IND AS Industry Meet - General Insurance Council

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27th November 2024

Agenda

- Purpose of IND AS Industry Forum
- Way Forward
- Profitability Comparison b/w IGAAP and IND AS
- Level of Aggregation Considerations
- PAA Eligibility Challenges
- Comparison and Similarity b/w RBC and IFRS 17
- Challenges for Synergy

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Purpose

Key Objectives of the IND AS implementation Forum

- Establish consensus on interpreting grey areas in principle-based IND AS standards
- Facilitate collaboration and experience-sharing among industry participants
- Address teething issues in data gap and financial impact assessments, also extend co-operation during implementation stage
- Promote greater comparability in financial disclosures
- Streamline discussions with auditors to expedite decision-making
- Taxation related issues and representation at the industry level
- Disclosure requirements as per new IND AS Standards and subsequent changes in regulations/guidelines Management KPIs
- Management KPIs

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ONE IL Team

Way Forward: Suggestions

- Two Groups: Insurance and non insurance related
- Participation expected from all companies
- Regular meetings/discussions

Key Interpretation / Deliberation Areas

Serial No.	Key Areas
1	Level of aggregation and its possible impact on disclosures e.g., Motor OD and TP split as separate portfolio vs Motor Package Policy/Contract
2	PAA testing eligibility approach and considerations(Long-term Motor Third Party)
3	Onerousity testing and considerations
4	Coverage unit considerations and calibrations approach
5	Risk Adjustment approach and considerations
6	Discount rate and illiquidity premium calibration
7	Significant financing component criteria and calibration
8	Reinsurance profit commission recognition
9	Transition approach and data preparation
10	Financial format disclosures and alignment with LOA
11	Internal MIS reporting from IND AS results
12	Same basis for both IND AS and RBC
13	Source system data ETL and efficient data loading in to IND AS environment
14	Target Operating Model (TOM) architecture
15	Any Other Agenda

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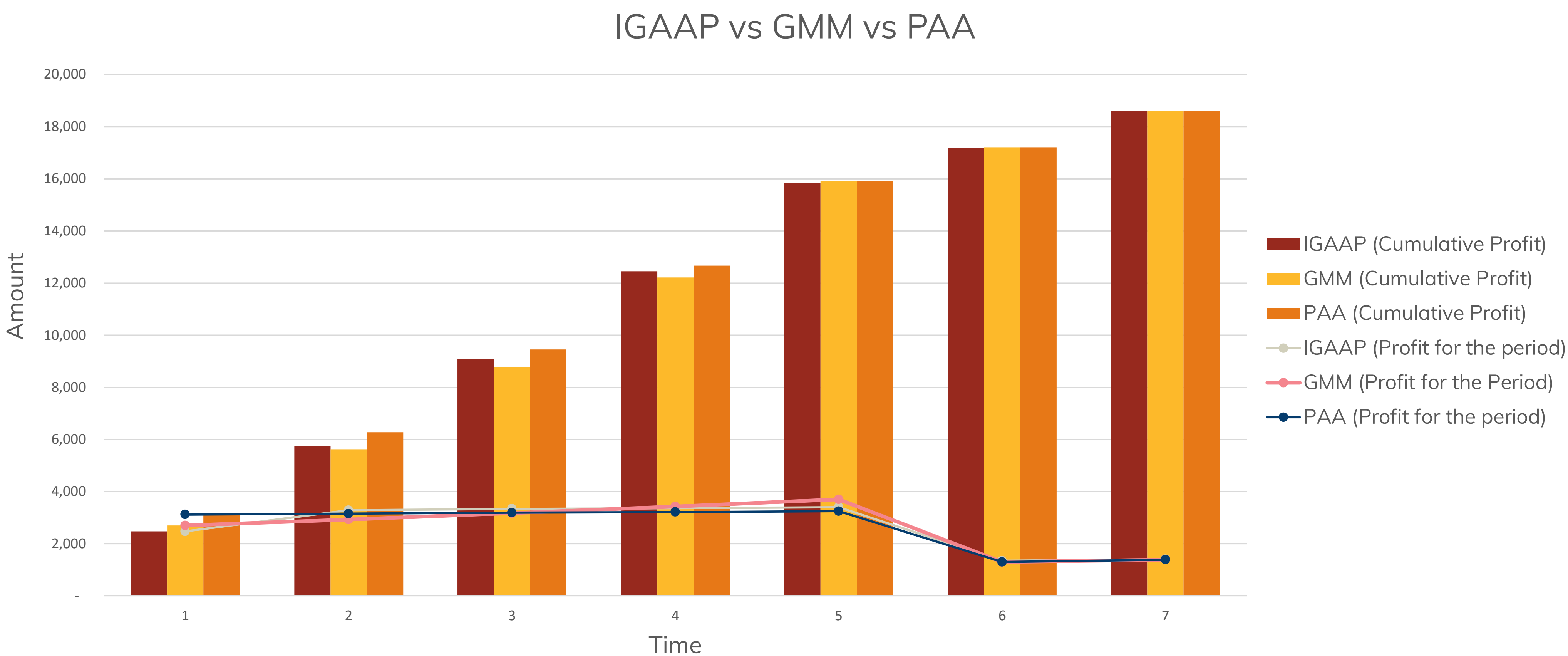
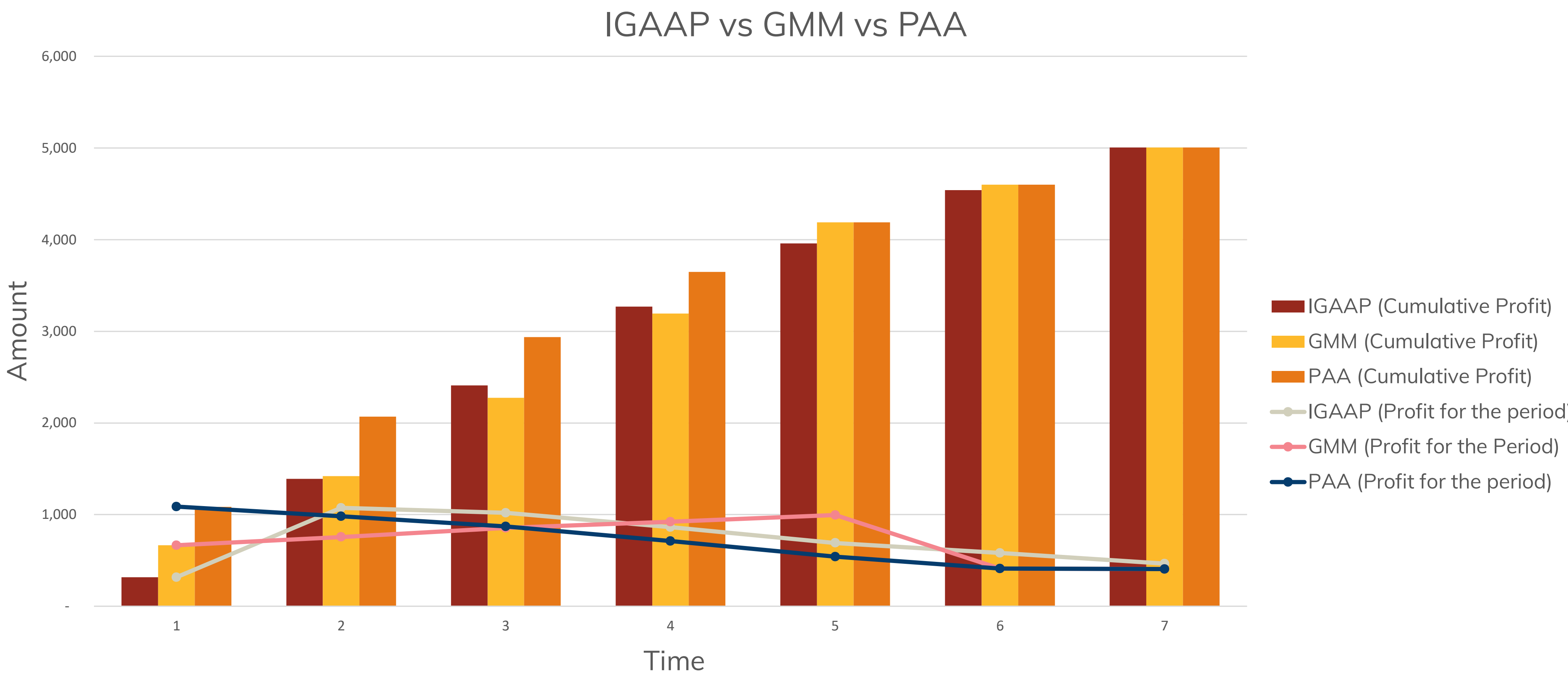
Profitability Distribution



