# Financial Condition Report (FCR) for General insurance companies



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# Financial Condition Report

For the financial year ended: 31st March 20..

Of

(Name of the Non-Life Insurance Company)

By

(Name of the Appointed Actuary)


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## FCR Preparation

## I. The Objectives:

The objective of Financial Condition Report is to investigate the entire general insurance business carried on by the insurer as on the date of valuation and to report the strengths and weaknesses in terms of the risk the insurers carry with respect to meeting solvency requirements, profitability, liquidity, expense, investment return, asset-liability mismatch, insurer's future position, other risks-specific to the business etc.

This report shall specifically address:

a. The sensitivity of the future solvency position to potential changes in the economic environment, claims experience, pricing strategy and all other relevant factors, if any

b. Building of early warning signals to assess the financial condition

c. Comprehensive view on the company

## II Lines of Business

a. It is recommended that AA must necessarily analyze and comment on the following lines of business, as per IRDAI(Expenses of Management of Insurers transacting General or Health Insurance Business) Regulations, 2016:
   i. Fire;
   ii. Marine;
   iii. Health including Personal Accident:
      (a) Health Retail,
      (b) Health Group and
      (c) Health Government Schemes;
   iv. Motor;
   v. Miscellaneous:
      (a) Retail
      (b) Group / Corporate;
   vi. Any other segments which contributes more than 10 percent of the Miscellaneous class of business;
   vii. Any Other Class as may be specified by the Authority.

b. In addition, AA must analyze and comment on any product that is material from the perspective of financial condition of the insurer. For the sake of uniformity amongst insurers, a material line of business may be defined as under:
   - Motor Third party, whether written as part of a Motor package policy or Motor Act Only policy, regardless of the size, and
   - Any product which meets any one of the following criteria:

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    - It contributed to 5% or more of company's total GWP during the reporting period,
    - It contributes to 5% or more of company's NWP,
    - It contributes to 5% or more of company's Gross Incurred Claims,
    - It contributes to 5% or more of company's Net Incurred Claims. AND
  - Any other product or line of business which AA believes is material to the financial condition of the insurer.
  - AA may produce any other data or table that he/she believes aids in the analysis &/or presentation of financial condition of the company.

**III Instructions:**

A. The AA shall ensure the following:

   a. **Hard copy of Financial Condition Report along with the Board comments, duly signed by the CEO, Appointed Actuary and Mentor(if applicable), shall be submitted to the Authority within 30 days of Board meeting/ 30th of June, whichever is earlier. Also the soft copy of the said report, annexure of the report in excel sheets along with Annual Report(Table/Schedules in excel format) shall be sent to actuarial-valuation-nl@irda.gov.in**

   b. **The format and tables stipulated in this document shall be adhered to without any alteration. The fields which are not relevant shall not be left blank, but shall state "not applicable" or "NA".**

   c. **The numbers provided in the FCR shall be:**

      i. **Reconciled with the financial statements** of accounts and **IBNR**, wherever applicable.

      ii. **Provided in unit of thousands**

      iii. All outgo entries in the Annexure of FCR shall be shown in brackets ()

   d. **The chronological order in the LOB table shall be strictly followed.**

B. The Appointed Actuary (AA) shall provide detailed analysis along with the actions proposed, if any, on each section of the FCR.

C. The AA shall put his/her digital signature below each table.

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## Section 1: Executive summary

1.1 The executive summary shall summarize the report in a way so that the recipient of the report becomes acquainted with the large body of material to follow without having to go through it in detail.

1.2 The audience of FCR is Board of the insurance Company and the Regulator. This has to be borne in mind when the Executive Summary is prepared. The essence of the whole report needs to be succinctly captured in this section.

1.3 The Appointed Actuary shall explain the adequacy of reserving (i.e. IBNR, Outstanding Claims Reserve, Unearned Premium Reserve, Premium Deficiency Reserve, etc.).

