

10th Capacity Building Seminar in General Insurance

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Ind-AS 117 : Aggregation & Contract boundary in practice

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Agenda

- Level of aggregation
- Similar Risk and Manage Together
- Profitability and Annual Cohort
- Contract Boundary
- Lines of Business Considerations



A quick revision!!

Ind AS 117

Applicability

**(Re)Insurance Contracts
&
Investment Contract
with Discretionary
Participating Features**

Practical Requirement

Aggregation

- Portfolio of IC (PIC)
- Group of IC (GIC) within PIC

Principle Objective

- Limit offsetting impact of loss making IC
- Report profit in appropriate reporting periods

- Insurance Contracts (IC) → *transfers significant insurance risk to the entity*

Level of Aggregation

Level of aggregation – Portfolio of Insurance Contracts

– A portfolio of insurance contracts (PIC) is aggregation of insurance contracts subject to:



- *Similar Risk & Manage together* - no clear definition provided under standard.
 - Insurance contracts within the same product line expected to have similar risks
 - Managed together require understanding on usual business practices

Para 14 : “An entity shall identify portfolios of insurance contracts. A portfolio comprises contracts subject to similar risks and managed together. Contracts within a product line would be expected to have similar risks and hence would be expected to be in the same portfolio if they are managed together. Contracts in different product lines (for example single premium fixed annuities compared with regular term life assurance) would not be expected to have similar risks and hence would be expected to be in different portfolios”

Para 16 : “An entity shall divide a portfolio of insurance contracts issued into a minimum of:

- a) a group of contracts that are onerous at initial recognition, if any;
- b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any;
- c) and a group of the remaining contracts in the portfolio, if any”

Para 22 : “An entity shall not include contracts issued more than one year apart in the same group”

Poll Question!

Similar Risk

Which risks amongst the below shall be taken into consideration when determining whether or not the contracts entails a similar risk?



Insurance Risk

Expense Risk

Lapse Risk

All of the Above

Similar Risk

While evaluating whether the contract has similar risk or not, which all risk will be considered ?

Insurance Risk

Expense Risk

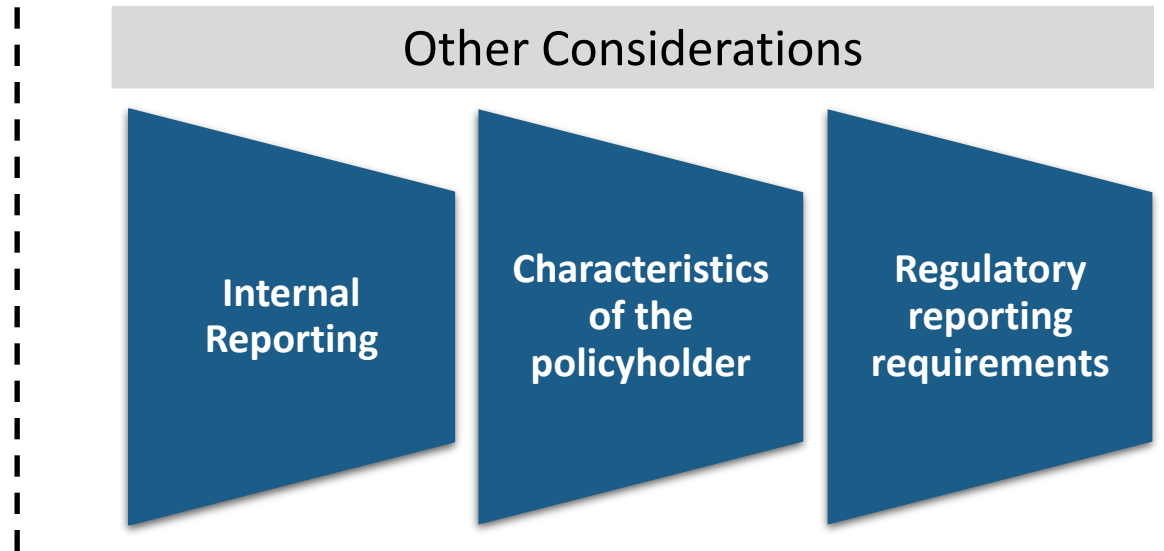
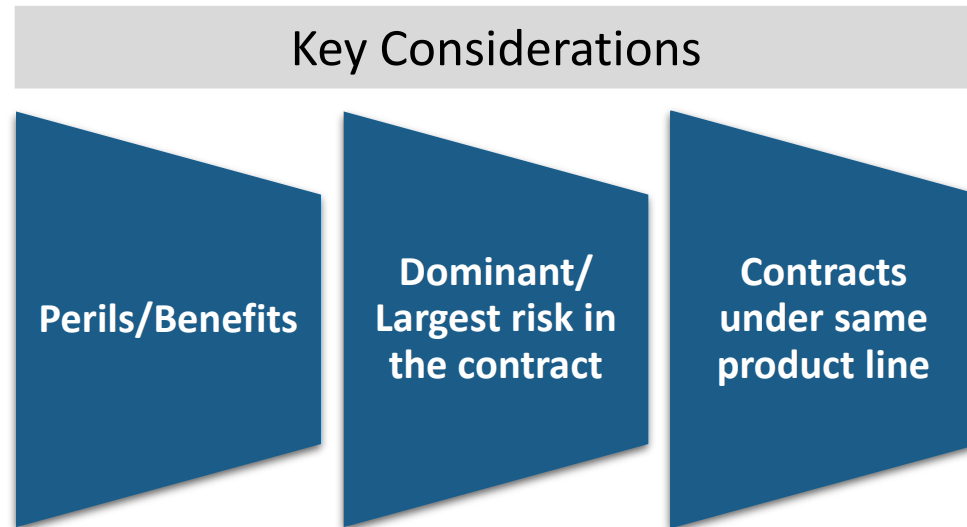
Lapse Risk

All of the Above

While Checking for the Similar risk, company shall consider ***all types of risks*** affecting the PIC and ***not*** just the ***insurance risk***.