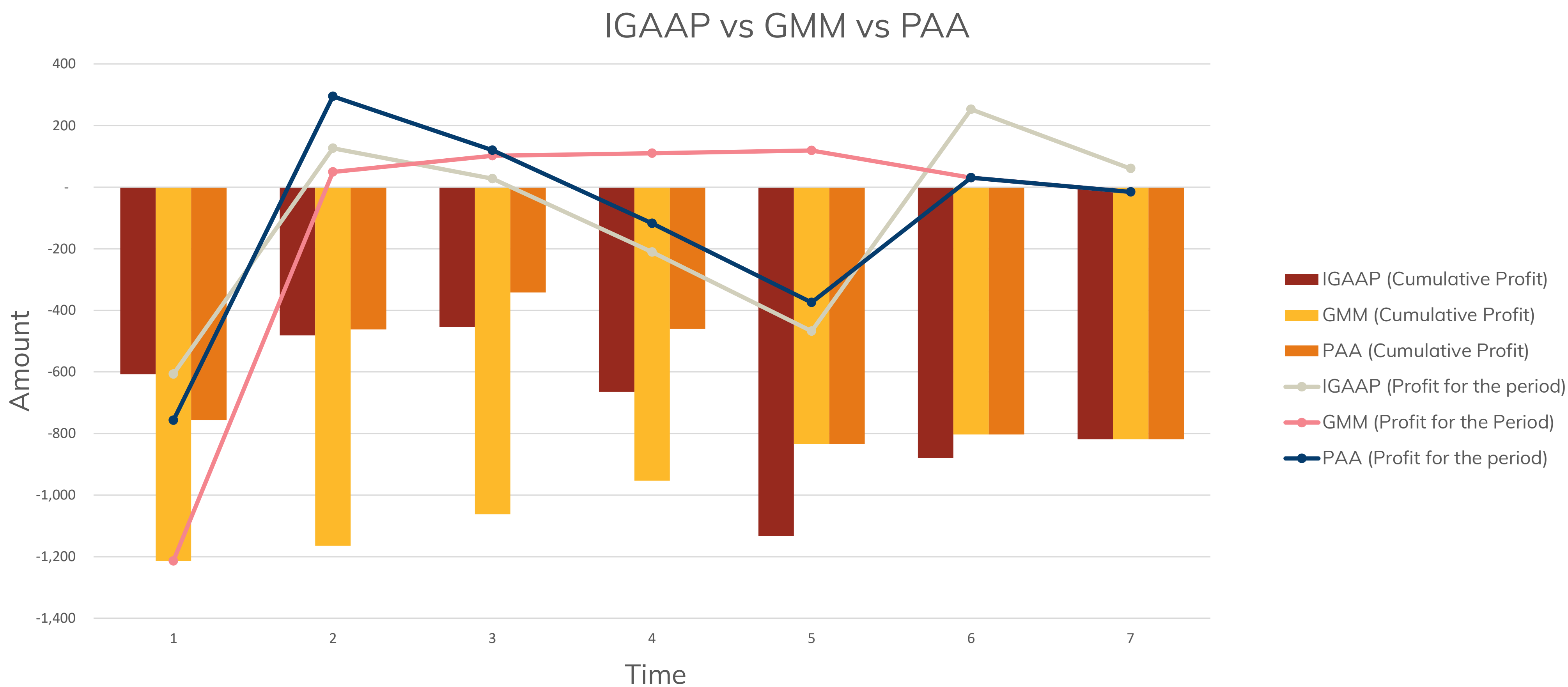
Assumptions –
1. Long Term Product 2. LR – 30% 3.Policy period – 5 years 4.RA – 5% 5.Discount Rate – 8%
6.Acq. Cost – 5% 7. 3-yr Claims Payment Pattern

