INSTITUTE OF ACTUARIES OF INDIA

EXAMINATIONS

29th November 2023

Subject CP3 – Communication Practice

Time allowed: 3 Hours 15 Minutes (10.15 – 13.30 Hours)

Total Marks: 100

INSTRUCTIONS TO THE CANDIDATES

1. ***Mark allocations are shown in brackets.***
2. ***Attempt all questions beginning your answer to each question on a new page.***
3. ***Attempt all sub-parts of the question in one document only, unless otherwise instructed to do so.***
4. ***Do save your work in solution template on a regular basis.***
5. ***All the detailed guidelines are available on exam screen.***
6. ***Please check if you have received complete Question Paper and no page is missing. If so, kindly get new set of Question Paper from the Invigilator.***

AT THE END OF THE EXAMINATION

Please return your answer book and this question paper to the supervisor separately. You are not allowed to carry the question paper in any form with you.

Q. 1) In a recent meeting conducted by the Insurance Regulator with the CEOs of the Insurance Companies, it was announced that the market will move from the current accounting regime to IFRS 17 effective 1st January 2026. Further, the regulator has asked all the Insurance Companies to appraise their Board of Directors about this during next Board Meeting.

You are the CFO of a mid-size General Insurance company. Post the meeting with the Regulator, the Company's CEO has asked you to outline the key changes from the current accounting regime to the proposed IFRS 17 and also to prepare a high-level implementation plan which can be presented to the Board.

This should be a high-level note as it will be briefly discussed with the Company's Board of Directors in presence of Statutory Auditors, hence the document should be crisp highlighting the key points which the CEO should take up for discussion. **[90]**

Your team has shared following information which they felt might be useful for you to prepare the note which the CEO can discuss during the Board Meeting.
(Please note the numbers in the description below are fictitious and are only for representation purpose).

Company background

Company came into existence in the year 2016 and since then has been operating in the non-life market. The key lines of business written by the company are Motor Third-party Liability, Motor Own Damage, Health, Commercial Property, Engineering and Financial Liability.

The Company has registered Gross Written Premium of ₹ 7,289 crores during FY 2022-23 with a business growth of 23.8% from previous year. 48% of the business is from Motor segment where Motor Own Damage and Motor Third Party liability have equal share.

The company ventured into Health insurance business just before the pandemic and the Company has touched ₹ 1,320 crores last year with more than the industry growth rate. Remaining business comes from Commercial lines.

Profit before tax was ₹ 391 crores.

Brief on IFRS 17

IFRS 17 requires companies to measure insurance contract on updated estimates and assumptions which reflects timing of cash flows and the uncertainty of insurance contracts.

IFRS 17 will apply to a range of different contracts, which fall under the following categories:

- Insurance and reinsurance contracts issued by the company.
- Reinsurance contracts held by the company.
- Investment contracts with discretionary participation features that it issues, provided that the entity also issues insurance contracts.

Measurement models – The new accounting standard prescribes 3 methods for the calculation of unearned liability:

a) **General Measurement Model (GMM) –** This is the default approach wherein liabilities are calculated allowing for the time value of money and present value of profits, called the contractual service margin is released over the life of the contract.

b) **Premium Allocation Approach (PAA) –** Simplified version of GMM, wherein if the contracts are of a shorter duration, then unearned liability is similar to the Unearned Premium Reserve approach followed in the existing regime.

c) **Variable fee approach –** It is applicable to contracts in which the entity shares the returns on identified underlying items with policyholders. In other words, this is a model for insurance contracts where the policyholders share in the profits and losses of the insurance company.

i) Key differences between the existing accounting regime and the proposed IFRS 17:

a) **Calculation of reserves and cashflows** - The reserves taken into consideration should be explicit, unbiased and probability weighted estimate of future cashflows. Currently, companies allow for implicit prudence margin.