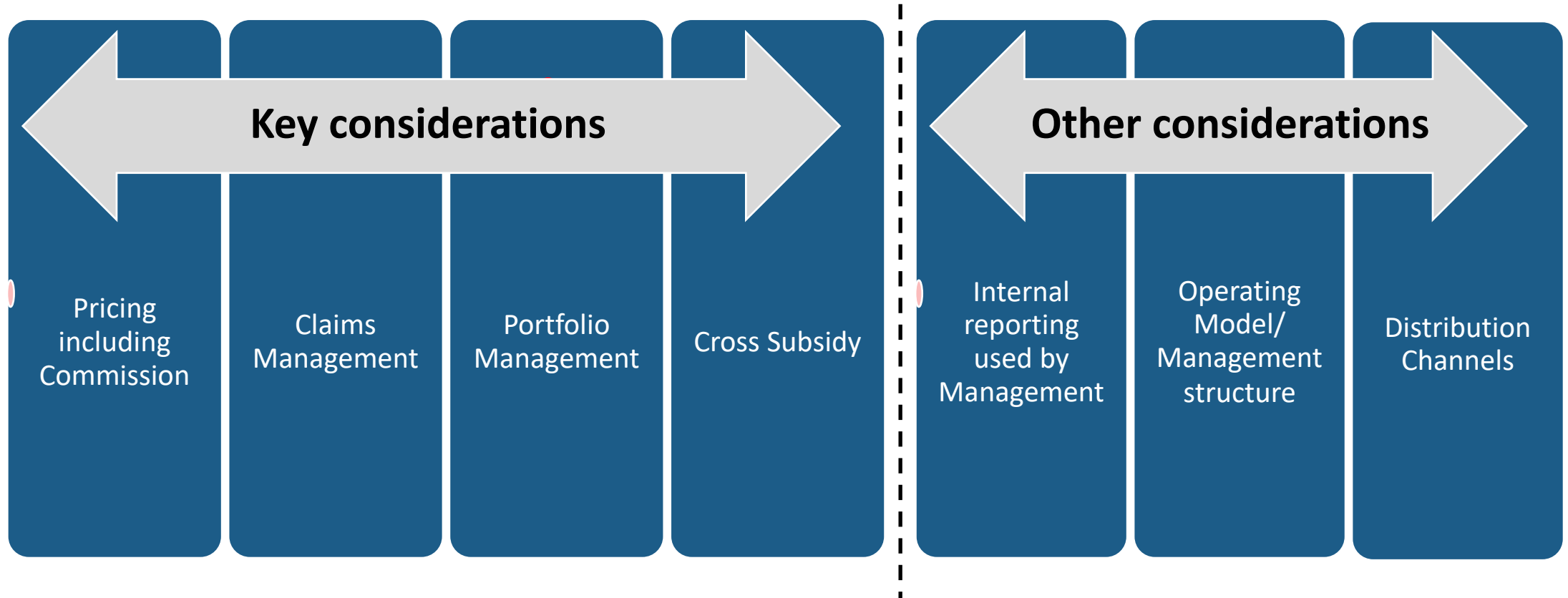
Similar Risk

- Similar risk would **not** necessarily mean
 - Identical risk
 - Similar insurance risk
 - Similar tenure
 - etc..



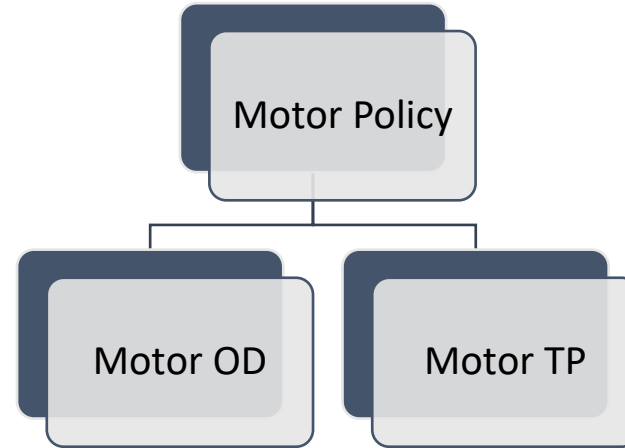
Managed Together

- While determining PIC being managed together following consideration can be made



Poll Question!

Multi Coverages Policy

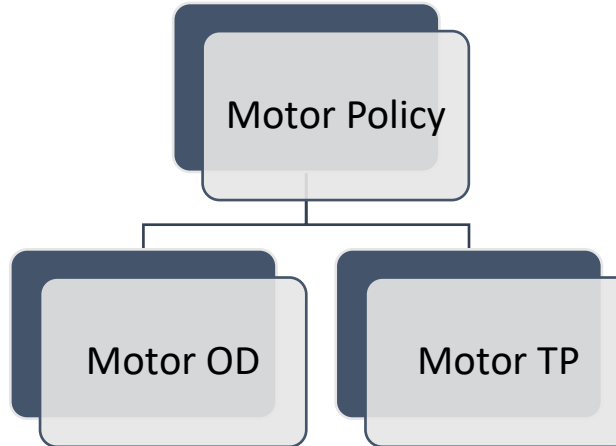


Company XYZ has issued Motor Comprehensive policies which have both Motor TP and Motor OD covers. XYZ shall create Portfolio by :

Splitting contract into each coverages

Aggregating both coverages in a single portfolio

Multi Coverages Policy



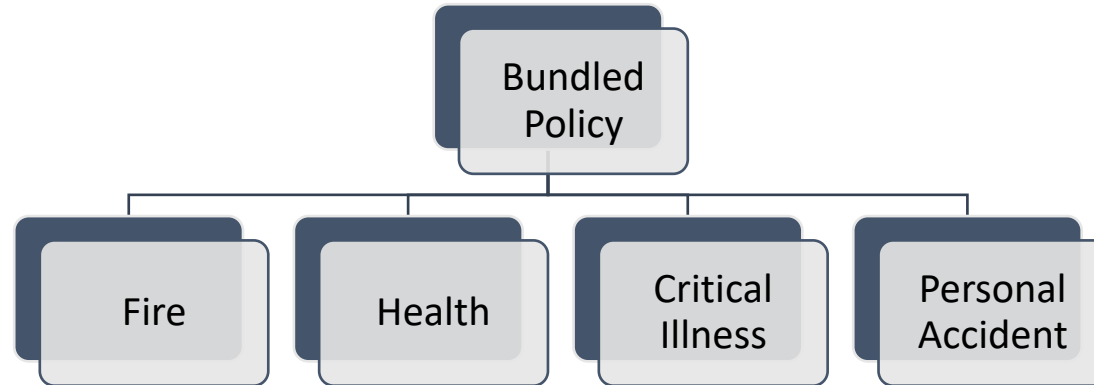
PIC having similar risk and managed together



Single legal contract and thus can be aggregated into single portfolio.

