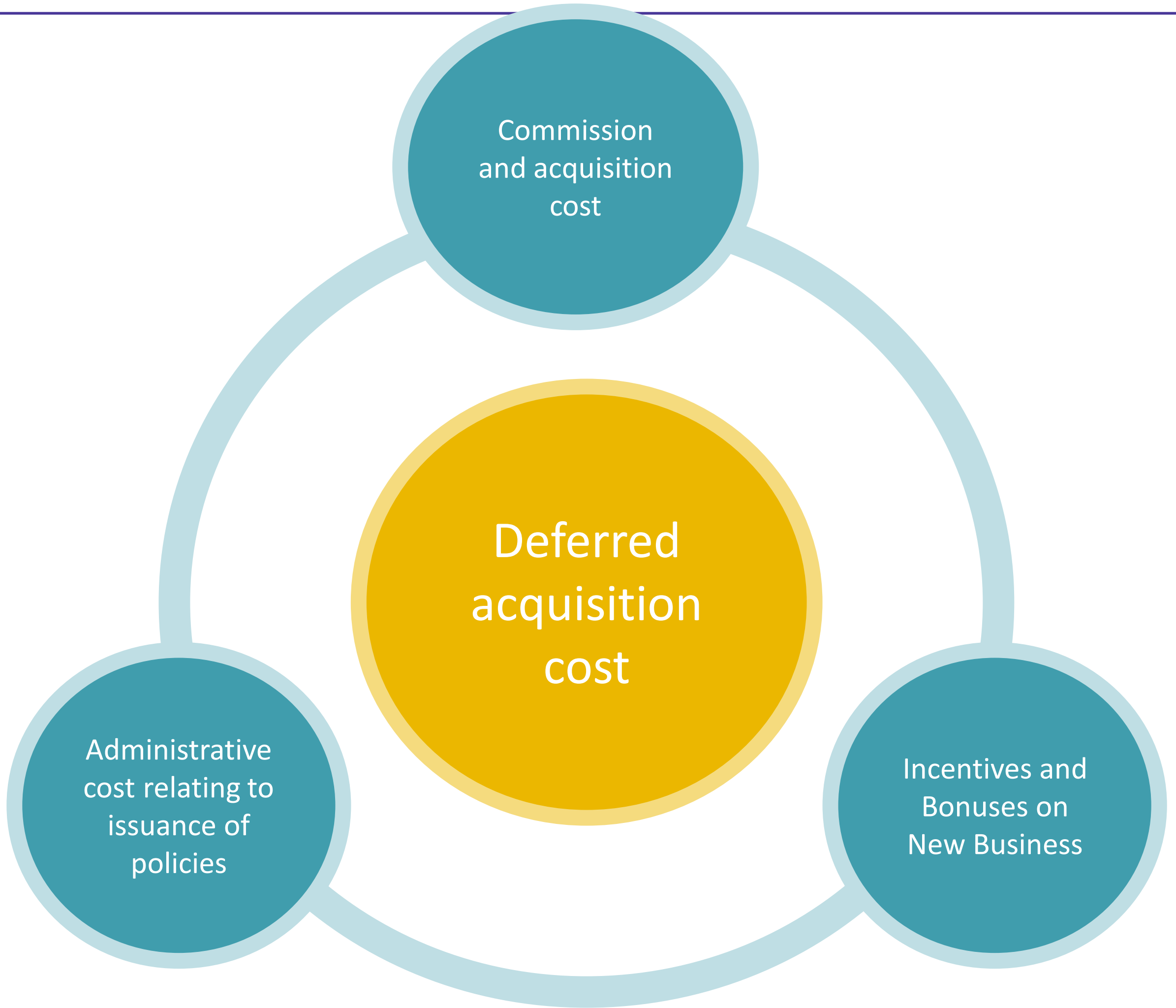
Embedded Derivative

Type of embedded derivative	Treatment	Reason
Death benefit linked to equity prices or equity index, payable only on death or annuitisation and not on surrender or maturity	Should not be separated from the host contract	Embedded derivative is itself an Insurance Contract
Death benefit that is the greater of: Unit value of an investment fund (equal to the amount payable on surrender or maturity); and guaranteed minimum.	Should not be separated from the host contract	Embedded derivative is itself an Insurance Contract
Option to take a life-contingent annuity at guaranteed rate (combined guarantee of interest rates and mortality charges).	Should not be separated from the host contract	Embedded derivative is itself an Insurance Contract
Embedded guarantee of minimum interest rates in determining surrender or maturity values that is at or out of the money on issue, and not leveraged	Should not be separated from the host contract	Doesn't satisfy point 1. The economic characteristics and risks of the embedded derivative are closely related to the economic characteristics and risks of the host contract
Embedded guarantee of minimum interest rates in determining surrender or maturity values: in the money on issue, or leveraged.	Should be separated from the host contract	Embedded derivative is not an Insurance Contract and economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract

