IndAS 104 : Practical Challenges; Important Decisions; Future Implications

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All views are that of the author

Building a better working world

Agenda

1. Contract Period
2. Classification of Contract
3. Unbundling
4. Technical Reserves
5. Reinsurance
6. Liability Adequacy Test
7. Embedded Derivatives
8. Shadow Accounting

Contract Boundary

- Why do we need? – Important when we look at the following contracts.

- Pension Contracts
- Yearly Renewable
- Life Health Insurance
- ULIP settlement Option
- Discontinuance Fund

Ind AS 104 does not specify any contract Boundary

Investment → Insurance

IFRS – Phase II
Contract boundary

Cash flows are within the boundary of an insurance contract when the entity can compel the policyholder to pay the premiums or has a substantive obligation to provide the policyholder with coverage or other services.

- Determination of the boundary of a contract:
  - Consider all substantive rights that are held by the policyholder, whether they arise from a contract, law or regulation
  - Do not consider restrictions that have no commercial substance
- Substantive obligation to provide coverage or other services ends when:
  - Insurer has the right or practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects these risks, or
  - both of the following criteria are satisfied:
    - Insurer has the right or the practical ability to reassess the risk of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio, and
    - the pricing of the premiums for coverage up to the date when the risks are reassessed does not take into account the risks that relate to future periods

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Steps to be followed for Classification

1. Identify the / an insured event
2. Determine that the insured event affects the insured adversely
3. Identify a scenario in which the insured event occurs
4. Ensure that 3. has commercial substance
5. Determine the amount payable by the insurer
6. Determine another scenario in which the insured event does not happen.
7. Ensure that 6. also has commercial substance
8. Determine the benefit under 7
9. Compare 5. and 8. If necessary, allow for time value i.e. compare actuarial equivalents
10. Test if 5. is significantly more than 8

Classification of contracts

Which type of contracts are these?

- ULIP:Pension:return of 105% premium or fund value on death
- ULIP:Pension:ADB rider option at policy anniversary
- Immediate Annuity for life; no death benefit
- Immediate Annuity for life at 5%; return of premium on death
- Group Gratuity with death benefit of 1000
- Reg Prem trad endowment; death benefit is annuity for return of premium @5%

Classification of contracts

Which type of contracts are these?

- Traditional Group Gratuity with interest declared in advance for a year/quarter
- Traditional Group Gratuity with interest declared in arrear at year/quarter
- Group Gratuity (Trad/ULIP) with guarantee of a floor of 11%
- VIP with accumulation account and NRY @ 3% on maturity. No death benefit.
- ULIP with a guarantee of 5% investment return applicable on death/maturity
- ULIP with no death benefit. ADB rider chosen and lapsed after one year.

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Unbundling – is it compulsory?

ULIP/VIP with Actuarial Funding where gap >0

Max NAV ULIP where current NAV<<Max

ULIP with x% return and guarantee is in money

VIP with return of prem guarantee and in the money

Phase II - Implication

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Technical Reserves: Are these allowed?

Data Inadequacy Reserve	Resilience Reserve	(Known/Unknown) Operational Risk Reserve	IBNR
Lapse/Revival Reserve	Discontinuance Reserve	UPR	AIDS/Cat Reserve
Closure to NB Reserve	Free Look Reserve	Options/Guarantee Reserve	Sub-Standard Life Reserve
Unmodeled Reserve	GSV/SSV Reserve	Exp Over-run Reserve	Sec 45 Reserve

Measurement – Can we change?

YES

Ind AS 101 – applicable for opening IFRS: It states-

An entity shall use the same accounting policies in its opening Ind AS Balance Sheet and throughout all periods presented in its first Ind AS financial statements. Those accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period, except as specified in paragraphs 13–19 and Appendices B–D.

An entity's estimates in accordance with Ind ASs at the date of transition to Ind ASs shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.

Measurement – Can we change?

An entity shall apply Ind AS 104 Insurance Contracts for annual periods beginning on or after date of transition to Ind ASs. Earlier application is encouraged. If an entity applies this Ind AS 104 for an earlier period, it shall disclose that fact.

When an insurer changes its accounting policies for insurance liabilities, it is permitted, but not required, to reclassify some or all of its financial assets as ‘at fair value through profit or loss’. This reclassification is permitted if an insurer changes accounting policies when it first applies Ind AS 104 and if it makes a subsequent policy change permitted by paragraph 22. The reclassification is a change in accounting policy and Ind AS 8 applies.

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Is liability adequate ?

1) In the money ULIP guarantees though the guarantees are applicable on maturity/death? {Max NAV, Capital, x% return etc}

2) Current assumptions -> maintenance expense over-runs [?]

3) Rural business – assumptions completely away from actual experience [?]

- Group Term/Health -> UPR even though current experience shows Prem<<Claims
- Participating business -> File & Use says payout x% of asset share though reserving explicitly does not reflect the same; Is TB assumption adequate? [This requires the test at the current assumptions – ie current interest rates for bonus and discounting]
- Rider reserve -> only UPR/claim is held though contract is long term and experience is adverse [?]
- Sub-standard life -> Only UPR is held; no experience data [Is LAT done?]
- NRY on ULIP/VIP

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Is it impairment?

- Gross Reserves and Reinsurance Asset:- Both on same assumptions – Actual experience is 50% IALM, 8% interest rate :: underlying assumption is 200% IALM and 5% interest rate
- Past experience – Reinsurance recovery 95% - future assumption 100% recovery ?
- Credit rating of reinsurer drops from AAA to AA+
- O/s Claim in dispute – Gross is full and Reinsurance Asset (recovery)
- Reinsurance contract in violation – reinsurance o/s asset {reinsurer needs to be notified within x days of claims}

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Are these embedded derivatives ?
Do we need to separate them?