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## Section 2: Financial Analysis & Future Projection

2.1 AA is expected to provide an enterprise level analysis of the current financial position and is expected to give a quick snapshot and set the context for the subsequent sections of the report

2.2 The following aspects are expected to be covered

a. Performance in the financial year
b. Financial analysis and comparison with what was budgeted – Income statement, Balance sheet and key ratios to be analyzed and actual versus expected analysis to be performed
c. Future projections (based on Management inputs)
d. Industry comparison – Key parameters to be benchmarked with industry information available as on date of preparation of report
e. Major events that had taken place during the year relevant to the operations of the insurer or the promoter companies (e.g. mergers, acquisitions, a new business activity, significant financial loss, changes in the company structure, etc.)
f. Financial highlights from the latest published financial statements of the promoter companies (assets, liabilities, profits for the year, etc.)

2.3 Format for the representation of company financials is given in the annexure III(a).



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## Section 3: Enterprise Business Analysis

In this section AA shall provide analysis on a more granular level including LOBs, Geography, Channel, Type of Customer (Retail/Commercial) or in any other manner deemed appropriate by AA so that the key issues are highlighted.

Analysis could pertain to:

3.1 Profitability – trends in ICR, COR, Expense ratio, Commission ratio etc. Comments if any on the expense allocation methodology may also be made in this section.

3.2 Reserve adequacy – Development of Ultimate Loss for an accident year over the next few years needs to be provided based on the data in the required format. Significant deviations (positive or negative) need to be explained.

3.3 Reinsurance structure including retention ratio. Comments on reinsurance arrangement for the next year (based on the proposed RI policy) need to be made. AA's views on changes in the proposed policy compared to previous year needs to be highlighted. A three year analysis of ceded business is needed.

3.4 Grievances – AA's comments on data on customer grievances and steps to be taken from a policyholder protection point of view needs to be emphasized

3.5 Sufficiency and quality of data : AA's comments on the sufficiency and quality of the data used in the calculation of IBNR and other reserves (including IBNER and PDR) where actuarial advice is sought by the Authority.

3.6 Data deficiency reserve: If the AA feels that there is a need to setup data deficiency reserve, comments about the same can be made in this section.

3.7 Consistency: AA's comments on consistency between pricing policy, underwriting policy and reserving policy of the insurer.

3.8 Appropriateness of methodologies: AA's comments on the appropriateness of the methodologies and underlying models used, as well as the assumptions made in the calculation of IBNR and other reserves (including IBNER and PDR).

3.9 Reliability and adequacy of calculation of IBNR: AA's comments on the reliability and adequacy of the calculation of IBNR and other reserves (including IBNER and PDR) where actuarial advice is sought by the Authority.

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## Section 4: Analysis of material lines of business (LOB)

4.1 A material line maybe defined as a LOB which is 5% of GWP, 5% of NWP, 5% of NIC of the reporting year or any other LOB which the AA considers to be critical to the company from an FCR point of view. AA's comments on the foreign operations of the company, if material, should also be included in this section based on the information available to him/her.

4.2 The following points may be included in the analysis pertaining to this section for each material LOB:

a) Growth over the years
b) Future projection
c) Business Mix
d) Loss ratio trends
e) Premium adequacy
f) Reinsurance policy
g) Reserving adequacy
h) Commentary on Expense Allocations, its appropriateness, compliance to IRDAI (Expenses of Management of Insurers transacting General or Health Insurance Business) Regulations, 2016 and Section 40B and 40C of Insurance Act.
i) Profitability
j) Renewal analysis(for retail lines)
k) Impact of the LOB on to the financial condition of the company

The table to be prepared is given in the annexure III(a)



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## Section 5: Investments& Asset Liability Management

This section should include AA's comments on the following:

5.1 Current investment portfolio and strategy being followed.

5.2 AA's comments on the proposed investment policy for the next year especially the changes in the policy compared to last year

5.3 Analysis of the portfolio from an ALM perspective as on 31st March

5.4 ALM to be done as on 31st March on a run off basis. Formats for ALM working to be added as per IRDA/ACTL/CIR/ALM/006/01/2012 dated 3rd January, 2012.