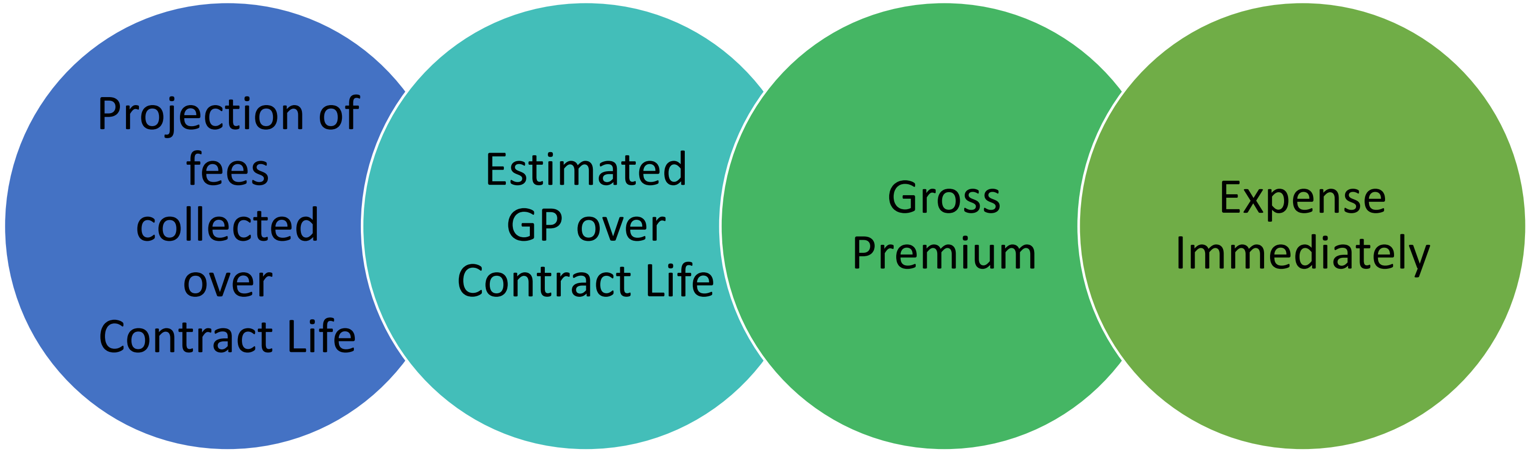
Deferred Acquisition cost

Deferred Acquisition Cost

- Cost of acquisition to be deferred against future revenue or investment margin.
- Valid if the reserves are calculated using NPV method.
- Statute requires Indian Insurance companies to value reserves using GPV method and hence may not be valid under existing regime.
- May be required to be created for Investment contracts.



Possible amortisation methods



Liability Adequacy Test

Liability Adequacy Test

- The Liability Adequacy Test (LAT) applies to
  - Insurance contracts and
  - Investment contracts with DPF
- An insurer shall assess at each reporting date whether its recognized insurance liabilities are adequate, using current estimates of future cash-flows under its insurance contracts
- Current estimates of all contractual cash flows means that all cash flows during the whole life time of the contract should be calculated at each valuation date using updated best estimate assumptions
- If the test reveals a deficiency, such is charged to Profit and loss
- Application of the test is at portfolio level provided the Insurance entity's accounting policy meets the minimum requirements

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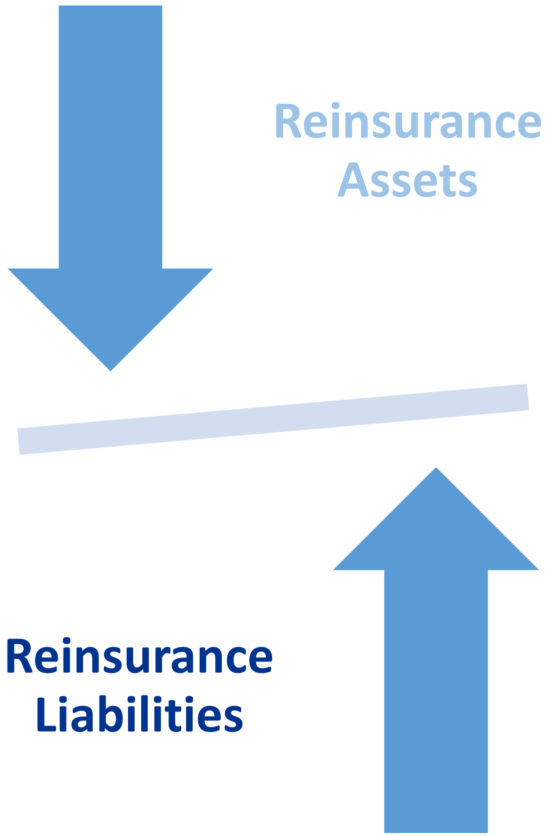
Reinsurance Accounting

Reinsurance Accounting

Offsetting not allowed:

- IFRS 4 specifically prohibits offsetting reinsurance assets against related insurance liabilities; and income or expenses from reinsurance contracts against expenses or income from related insurance contracts.
- Insurers are required to change existing accounting policies which allow for offsetting to comply with IFRS 4.



Impairment:

- An insurer is required to consider, at each reporting date, whether its reinsurance assets are impaired.
- The loss events described under IND AS 109 for the impairment of financial assets can be used as guidance for assessing the impairment of reinsurance contracts.

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Global Reserves

Global Reserves

- As per IND AS 104, the company shall not recognize as a liability any provisions for possible future claims, if those claims arise under insurance contracts that are not in existence at the reporting date.

- Hence, it is not allowed to have
  - Any provision that tends to act as an **Income smoothing mechanism**, reducing profits in reporting period in which Insurance claims are low and reducing losses in reporting periods in which Insurance Claims are high.
  - Any provision that has been kept **for improving the solvency position** of the Insurer or settlement of future claims, arising from insurance contracts which are not in existence at the end of reporting period.

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Disclosures

Disclosure Requirements for Life Insurance

- ✓ Detail information about insurance risk exposures, possible risk concentration and the impact of changes in key variables on the key assumptions used.
- ✓ Information about amount, timing and uncertainty of future cash-flows.
- ✓ Terms and conditions of contracts that have material; effect on the timing, amount and uncertainty of future cash-flows.
- ✓ Information about actual claims compared to previous estimates.
- ✓ Information about interest and credit rate risks.
- ✓ Disclosure of gains and losses from purchasing reinsurance contracts such as Profit commission.

Thank you