Profitability Distribution



Assumptions –
1. Long Term Product 2. LR – 100% 3.Policy period – 5 years 4.RA – 5% 5.Discount Rate – 8%
6.Acq. Cost – 5% 7. 3-yr Claims Payment Pattern

Profitability Distribution



Assumptions –

1. Long Term Product 2. LR – 130% 3.Policy period – 5 years 4.RA – 5% 5.Discount Rate – 8%
6.Acq. Cost – 5% 7. 3-yr Claims Payment Pattern

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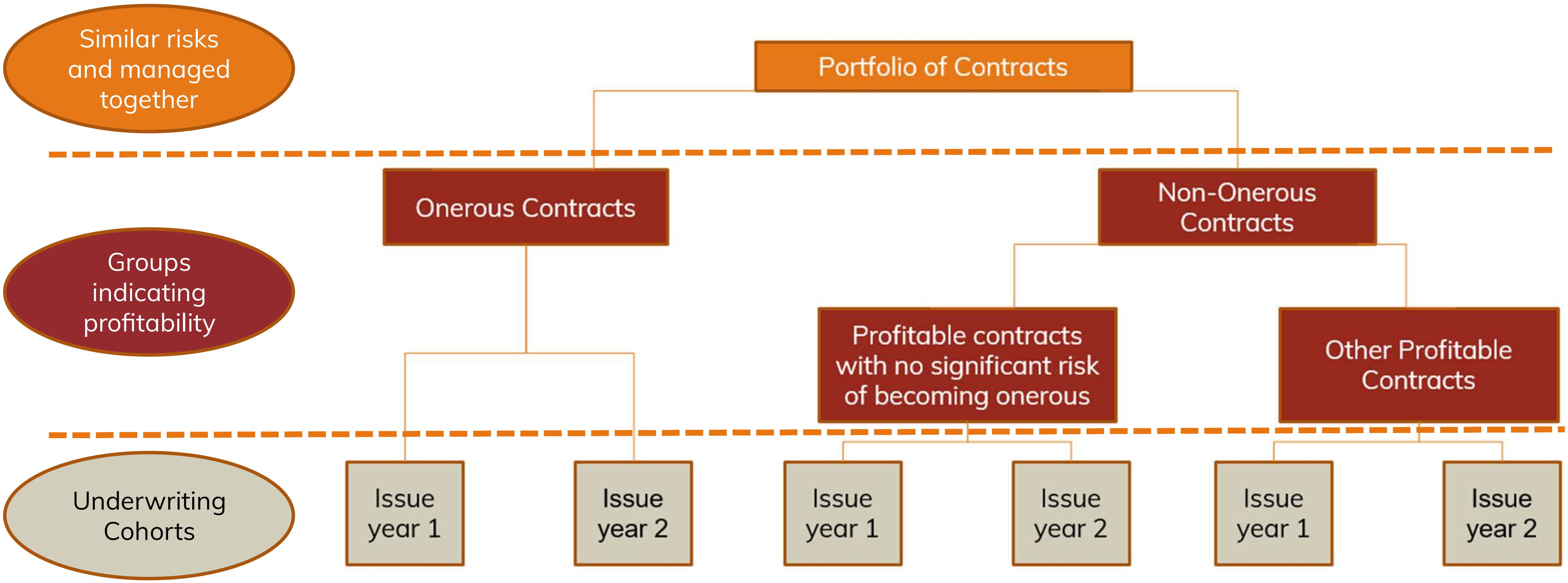
Level of Aggregation- Overview



Level of Aggregation

Motor OD-TP Split – ‘Similar Risk’

Arguments for Risk trigger, exposure

- Similar
  - Road Accident is the risk trigger
  - Mostly 1 year exposure
- Different
  - OD pertains to vehicle damage however TP exposure involves Death/Injury to others
  - Most occurrences don’t result into both OD/TP claim at same time
  - Frequency & Severity of Claims

Level of Aggregation

Motor OD-TP Split – ‘Managed Together’