Contract has been defined as the lowest level of unit of accounts. Additionally, a legal form of single contract would generally be considered as a single contract in substance.

Multi Coverages Policy

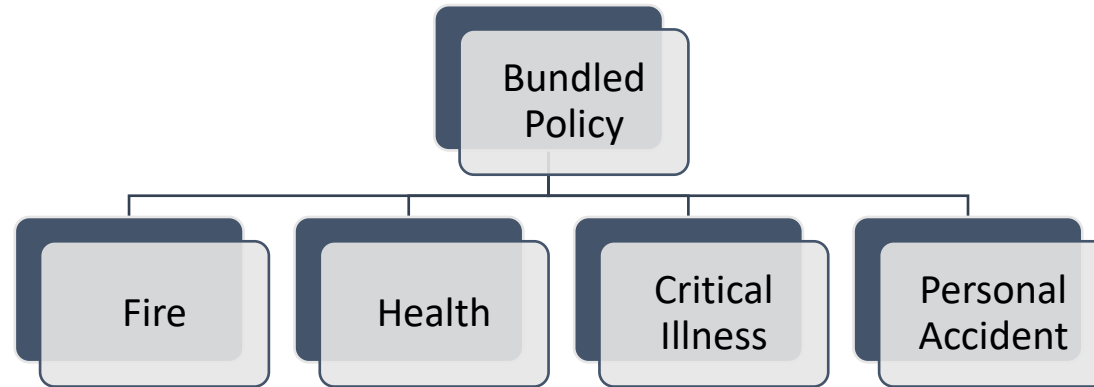


Company ABC issues a Bundled policies which includes Fire, Health, CI, PA covers for the convenience of customer. ABC shall create Portfolio by:

Splitting contract into each coverages or similar portfolio

Aggregating all the coverages in a single portfolio

Multi Coverages Policy



Coverages doesn't having similar risk or managed together

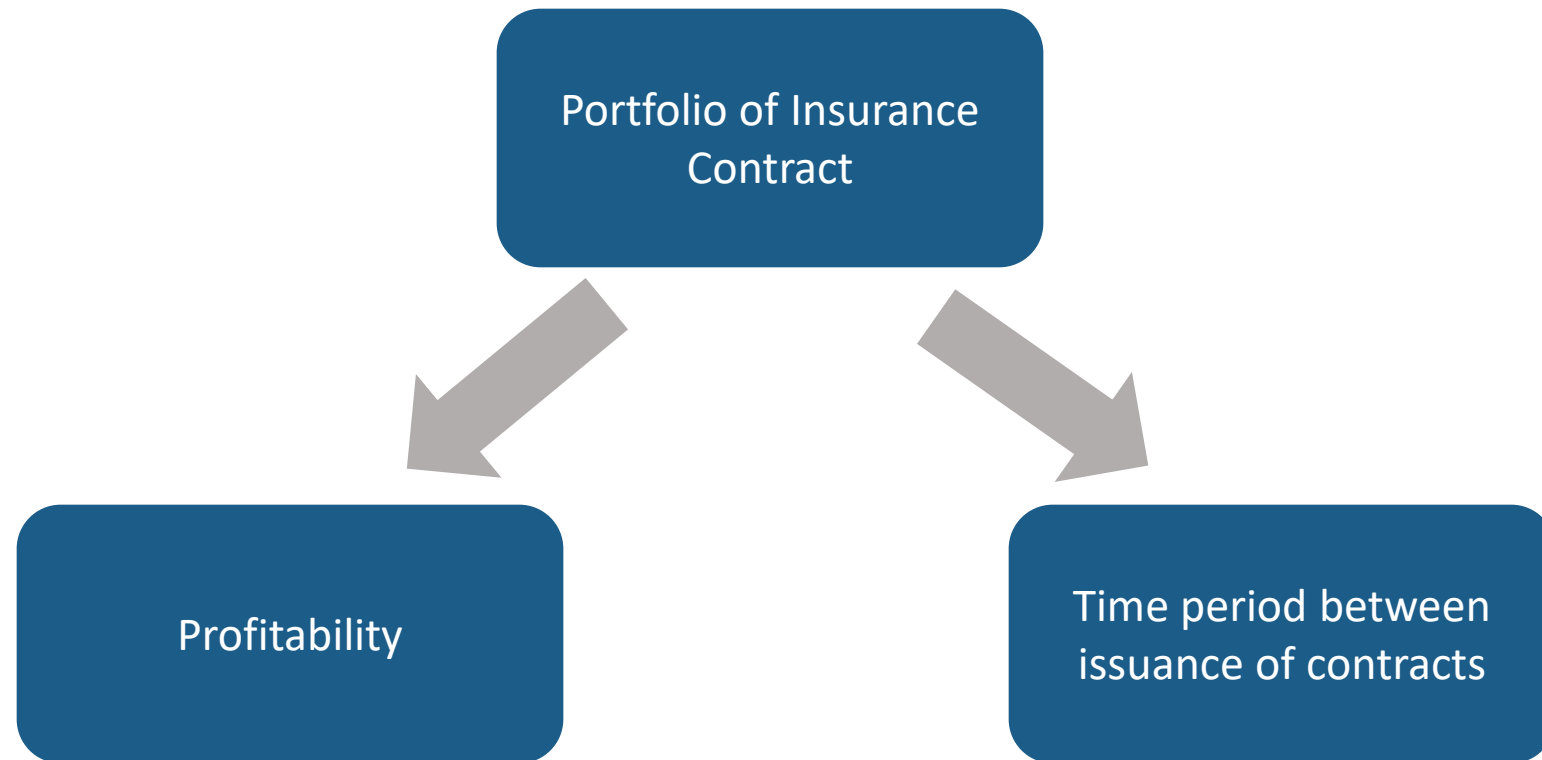


Ideally, Split contract into each coverages or similar portfolio

Considerations for any interdependencies between components e.g. shared deductibles / limits and/or termination of one component results in termination of the whole contract etc.

