Level of Aggregation - Motor

- Updates on the GI Council representation to IRDAI on OD and TP reporting segments was provided to the forum. It was highlighted that the request made was to be aligned to the principle based standards and give flexibility to certain group of companies to report at segment combining OD and TP as they may be able to justify the combined OD and TP as one measurement group adhering to the principles of similar risks and managed together as majority of motor businesses are with coverages combining OD and TP at contractual level where all business decisions are taken at the contractual level only.
- The prescription of reporting segment at OD and TP separately indirectly implies a prescription of measurement group at least at OD and TP levels which defeats the flexibilities allowed under a open ended and principle-based standards.
- It was also highlighted that post 2023 implementations at Global level, it was noticed most of the direct companies have reported at combined OD and TP level driven by the OD and TP coverages provided at single contractual level.
- It was highlighted and discussed that the immediate clarity is required since it takes a significant effort and cost to configure policy choices in the system once finalized. The policy choice around the measurement group level is one of significant policy choices and any revision will lead to double cost and efforts.
- It was highlighted that the insurance companies can still make some theoretical allocations of the measurement results derived at combined level, if already done at the combined level, to the granular levels at OD and TP but in IND AS workings the theoretical allocations come out to be very absurd.

Level of Aggregation - Reinsurance-held contracts

- Discussion ensued on the challenges and benefits of segregating reinsurance treaties based on underlying lines of business. Especially the challenges on account of reinsurance commission structure dependent on the combined performance of all LOBs in a treaty.
- The advantages include enhanced performance evaluation through splitting treaties by gross business segments covered, supporting a more granular assessment of net liabilities.
- Conversely, the limitations associated with splitting the Unit of Account (UoA) in cases of interdependencies among data elements were addressed as highlighted in the point above.

- It was also highlighted the other option of defining the UoA at broad proportional and non-proportional categories combining all the proportional and non-proportional treaties under the respective buckets.

Contract Boundary

- The session addressed contract boundary implications for reinsurance contracts under Ind AS 117, presenting both the standard scenario and situations incorporating cancellation clauses.
- ICICI Lombard illustrated with an example demonstrating the distinction in coverage terms between direct insurance and corresponding reinsurance contracts. Furthermore, the potential impact of contract repricing on measurement was discussed.
- Contract boundary consideration for covers like Extended Warranty was also discussed.
- It was also highlighted with examples on special cases where the cessions were allowed retrospectively from the underlying contracts with risk start date far earlier than the reinsurance treaty start dates.

Significant Variability

- The seminar deliberated on the assessment of significant variability of contractual cash flows in the context of PAA eligibility testing. The discussion was primarily around whether Risk Adjustment, which forms part of fulfilment cashflows, brings enough stability while reducing the variability of cashflows. This topic was underscored as a key point raised by auditors and regulators, with terrorism and catastrophic coverage cited as a potential area exhibiting significant variability.

Discounting Practices

- Queries raised by auditors and regulators concerning the computation of illiquidity premium loadings were discussed, including the approach of applying individual loading factors for example, expected and unexpected default rates, versus an overlay on the risk-free curve.
- The possibility of adopting distinct discount rates for Liability for Incurred Claims (LIC) and Liability for Remaining Coverage (LRC) was also examined.

Non-Distinct Investment Component (NDIC)

- ICICI Lombard presented insights on NDIC in relation to reinsurance held contracts.
- Clarification was sought regarding whether minimum payout features constitute NDIC or can be classified as reimbursement of expenses.

- The matter of discounted NDIC was also discussed. The investment income is initially earned by the reinsurer in this case on NDIC which acts as a deposit till the time deposit amount is withdrawn back at the time of treaty closures.
- Additionally, considerations were shared on any potential implications of NDIC on capital requirements and risk charges under the Indian Risk Based Capital Framework (IRBCF). The topic was picked up as the NDIC gets deducted from both premium earning and expenses in the IND AS PnL statements leading to any possibility of reduction in the premium volume charges for the new RBC format.
    - Whilst discussing IRBCF in the context of IFRS, ICICI Lombard also covered an illustration showcasing impact of profit-sharing and stoploss arrangement on capital requirements.
- Further, ICICI Lombard also illustrated impact of Risk-Sharing & Surplus-Sharing arrangement in case of Crop Insurance (Cup & Cap Model - 80%-110% or 60%-140%), given that this mirrors the features of NDIC.

Materiality Considerations

- The session concluded with a discussion on critical judgment areas requiring materiality assessments.
- Emphasis was placed on revenue release patterns, Contractual Service Margin (CSM) coverage units, and the identification of significant financing components.
- The materiality assessment should consider whether the underlying item is a P&L item or BS item, accordingly the threshold should be benchmarked against any regulatory prescribed guidelines (e.g. SEBI, IRDAI)
- Materiality criteria could be applied at UOA level instead of underlying products, as products with significant contribution to a UOA (premium) would overall derive the UOA financials.
- Revenue Recognition (PAA): Release for risk could be a function of seasonal variation in sourcing of business, plus for long term products it could be function of varying sum insured (increasing / decreasing) over the policy tenure.

Questions and Clarifications

Audience were encouraged to sought answers to any questions/doubts they had regarding the agenda items. Some questions were raised which primarily focused on the combined UoA for Motor TP and OD, inclusion of risk adjustment in variability assessments, discounting methodologies, and NDIC treatment. Responses reflected the current stance based on ongoing audits and regulatory consultations

Conclusion

The seminar concluded with reaffirmation of the importance of precise UoA definitions and robust application of Ind AS 117 principles in reinsurance contract accounting. GI Council remains committed to engaging with auditors and regulators to address outstanding queries and facilitate