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## Section 6: Current & Future Solvency and Estimation of Economic Capital

6.1 This is a critical chapter wherein the AA is expected to discuss about the current and future solvency position of the company.

6.2 AA is expected to perform stress/scenario testing (which he/she deems appropriate from the company's point of view) to analyze the possible movement of solvency ratio at various levels of confidence.

6.3 The scenario/stress testing is expected to be performed on the business projections given earlier.

6.4 If the Authority prescribes any specific stress/scenario test to be done for all the players in the industry then that also needs to be included in this section.

6.5 AA shall estimate the Economic Capital as per circular IRDA/ACT/CIR/MIS/111/05/2011 dated 25th May, 2011 and submit the related disclosures.

Format to represent the results from scenario / stress testing is given in the annexure III(a).

Scenarios are to be explicitly mentioned by AA



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## Section 7: Risk Management

7.1 In this section, the AA shall focus on identification of potential risks faced by the insurer both on a gross and net basis in a comprehensive manner along with mitigation and impact on the company.

7.2 Ideally, the overall characterization shall include the various key risk accumulations, be they by exposure lines or operational units, etc., per the AA's discretion. In addition, shall characterize individually those accumulations that are material. For instance, Third Party exposure is a significant accumulation in its own merit for insurers that write Motor business. The AA shall opine how the overall risk characteristics of the insurer compare with the stated risk appetite approved by the insurer's board of directors.

7.3 The AA shall discuss the following point-wise

- The material lines of business written
- The material reserves arising from lines in run-off (if any)
- Key Risks
- Risk Concentration. Region wise, product wise, line of business wise, distribution channel wise, any other factor deemed material by the AA, etc.
- Key trends or factors that have or may have a significant impact on the financial condition of the company
- The impact arising out of the company's operational practices like discounts, response to market competition, reserving practices, catastrophes, business volume, etc.

7.4 Risk Characterization

The AA shall characterize the risk faced by the company with the help of:

- Accumulation of risk exposures under different categories that pose a material threat to the company's financial condition. To the extent possible, the risk categories should be mutually exclusive and jointly exhaustive but the over-riding factor is to include all groupings that can lead to a large scale impact on the company. The AA shall define the materiality of the groupings -- potential financial impact as a percent of net worth. Operational risk and Investment Risk shall be modeled independently from the underwriting exposure categories to the extent that their impact is not included in the underwriting groupings. For example, risks arising out of TPA operations could be included as part of the underwriting risk or separately as an operational risk



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- It is desirable that the AA augments his analysis by constructing a "variance co-variance" matrix and provide the basic statistical measures. Minimally, given the tail length of certain key category risks a multivariate log normal distribution can be modeled on the data.

7.5 Risk management and mitigation

The AA shall evaluate the capacity of the company to handle the underlying risk.

- An overview of the risk management functions with special focus on the chain of command employed in accepting and managing risks.
- Steps taken to understand the quantity of risk and risk appetite.
- The risk return trade-off guiding the company's underwriting and investing operations including the overarching characteristics of the implemented protection structure including reinsurance contracts.
- Risk monitoring procedures, review process and feedback loop.
- Contingency plans for emerging risks and the development of latent claims (if any).
- Development of necessary structural changes in pricing and reserving methodologies as a function of the risk performance of the company.

7.6 Sensitivity

At the enterprise level, the AA shall perform sensitivity analysis and present the results. Format is provided in the annexure III(a).