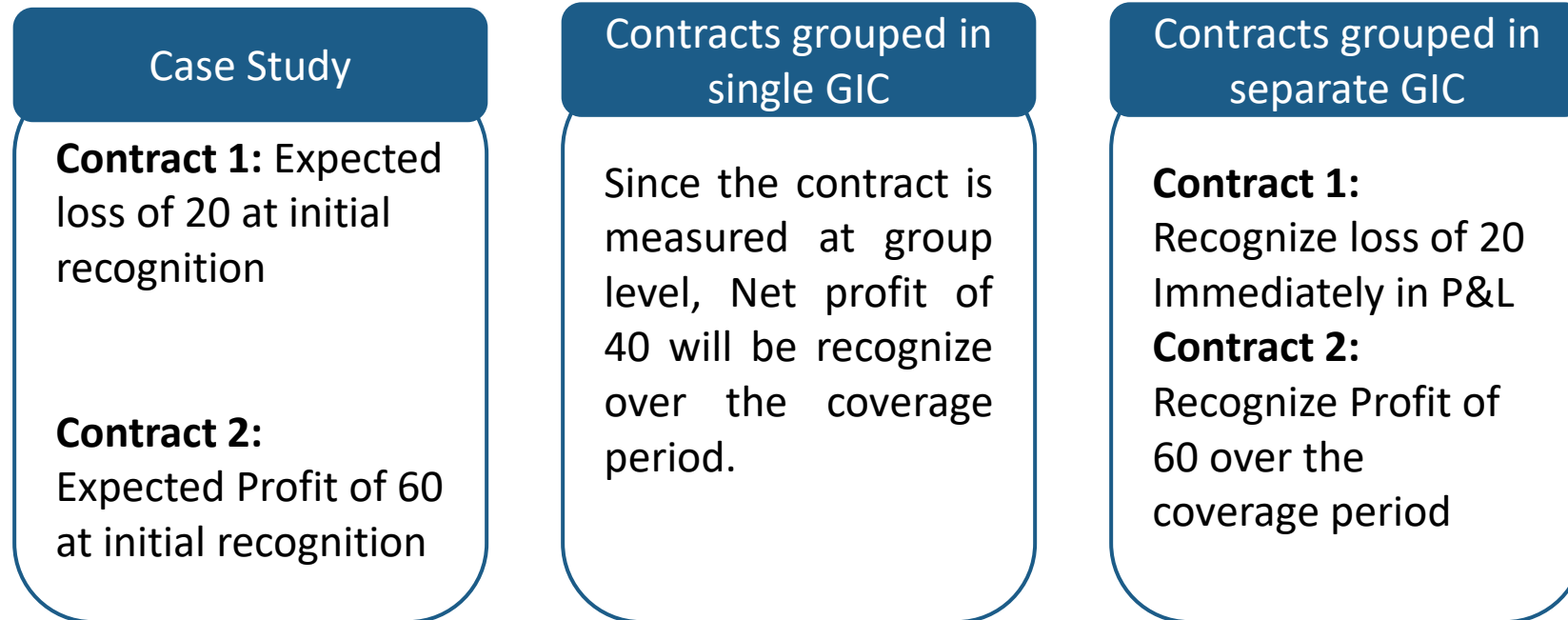
Level of aggregation – Group of Insurance Contract

- PIC to be further categorized into group of insurance contract (GIC) on the basis of at least two criteria:



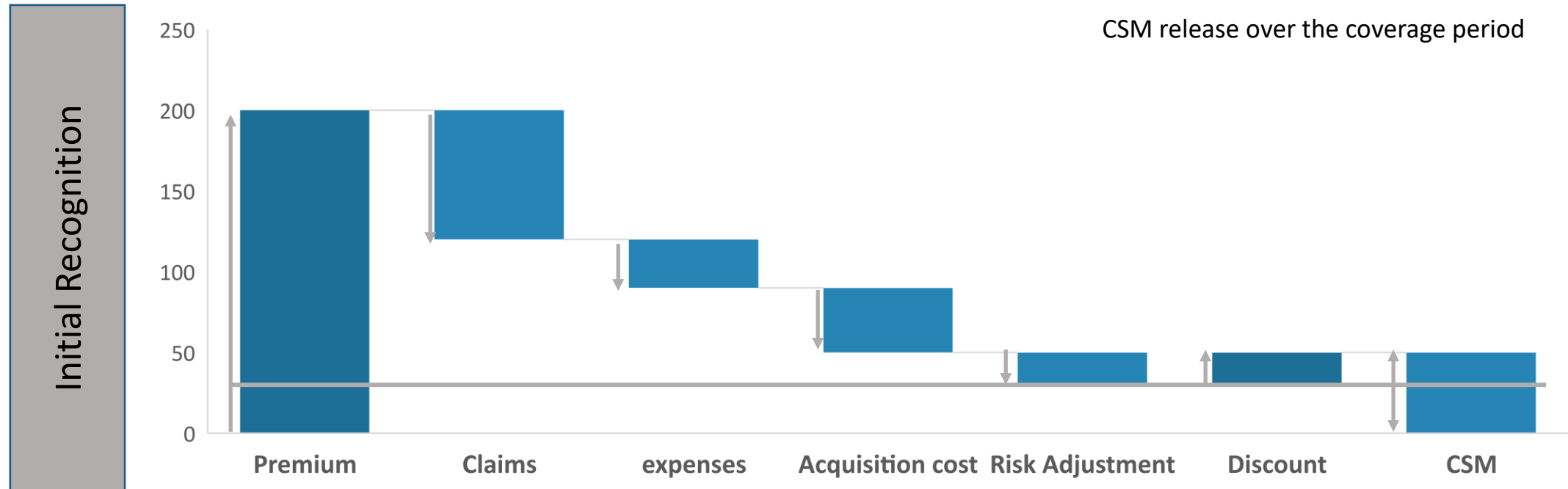
Requirement for Level of aggregation

- Level of aggregation affects profit recognition pattern of the company and ensures systematic treatment of cross subsidy between insurance contract.