An embedded derivative is a component of a hybrid contract that also includes a non-derivative host, with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

P/h benefits linked to underlying assets as in ULIP/VIP/Par [?]

Surrender/FreeLook Option – On ULIP; on fixed schedule, on par with a terminal bonus

Traditional insurance contract with implicit interest rate guarantee on maturity; Par with guarantee of x%

ULIP with a floor on investment return (0%, x% etc)

Are these embedded derivatives ?
Do we need to separate them?

Option to purchase a rider;

Option to extend the term of contract or buy a new contract

Max NAV/NAV guarantee on ULIP

Loyalty additions on ULIP (%of Prem, %of Fund)

Option to take DB\MB as lumpsum or annuity @ x% guaranteed rate

Option to take dividend as cash or deposit or SA increase

NRY on ULIP/VIP

Are these embedded derivatives ?
Do we need to separate them?

Settlement Option on ULIP

Gauranteed additions on Par

Paid up / Revival Option on all types of contracts

Switch/redirection options

Option to pay premium in advance / Premium holiday; Partial Withdrawal option

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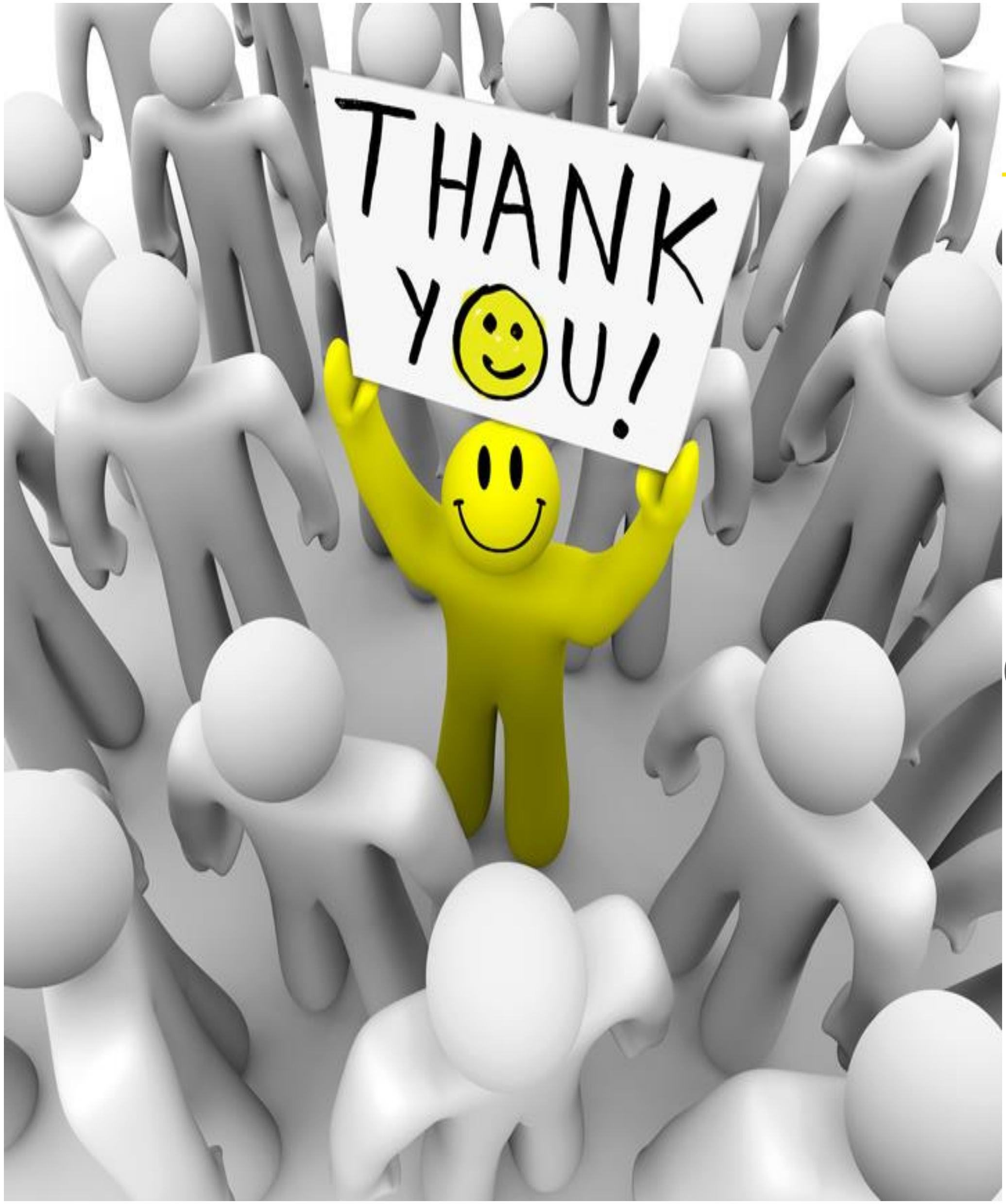
Shadow Accounting

Applicable if

“ realized gain/loss on asset have a direct impact on the measurement of liability”

If yes, then one has a choice to reflect unrealized gain/loss through shadow accounting (OCI)

Are there any liabilities where realized gain/loss has a direct impact on liability calculation ? {ULIP – but even unrealized have the same impact}



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