Liability lines usually have longer claim development and settlement pattern as compared to the short tail lines of business and should be reflected in the cashflows accordingly.

b) **Discounting** – Currently the regulation does not allow explicit discounting of reserve. Under proposed changes, basis the nature of liability, the reserves will be discounted to calculate the present value of the liability resulting in the reduction of reserves as until now the liabilities are not discounted. Future cashflows can be discounted using a suitable discount rate derived using "top-down" or "bottom-up" approach. This is expected to have a positive impact on the P&L as this would lead to reduction in overall liability by ~8% to 10% thus impacting the P&L positively. This will primarily be on account of the lines with longer claim settlement as payments will be spread over 7 to 10 years resulting in a higher impact of time value of money.

c) **Risk adjustment factor** – This reflects the compensation that the Company requires for uncertainty and is an estimation for volatility in the underlying cashflows. It explicitly allows for any non-financial risk and will have to be calculated using statistical methods and it is expected to increase the prudence levels by 4% to 6%, hence decreasing the profit levels.

d) **Deferred acquisition cost** – Since we currently do not allow for the impact of deferring our acquisition cost this will result in a positive impact on P&L as profit emergence will be smooth over the life of the contract. This will lead to an upside of ~8% to 10% in the P&L.

e) **Onerous contracts** – The loss component pertaining to contracts which are expected to be loss making will be recognised on inception of the contract. Currently, this was not being done and will impact the P&L negatively as there are some contracts written by the company which are loss making and hence will result in a drop of profitability by ~2% to 4%

f) **Disclosure** – The new information requested will change the way how financial statements are presented and requires presentation of roll forward for Liability For Remaining Coverage (LFRC), Liability For Incurred Claims (LIC), cost of acquisition, loss component and other judgmental areas. Also, disclosures should be made separately for insurance contract issued and reinsurance contracts held.

Overall, it looks like that your company will be positively impacted by the change and will result in higher profits by 10% to 12%.

ii) High level implementation plan

a) Phase I – Impact and gap assessment

Approach

Financial Impact assessment study – this would illustrate the difference between the current accounting regime & the proposed accounting regime and its high-level impact on the financial statements of the company due to various changes in the accounting practices. At this stage the company would conduct a high-level assessment for eligibility of Premium Allocation Approach on the existing lines of business and would not do a detailed level of aggregation exercise. The gap assessment needs to cover business with at least 50% of Gross Written Premium. Also, there will be assumption made around policy choices which would then be referred in the next phase for finalisation.

Data gap assessment – this would illustrate the additions/ modifications that need to be made to fulfil the requirements of the new accounting regime at a high level. This would imply that data field wise analysis would not be carried out but an assessment of what are the data requirements of the new accounting standard and what are the corresponding missing elements.

Deliverables

An impact assessment report highlighting the key impacts on Profit and Loss account and the Balance Sheet of the company.

A data gap assessment report highlighting data, systems and processes that would require addition and modification.

b) Phase II – policy choices and implementation plan

Approach

Deep dive into each aspect of the standard such as level of aggregation, onerosity, eligibility test for Premium Allocation Approach, discount rates, risk adjustment factors, choice of measurement models etc.

Finalise the Company’s choice on each of the accounting, actuarial and technology aspect to begin the implementation phase.

Initiate assessment of vendor/ technology partner for implementation of the sub-ledger solution for IFRS 17.

Develop a detailed implementation plan and build on the target operating model along with the business requirement documents once the vendor/ technology partner has been on-boarded.

Deliverables

- Final policy papers highlighting the key choices.
- Decision on the IFRS 17 technology partner.
- Detailed implementation plan.

c) Phase III – Implementation plan

Approach

- Establish the sub-ledger vendor system solution.
- Build chart of accounts.
- Develop actuarial models.
- Develop reporting templates.
- Conduct User Acceptance Testing (UAT) on the models built and System Integration Testing (SIT) to ensure seamless flow of information from one system to another.
- Final dry runs to ensure the end-to-end process is completed seamlessly without any errors in numbers and breakages in system.
- Build the opening balance sheet with the policy choices made by the company and allow for the impact of transition on Shareholder equity.

Deliverables

- Document illustrating final chart of accounts and reporting templates.
- Report illustrating the outcome of UAT & SIT and changes that need to be made.
- Report illustrating the outcome of the dry runs and errors that need to be rectified, if any.
- Opening Balance sheet as it would be presented in the comparative financials.

d) Phase IV – Post implementation monitoring

Constant monitoring and tracking of results at granular level to ensure reporting is smooth and resolve any queries raised by recipients of the results.

Q. 2) While drafting your response above what are some of the terms which you considered as jargon and left out of your reply or explained in detail/ simpler language so that a non-actuarial/ non-technical person can understand them? **[5]**

Q. 3) Given that the CEO has asked you to prepare a crisp note, one way to make your communication effective is by leaving out some information which may not be relevant for the purpose of discussion. Explain what information you considered as irrelevant and did not use it in the note. **[5]**

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