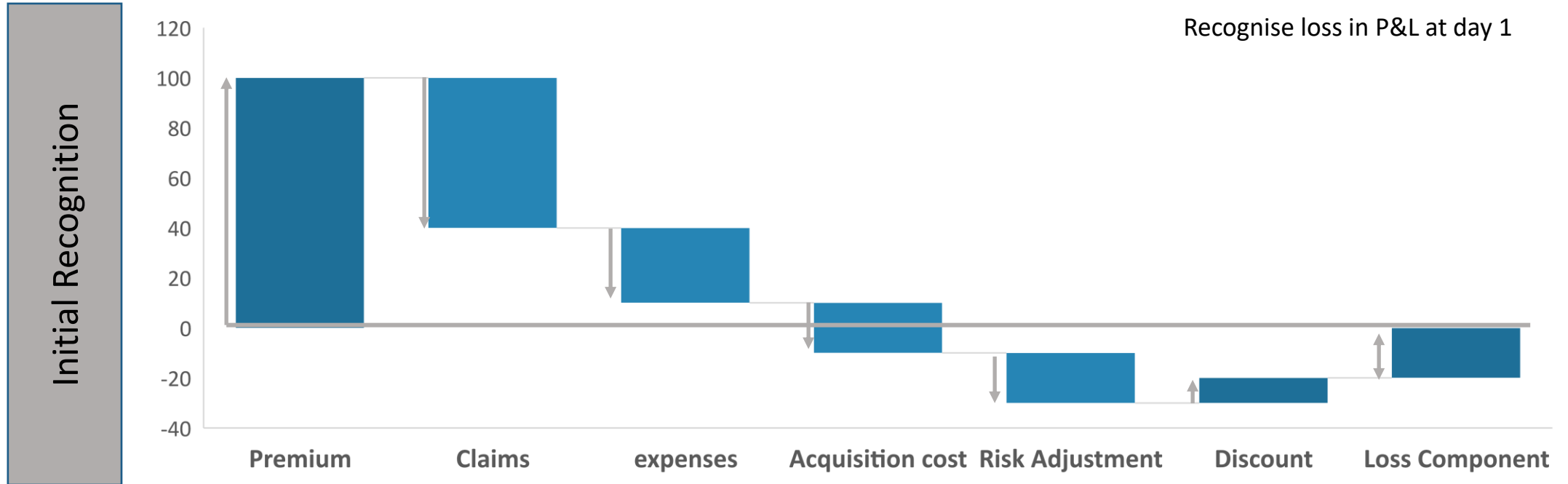
- Higher level of aggregation is allowed, provided cashflows can be segregated at group level.

Profitable Contract



- Entity can perform qualitative and quantitative test to demonstrate no significant possibility of becoming Onerous subsequently.
- A further granularity of Group is allowed under IFRS 17. However, entity have to perform cost benefit analysis.

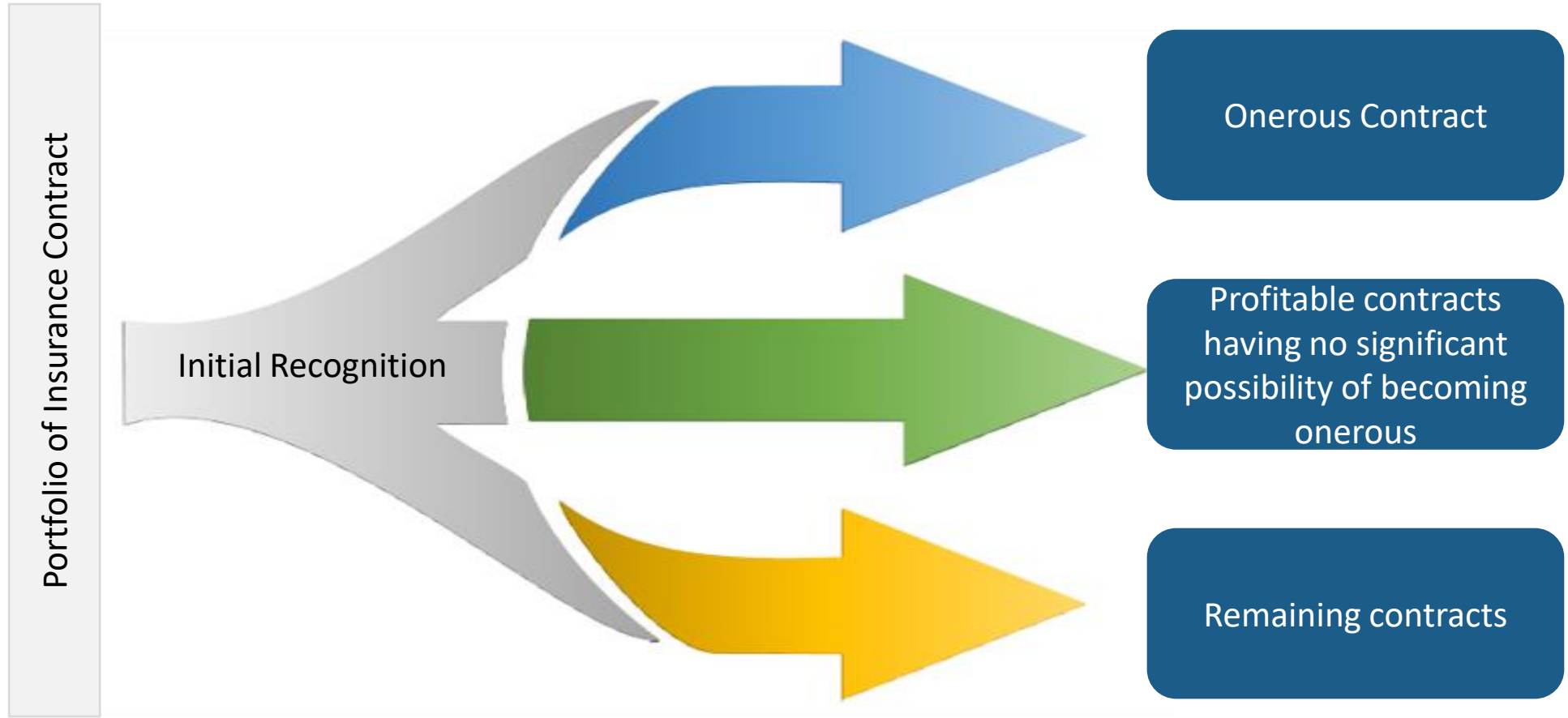
Onerous Contract



Assessment can be done at “set of contract” if:

Contracts belongs to same set
OR
Regulatory restriction on setting
different price within a Set

Profitability



Poll Question!