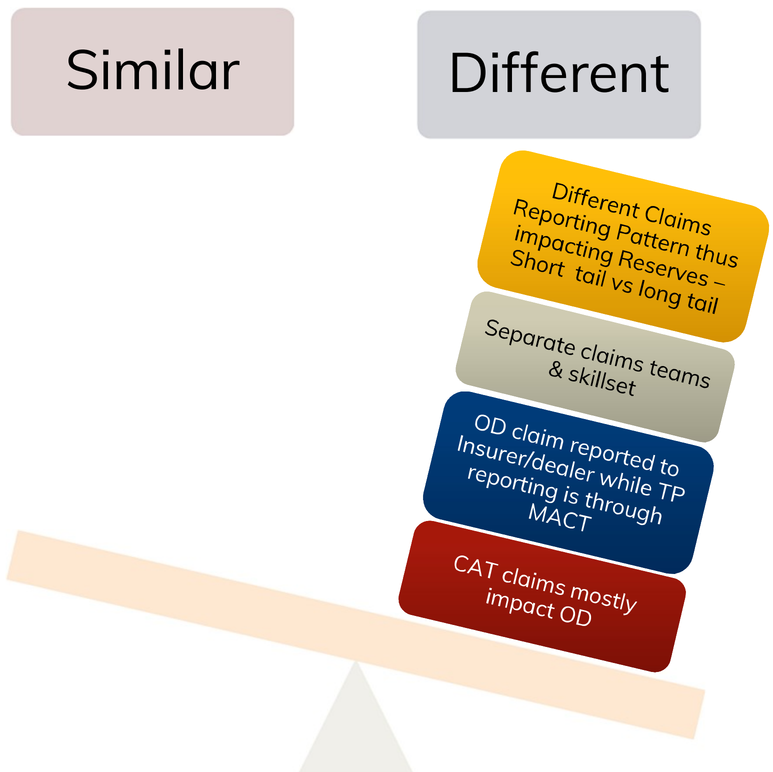
Arguments for Business Management

* While commission is different for OD and TP from market perspective for majority of the policies however due to new EOM regulations For insurer – the commission point can be tagged under Similar tab

Level of Aggregation

Motor OD-TP Split – 'Managed Together'

Arguments for Claims/Reserve



Level of Aggregation

Motor OD-TP Split – ‘Managed Together’

Arguments for Filings

Similar

- Majority business is comprehensive and hence filed as one product

Different

- Rating factors are different for OD & TP

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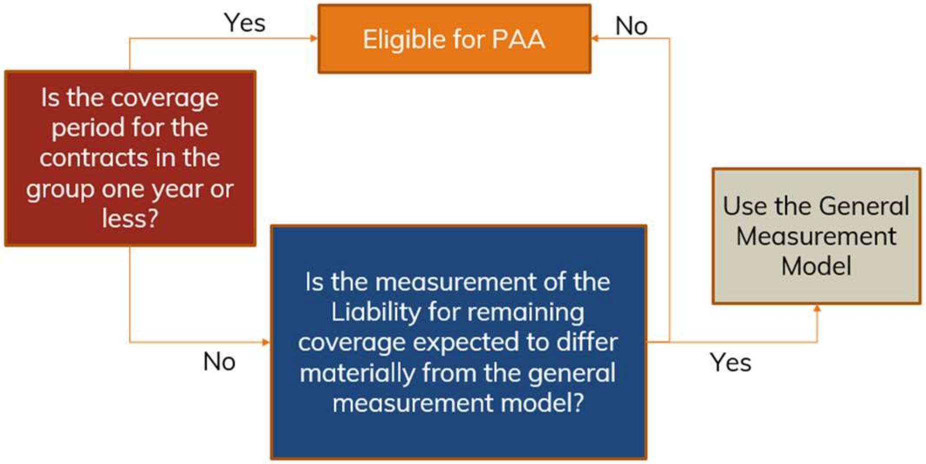
PAA eligibility testing- Criteria

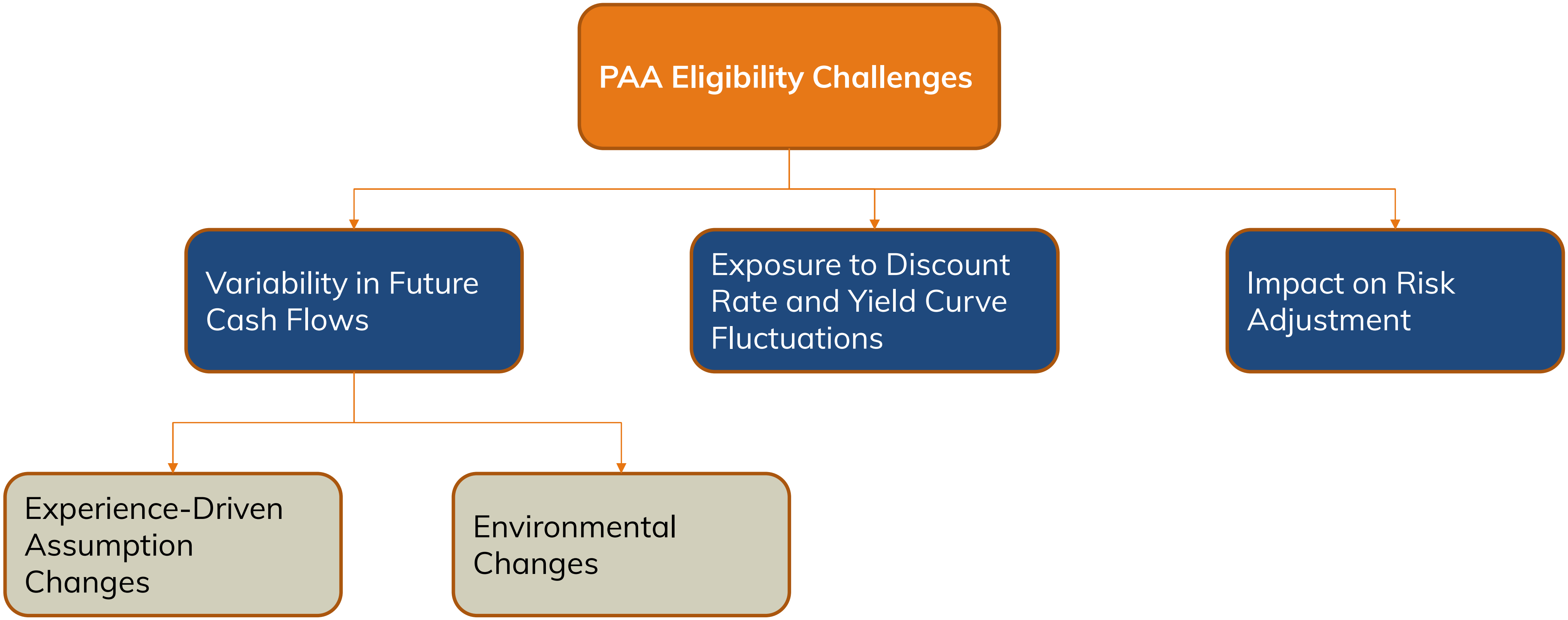
One of the following criteria has to be applicable for a group of insurance contracts to be PAA eligible –