The AA shall define explicitly the base & the pessimistic scenarios assumed in arriving at the projections and discuss point-wise the following:

- The sensitivity of the business to the key risk exposures.
- The methods and assumptions used to assess the sensitivities.
- The sensitivity of the risks that have a significant impact on the solvency of the company

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## Section 8: Reinsurance

In this chapter the AA shall discuss the following

8.1 Reinsurance programme of the company in the past year and its adequacy.

8.2 Reinsurance programme for the forthcoming year.

8.3 Changes with respect to previous year's programme to be highlighted.

8.4 AA may also include a table along with details and analysis of treaties.

8.5 AA's recommendations.

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## Section 9: Comments of the Board of the Insurer and Actions taken Report

The insurer shall provide the following under this chapter:

9.1 The date and place of board meeting where the report was presented

9.2 Whether formally presented or tabled or sent by circulation

9.3 Comments of the Board and proposed course of action, if any on the any part of the FCR or issues raised by AA

9.4 If the presentation happens after the submission deadline then the board comments may be sent separately to the Authority



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## Section 10(a): Certification by Appointed Actuary & CEO

**AA Certification:**

"I, (name of AA), the Appointed Actuary of (name of insurer), hereby certify,

a) that I have complied with the provisions of the Insurance Act, 1938, Regulations, Rules and Directions of the IRDA;
b) that I have taken into account all contingencies appropriate to the business that is valued and that the assumptions employed in the valuation are appropriate;
c) that the mathematical reserves have been based on accurate data and have been calculated and reported accurately, subject to the following qualifications (list the qualifications, if any);
d) that I have calculated the Required Solvency Margin accurately; and
e) that the mathematical reserves along with the Required Solvency Margin make good and sufficient provision for all the unmatured obligations under the terms of the policies on the books of the insurer.
f) that this Financial Condition Report depicts the true underlying financial position of the insurer as on the Financial Year ending dd/mm/yyyy

Name of Insurer:
Name of Appointed Actuary:
Signature of Appointed Actuary:

**CEO Certification:**

I certify that full and accurate data has been furnished to the Appointed Actuary (name) for the preparation of this Financial Condition Report as on the 31st day of March of ---------.(date of investigation).

Name of insurer:
Name of the CEO:
Signature of the CEO:

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Place:

Date:

Company Seal:

## Section 10(b): Certification by mentor (if applicable)

**Mentor Certification (if applicable)**

"I, (name of Mentor), the Mentor of (name of insurer), hereby certify,

a) that I have reviewed the submission made by the Appointed Actuary.

b) that I concur with the aforesaid submission.

Name of Insurer:

Name of Mentor:

Signature of Mentor:

Place:

Date:

Counter signed by CEO:

Place:

Date:

Company Seal:



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# <u>GLOSSARY</u>

1. **Average Gross premium :** Gross premium / number of exposures

2. **Average net premium :** Net premium / Number of exposures

3. **Average Sum insured :** Total sum insured / Number of exposures

4. **Allocated loss adjustment expenses:** correspond to those costs that the insurer is able to assign to a particular claim.

5. **Combined ratio** : Net commission ratio + expense ratio + Net incurred claim ratio

6. **Claim Frequency :** Number of incurred claims / Number of exposures

7. **Claim Severity :** Gross (net) Incurred claim amount / Number of Incurred claims

8. **Closed claim without claim payment (number):** Includes all the claims that are closed without claim payment.

9. **Closed claim without claim payment (amount) :** (<u>**For the purpose of this report**</u>) includes claim amount of all the claims closed without claim payment exclusive of allocated loss adjusted expenses and these expenses should be included in the claims closed with payment (amount).

10. **Closed claim with claim payment (number):** Includes all the claims that are closed with claim payment.

11. **Closed claim with claim payment (amount): (<u>For the purpose of this report</u>)** includes claim amount of all the claims closed with payment inclusive of **allocated loss adjusted expenses of both claims closed with & without payment.**

12. **Expense Ratio** : Operating expenses / Gross written premium

13. **Exposures :** An **exposure** is the basic unit of risk that underlies the insurance premium

14. **Earned Exposure Year:** Exposure per unit of year of risk coverage.