Profitability



CFO of a company XYZ have asked the Actuarial / Finance team to aggregate group of insurance contract at a higher level in order to cross-subsidize group of onerous contracts with profitable contracts.

Whether the team will be able to aggregate the Group of contract as asked by the CFO?

Yes

No

Profitability

CFO of a company XYZ have asked the team to aggregate the group of insurance contract at a higher level in order to cross subsidize the onerous contract with the profitable contract.

Whether team will be able to aggregate the Group of contract as asked by the CFO?

Yes

No

No, The group of insurance contracts cannot be aggregated at a higher level.

key information to be consider when creating a GIC based on profitability are:

- Pricing Information
- Internal Strategy report
- Valuation report
- Profit testing report

Profitability



Company XYZ has created the Group of insurance contract on the basis of profitability at the initial recognition. During the year, company has repriced the product at 50% of the existing price.

Whether company has to reassess the profitability of the new contracts and create separate GIC if required ?

Once GIC has been created no further reassessment is allowed

Reassessment is required as there is material change in the pricing of the insurance contract

Profitability

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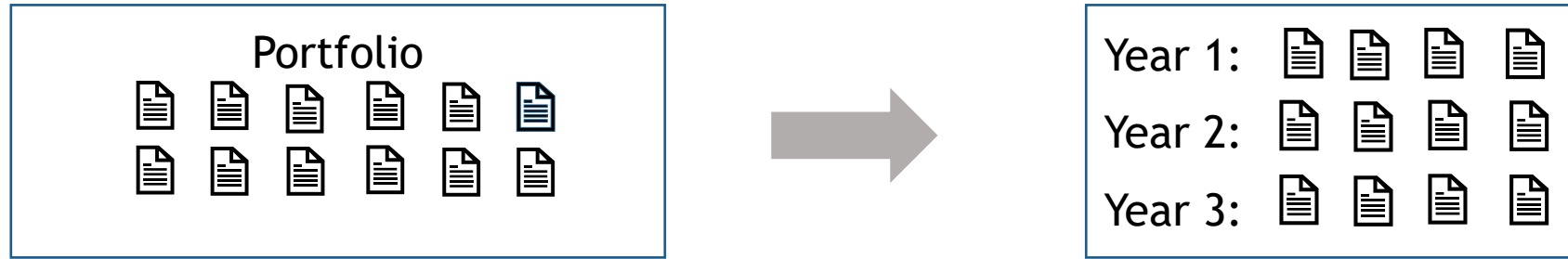
Reassessment is required, Significant changes in product structure or pricing could affect contracts profitability within a group. It requires reassessment and regrouping of insurance contracts issued after the change if required.

No Reassessment of the Contracts issued prior to the modification is required.

If expected profitability of an open group changes during the period, it might be appropriate to close the open group and open a new one

Minimum Annual Cohort for GIC

- Contracts issued more than 12-months apart need to be grouped separately
 - An entity shall create at least annual GICs within PIC and these would be tracked separately