- **Qualitative Criteria**
  - The contracts under the group should have a coverage period of less than 1 year.

- **Quantitative Criteria**
  - For group of contracts which have a coverage period > 1 year, the LRC_{GMM} should not be materially different from LRC_{PAA}.



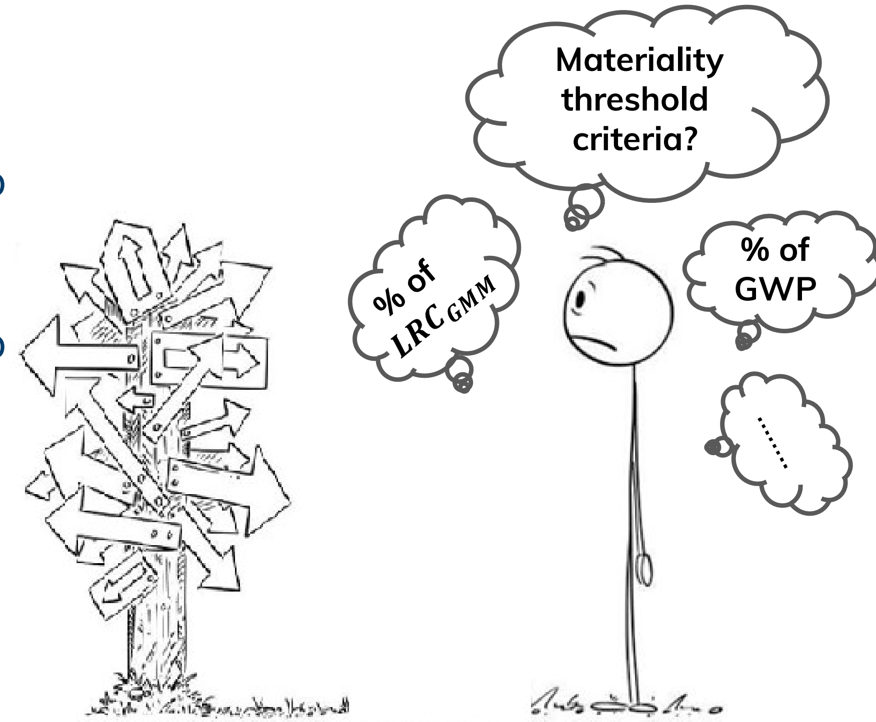
Long-Term Motor : PAA eligibility challenges



PAA eligibility testing- Quantitative Criteria

The following metrics could be used to check significant variability between LRC_{GMM} and LRC_{PAA} -

- $\frac{LRC_{GMM_t} - LRC_{PAA_t}}{GWP} < \pm\, Percentage\ Threshold$ for the Group
- $\frac{LRC_{GMM_t} - LRC_{PAA_t}}{LRC_{GMM_t}} < \pm\, Percentage\ Threshold$ for the Group
- $LRC_{GMM_t} - LRC_{PAA_t} < \pm\, Absolute\ Value$ for the Group