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15. **Insurance profit** : Underwriting profit + Investment income on insurance funds

16. **Gross Earned Premium (GEP)** : Premium from direct business written + Premium on reinsurance accepted +/-Adjustment for change in reserve for unexpired risk **(Definition as per annual report)**

17. **Gross Direct premium:** Premium received from direct business written (including coinsurance premiums)

18. **Gross written premium** : Premium from direct business written + Premium on reinsurance accepted

19. **Gross claims paid** : Claim amount paid on direct business written + Claim amount paid on reinsurance accepted business

20. **Gross Incurred claim** : Claim amount paid (gross) + Claims outstanding (Inclusive of IBNR) amount at the end of the Financial Year (gross) – Claims outstanding (Inclusive of IBNR) amount at the beginning of the Financial Year (gross) **(Definition as per annual report)**

21. **Gross Incurred Loss Ratio** : Gross incurred claim / Gross earned premium

22. **Gross claims Paid Loss Ratio** : Gross claims paid / Gross earned premium

23. **Gross commission:** Commission paid on direct written business + Commission paid on reinsurance accepted business.

24. **Net Earned Premium (NEP)** : Premium from direct business written + Premium on reinsurance accepted – Premium on reinsurance ceded +/- Adjustment for change in reserve for unexpired risk **(Definition as per annual report)**

25. **Net premium** : Premium from direct business written + Premium on reinsurance accepted – Premium on reinsurance ceded **(Definition as per annual report)**

26. **Net claims paid** : Claim amount paid on direct business written + Claim amount paid on reinsurance accepted business –Claim amount received from ceded business

27. **Net Incurred claim** : **C**laim amount paid (net) + Claims outstanding (Inclusive of IBNR) amount at the end of the Financial Year (net) – Claims

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outstanding (Inclusive of IBNR) amount at the beginning of the Financial Year (net) **(Definition as per annual report)**

28. **Net Commission** : Commission paid with respect to direct business + Commission paid with respect to Reinsurance accepted – Commission received with respect to Reinsurance ceded **(Definition as per annual report)**

29. **Net Incurred Loss Ratio :** Net Incurred claim / Net earned premium

30. **Net claims paid loss ratio** : Net claims paid / Net earned premium

31. **Net Commission ratio** : Net commission / Net Premium

32. **Number of Incurred claims :** Number of settled claims (i.e. claims are closed with / without payment) + open claims

33. **Operating expenses** : As per Schedule 4 of the Annual Report

34. **Income from investments:** As per Revenue account of the Annual Report

35. **Premium deficiency reserve**: Premium deficiency shall be recognized if the sum of expected claim costs, related expenses and maintenance costs exceeds related reserve for unearned premium reserve.

36. **Retention ratio** : Net Written Premium/ Gross Written Premium

37. **Reporting Delay:** It is time from when the event occurs through to the time that the insurance company is notified of the event.

38. **Salvage and subrogation:** Salvage represents any amount that the insurer is able to collect from the sale of damaged property. Subrogation refers to an insurer's right to recover the amount of claim payment to a covered insured from a third-party responsible for the injury or damage

39. **Settlement Delay:** It is the time period between notification to the Company and the payment of the claim.

40. **Solvency ratio :** ASM / RSM (as per Regulations)

41. **Tail length** : Estimated time taken for settlement of claim from the date of loss occurrence

42. **Underwriting profit** : Net earned premium – Net incurred claims+/-Net Commission-Operating expenses

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43. **Unallocated loss adjustment expenses:** are the claim related expenses but cannot be allocated to a specific claim. Examples of ULAE include salaries, rent, and computer expenses for the claims department of an insurer.

44. **Unearned Premium Reserve (UPR):** A reserve for unexpired risks shall be created as the amount representing that part of the premium written which is attributable to, and to be allocated to the succeeding accounting periods and shall not be less than

    - Fire business, 50 per cent,
    - Miscellaneous business, 50 per cent,
    - Marine business other than marine hull business, 50 per cent; And
    - Marine hull business, 100 per cent,

    Of the premium, net of re-insurances, during the preceding twelve months;

45. **Unexpired Risk Reserve (URR):** The reserves in respect of the liabilities for unexpired risks and determined as the aggregate of Unearned Premium Reserve and Premium Deficiency Reserve.

**Note: Please note that the claims paid and reserves are inclusive of allocated loss adjustment expenses**

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