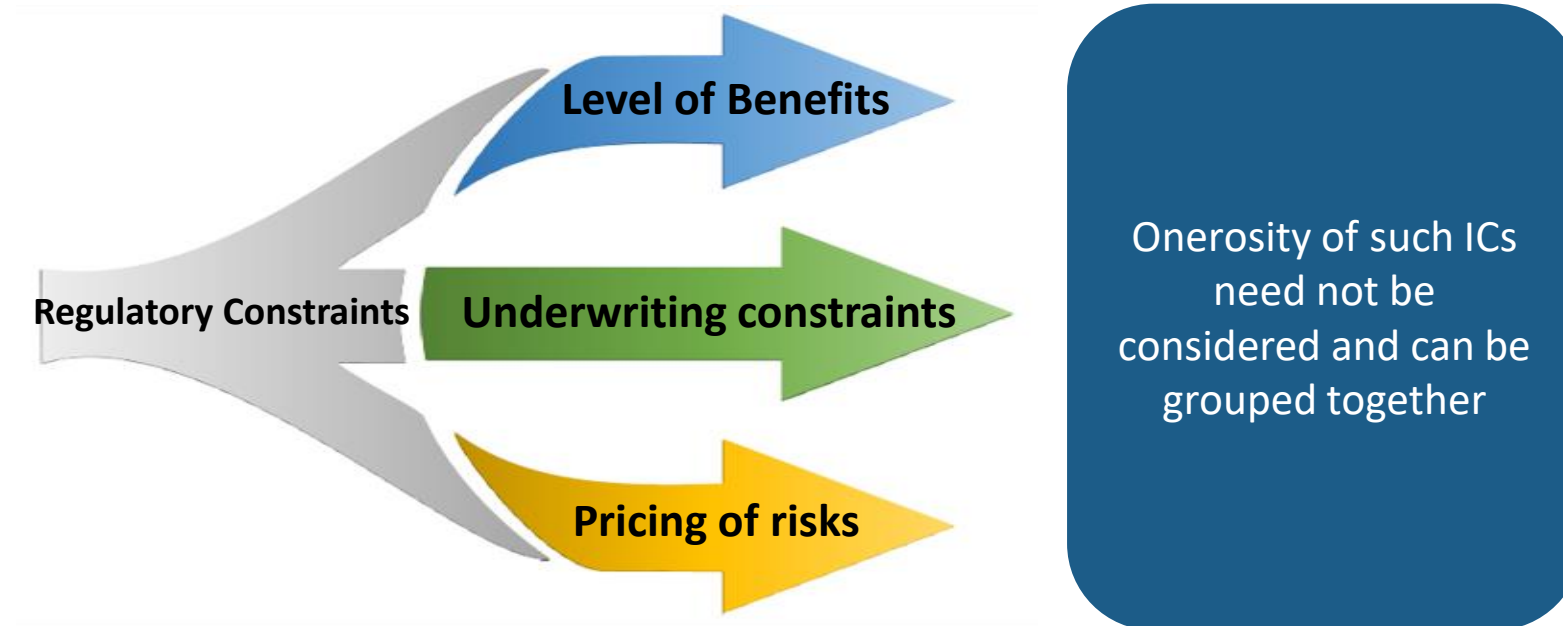


Annual cohort -
Calendar year, Financial
Year or Any 12 month

Period shorter than a
year is allowed

profitability tracked on
sourcing year basis

Regulatory constraints – Impact on Grouping of contracts

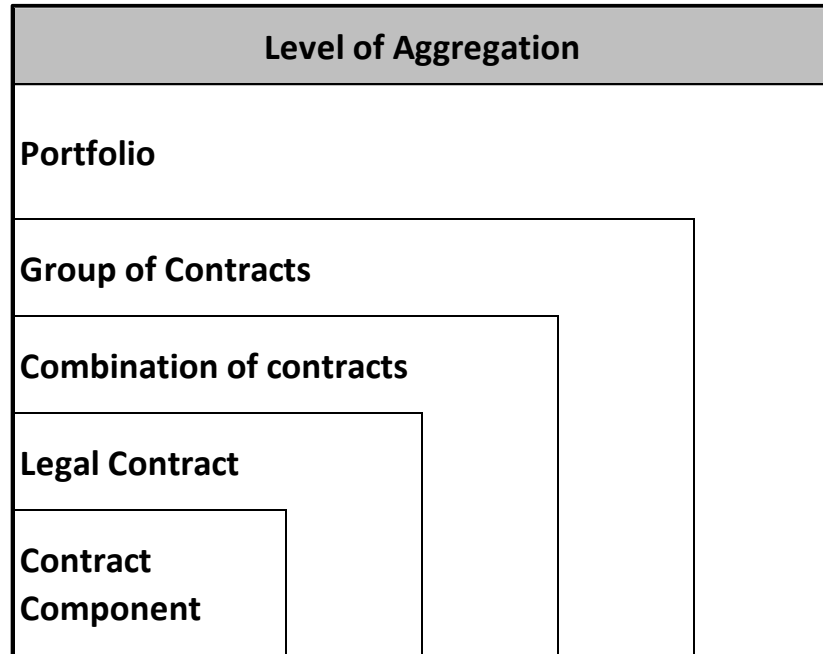


Examples in Indian context:

- Restriction in use of PED conditions in pricing but UW loading allowed at inception
- Contracts issued to individuals suffering from HIV, Mental Illness etc. unless explicit product offered
- Motor TP contracts

Extent of legal or regulatory constraints needs to be delineated from business decisions

In Summary



- Typically, legal form of a single contract to be considered as a single contract in substance
 - Further breakdown, requires careful judgement e.g. interrelated contracts, individual rights and obligations etc.
 - No single factor is determinative in making this assessment
 - Existence of a discount does mean it achieves an overall commercial effect
- Establish GICs at initial recognition of the first contract
 - GIC re-assessment required in case of contract modification e.g. changes in benefit structure, re-pricing of portfolio during year etc.
 - No re-assessment requirement even if contracts within a group or the group as a whole are found to be onerous in reality.

Impact of judgement of Portfolio on Insurance Company

- Grouping of insurance contracts
- Accounting policy
- Attribution of expense
- Contract boundary

Contract Boundary

Poll Question!

Contract Boundary



Whether contract boundary for all the insurance contract will be same as Policy period of the contract ?

Always Same

Can be same, higher or lower.

Can be same or higher but cannot be lower.