Materiality Thresholds by Regulatory Bodies

SEBI Listing Obligations and Disclosure Requirements

Minimum of

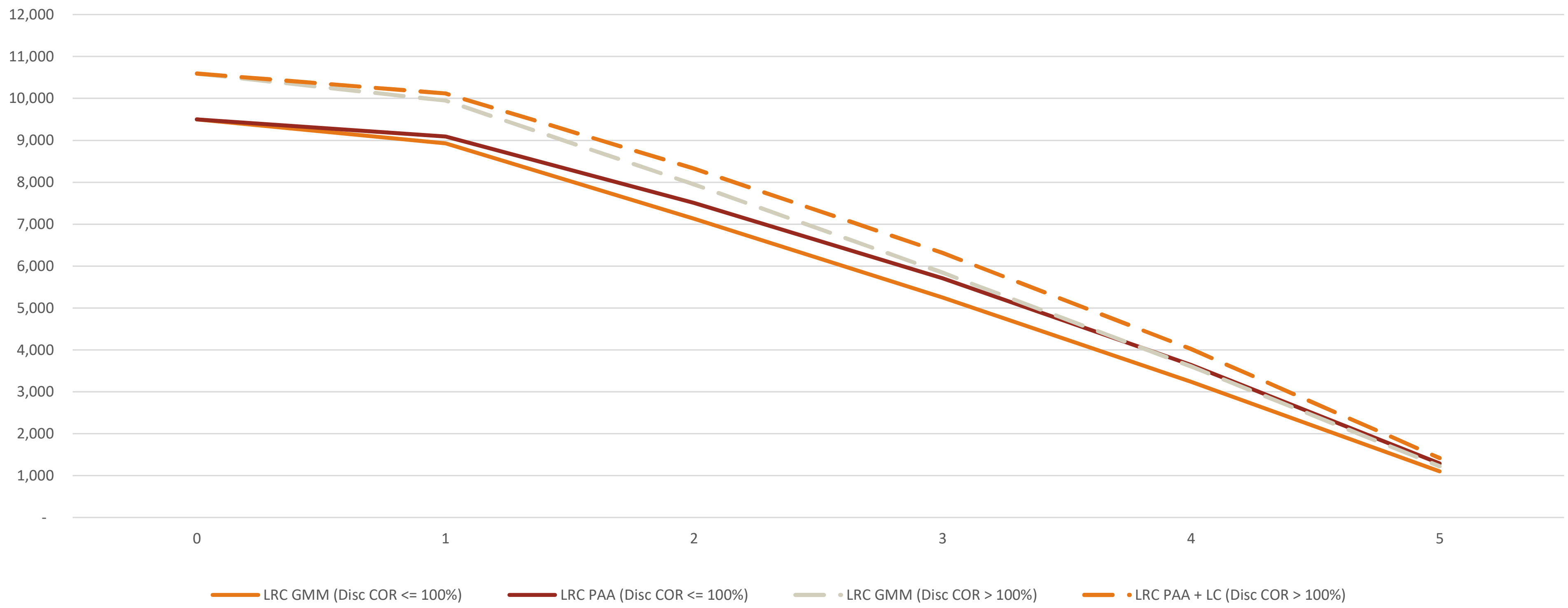
- 2% of turnover, as per the last audited consolidated financial statements
- 2% of net worth, as per the last audited consolidated financial statements
- 5% of the average of absolute value of profit or loss after tax, as per the last 3 audited consolidated financial statements

IRDAI Master Circular (17th May 2024)

If GWP from a new product exceed 10% of total GWP, report separately in financials

Capital Adequacy Ratio prescribed by **Reserve Bank of India** has to be maintained at 9% by Commercial Banks and at 12% by Public Sector Banks

LRC PAA vs LRC GMM : Illustration



Assumptions –
1. Long Term Product 2. LR (Disc COR < 100%) = 40% 3. LR (Disc COR > 100%) = 170% 4. RA = 5%
5. Acquisition Cost = 5%

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IFRS vs RBC Summary

<u>RBC</u>

- Determination of adequate capital requirements, given the risk profile
- Ensures solvency to meet financial obligations
- Emphasis on balance sheet for solvency purpose
- Policyholders & supervisors are the key stakeholders

- Market Consistent Valuation
- Improve Comparability and Transparency
- Improve Governance and Risk management

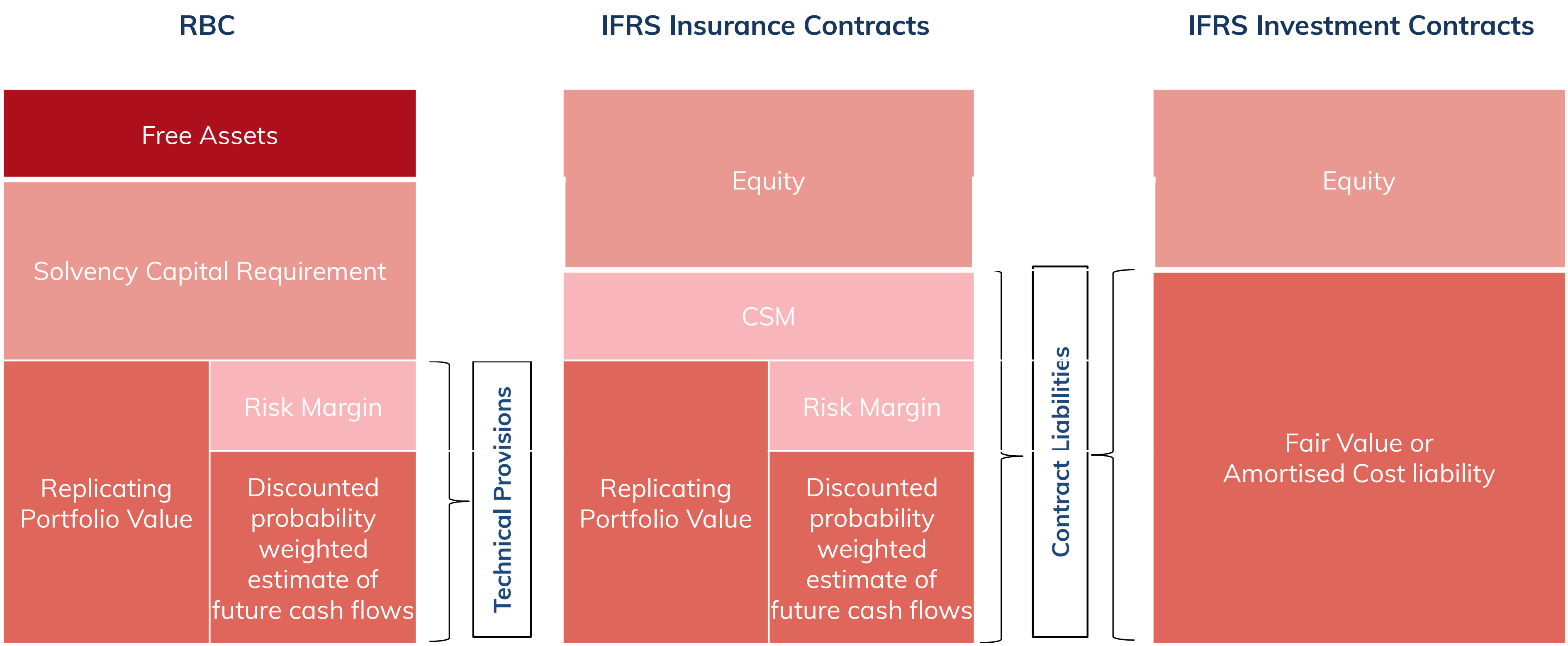
<u>IFRS</u>

- Disclosure of financial information basis principle-based accounting standards
- Helps market participants by enabling informed decision-making
- Emphasis on both income statement and balance sheet
- Investors and creditors are the key stakeholders

IFRS vs RBC Key Areas

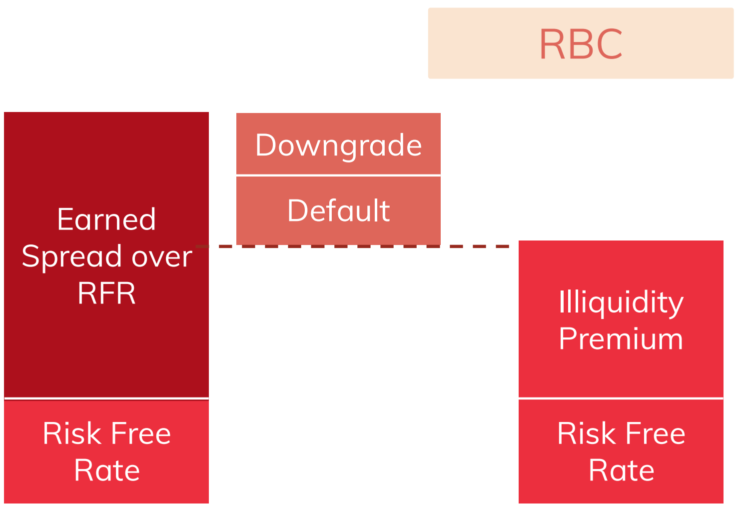
Area	RBC	IFRS	Observation
Definition and Scope	All contracts	Insurance and Reinsurance Contracts plus some participating investment contracts	• Direct and RI contracts need to be assessed separately whereas in RBC it is net of RI • In IFRS, participating contracts are not automatically in the insurance standard and • The measurement of investment contracts in IFRS is likely to be significantly different to RBC
Unbundling	Unbundling between lines of business	Unbundling of components required	• embedded derivatives, investment contracts etc. needs to be unbundled under IFRS17. • requirements to unbundle will have significant systems, data and process implications for some insurers. • Additional unbundling and reporting requirements, allocation of acquisition costs across unbundled components, complexity in processes and controls. • The requirement to unbundle components will have a significant effect on the emergence of profit due to the different measurement models applied to each component.
Cash flows	Prescribed, Going Concern basis	Incremental at portfolio level, Going Concern basis	• In RBC, Explicit guidance over which items to include for cashflow projections (premiums, benefits, expenses, tax etc) is given • Certain cash flows to be different between RBC and IFRS 17 e.g. Overhead expenses are excluded under IFRS if they are not attributable directly to policies. Similarly, acquisition costs not attributable to the contract level are excluded
Acquisition costs	Expensed as incurred	Contractual cash flows	• In IFRS, acquisition expenses identified at the individual contract level are implicitly deferred as a reduction to the liability • RBC takes a prospective view on risk – no concept of deferring revenue or costs over the life of the contract. • Hence, additional data and modelling required in IFRS as compared to RBC

IFRS vs RBC Contract Liabilities

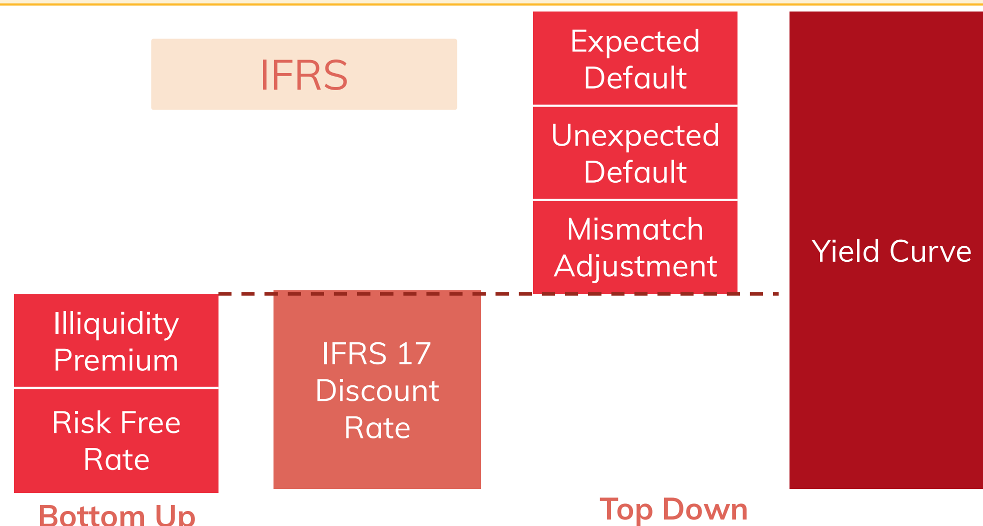


IFRS vs RBC Key Areas

Area	RBC	IFRS	Observation
Discount rate	Risk-free plus illiquidity premium	Risk-free plus illiquidity premium	• RBC is more prescriptive, where both RFR and illiquidity premium applied to all liabilities is prescribed ensuring sufficient capital to be held (mainly on prudent basis) • Discount rate in IFRS should be market consistent and should reflect specific characteristic of insured liabilities (mainly on fair value basis) in terms of duration & illiquidity



- Under RBC, Discount rate is derived as RFR + Deduction for credit default and basis risk + Illiquidity premium
- RFR is generally average yield of assets backing guaranteed liabilities
- Prescribed Method



- Under IFRS, discount rate is required to reflect the characteristics of the cash flows and the liquidity of the contracts consistent with the current observable market prices for instruments with cash flows which reflect the characteristics of the liability (e.g. timing, currency and liquidity).
- No Prescribed Method
- Can be determined using
  - Bottom Up
  - Top Down
- Both Approaches may produce different results

IFRS vs RBC Key Areas

Area	RBC	IFRS	Observation

Risk adjustment	Prescribed 6% cost of capital	One of three methods:
		Cost of Capital
		VaR
		CTE
			• IFRS permits one of three methods, while RBC prescribes a 6% cost of capital approach.
			• Diversification benefits:
			  • currently set at the entity level for RBC whereas at portfolio level in IFRS
			  • Hence, more diversification benefits will be permitted in RBC
			• RA in RBC factors the operational risks, default risk of the reinsurers whereas in IFRS only non-financial risks are considered
			• However, in both the cases no risk margin required separately when the technical provisions are determined as a whole using replicating portfolios.

CSM/Loss Component	No	Eliminate day-one Profit and recognizing the loss upfront	• The level of granularity required for the CSM/Loss Component calculation will impact modelling and data requirements.
Short duration contracts	Discounted basis with Risk margin for both claims outstanding and premium provision	Unearned Premium Reserve	• For IFRS, the Unearned Premium Reserve (UPR) model is mandatory for pre-claim liabilities with an onerous contract test at the portfolio level. There is no equivalent concept in RBC

IFRS vs RBC Key Areas

Area	RBC	IFRS	Observation
Tax Cashflow	Prescriptive	As per IAS 12	• In RBC, only tax payments that are charged to policyholders, or required to settle the obligations are included under the cashflow. All other tax payments are included elsewhere on the balance sheet • Whereas in IFRS, Income tax payments and receipts are recognized and measured under IAS 12.
Deferred Tax Asset/Liability	Same as IFRS but on solvency valuation basis.	As per IAS 12/Accounting Valuation basis	• DTA and DTL is created because of temporary differences between the valuation of asset and liabilities between IFRS base and taxation base. • Tax rate to be applied as applicable when the difference reverses • DTA should be recognized only where there is foreseeable future profits from which to make the deductions. • DTL needs to be recognised even when there are expected losses in future which could relieve the tax liabilities, Undiscounted basis • DTL and DTA are allowed to offset against each other only when there is a legal right and intend to realise the asset or settle the liability simultaneously. • In RBC, no DTA to be allowed which arise due to carried forward losses and it should not depend on any future profit emergence. • In RBC, DTA/DTL recognition test is performed, whereas in IFRS no such stringent requirements.

IFRS vs RBC Key Areas

Area	RBC	IFRS	Observation
Recognition/Derecognition	Recognised when the insurer is party to the contract		• In IFRS, A group of insurance contracts is initially recognized at the earliest of: - when the coverage period begins, - the date when the first payment from a policyholder in the group becomes due, or - when the group becomes onerous. • In RBC and IFRS , an obligation is derecognized when it is extinguished, discharged or cancelled or when it expires
Reinsurance	Net of reinsurance	Direct and Reinsurance separation	• Reinsurance recoveries against the gross cashflows are separately presented in the balance sheet. • The reinsurance related cash flows include the risk of nonperformance by the reinsurer, which is included on an expected value basis when estimating the fulfilment cash flows.
Portfolio Transfer	No such concept	Fair Value approach	• In RBC, all contracts are treated as organic, and follow the same recognition, measurement, and presentation approach. • Whereas in IFRS, in a portfolio transfer or acquisition, CSM of the insurance contract is calibrated to be the excess of the consideration received (portfolio transfer) over the BE plus RA. If BE plus RA is greater than the consideration received, then a loss is recognized, or goodwill is increased respectively.

IFRS vs RBC Key Areas

Area	RBC	IFRS	Observation
Goodwill on Acquisition	No such concept	Allows goodwill Recognition	• IFRS allows goodwill to be recognized as a specific asset • RBC proposes that no value should be attributed to acquired goodwill, given that goodwill is not considered to be an identifiable and separable asset in the marketplace. • RBC proposes that intangible assets are assigned a value, only where they may be fair valued under IFRS.
Financial Liabilities	Valued at Fair value	Valued either at fair value or at amortised cost	• Financial liabilities should be valued at fair value in conformity with IFRS upon initial recognition. Subsequent measurement should take account of differences in the risk-free rate but not the insurer's own credit standing. • Subordinated liabilities which satisfy the relevant requirements for recognition may be treated as available capital under RBC balance sheet. • IFRS proposes valuation will reflect the credit risk of the liability and therefore take account of the insurer's own credit standing. • IFRS recognises subordinated liabilities as financial liabilities.
Intangible Assets	Considered as Nil	Allows asset Recognition	• IFRS allows asset to be recognized when it is probable that the expected future economic benefits will flow to the entity and the cost of the assets can be measured reliably. • Initial measurement is at cost and subsequent measurement is either at cost model or Revaluation model. • RBC proposes that intangible assets are assigned a value, only where they are separable and where there is evidence of exchange transactions of the same or similar assets indicating that they are saleable in the marketplace.

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Challenges in Achieving Synergy

The are multiple challenges in achieving synergy between implementation of IFRS and RBC. Key Drivers are:

1. Objectives are different
2. Templatized calculation under RBC vs complete accounting overhaul under IFRS at the enterprise level
3. There are multiple nuances and subtle differences between the two which can't be achieved without transformation/adjustments
4. The key stakeholders are very different (regulator vs investors)
5. Prescriptive vs Principle based
6. Localized IFRS is not a possibility in India

THANK YOU