None of Above

Contract Boundary

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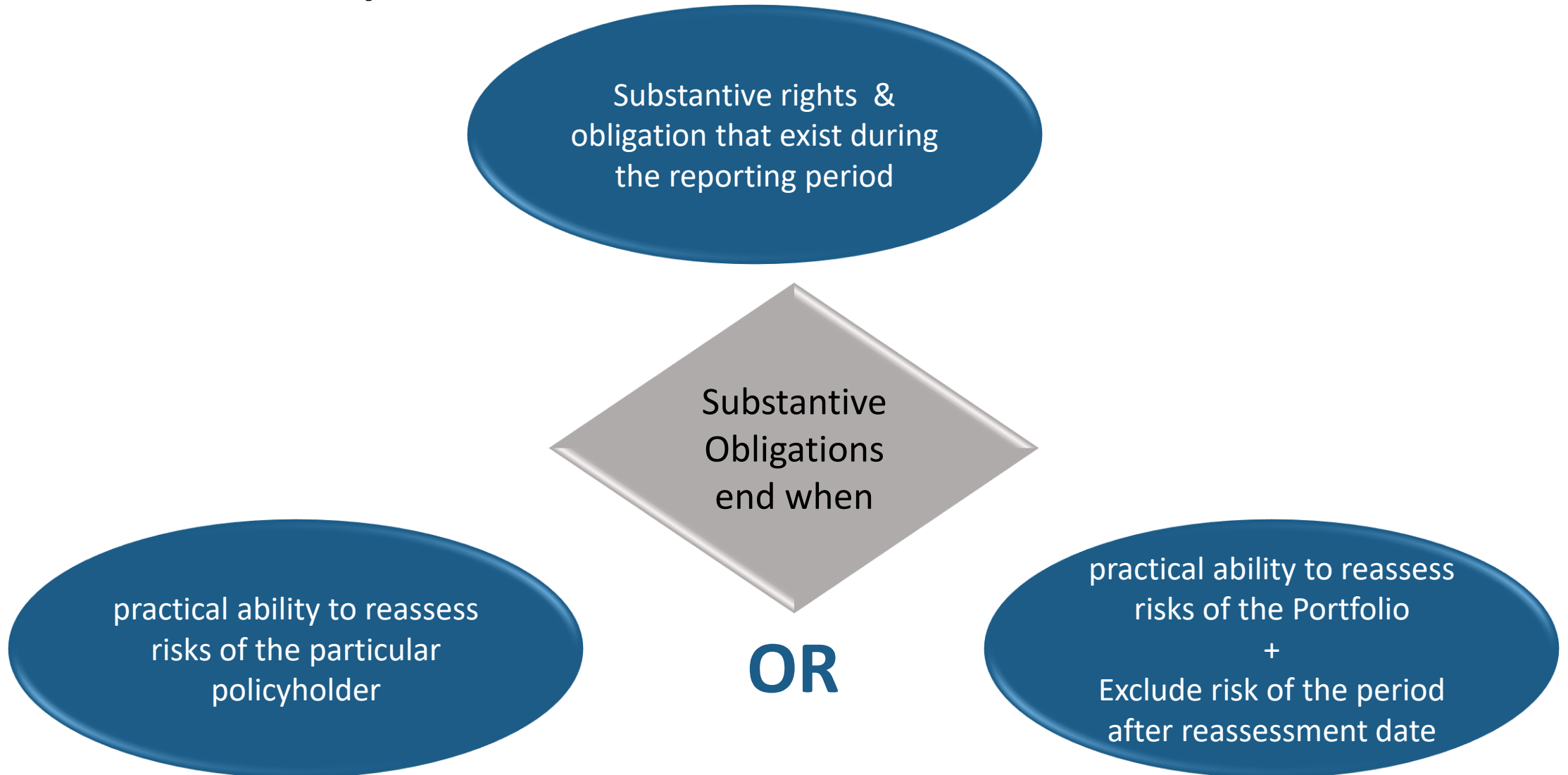
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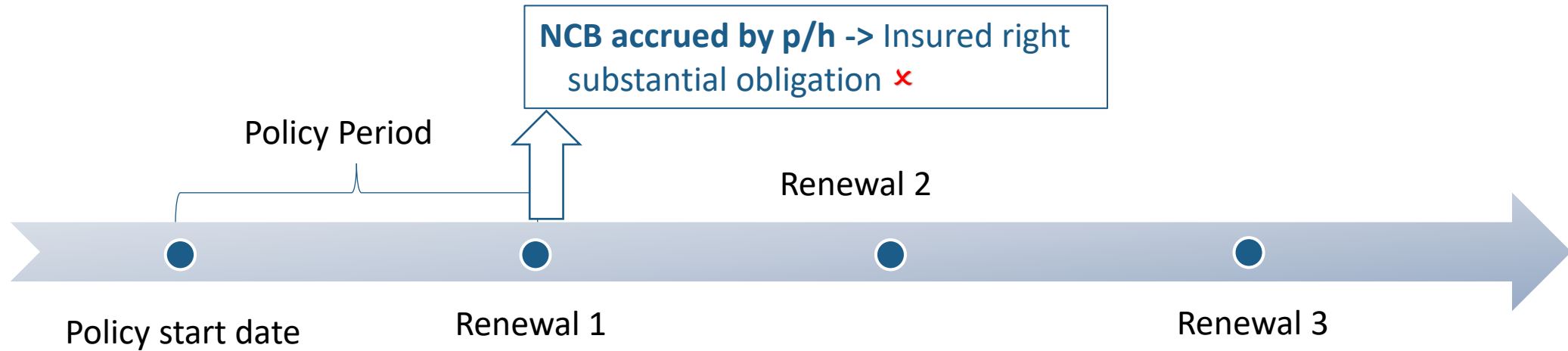
Can be same or higher but cannot be lower.

None of Above

Contract Boundary



Contract Boundary – Motor OD



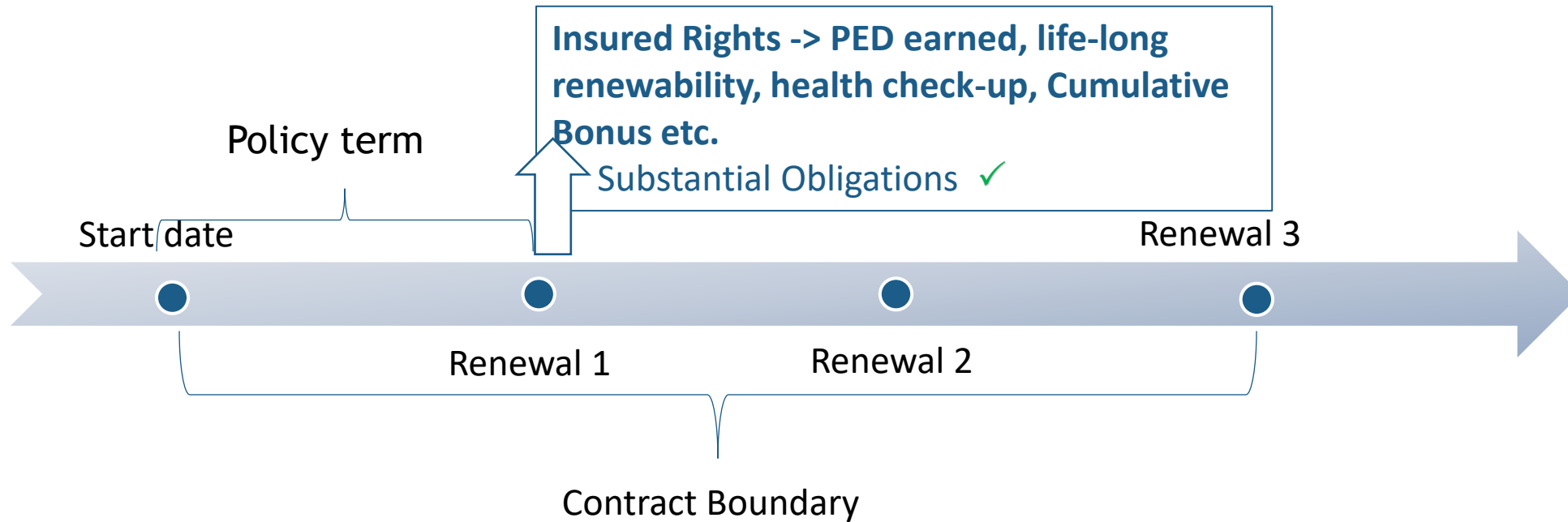
Points to be considered

Substantive Rights to receive premium and obligation to provide the service



practical ability to reassess the risks of the particular policyholder

Contract Boundary - Retail Indemnity Health Product



Points to be considered

Rights to receive premium and obligation to provide service

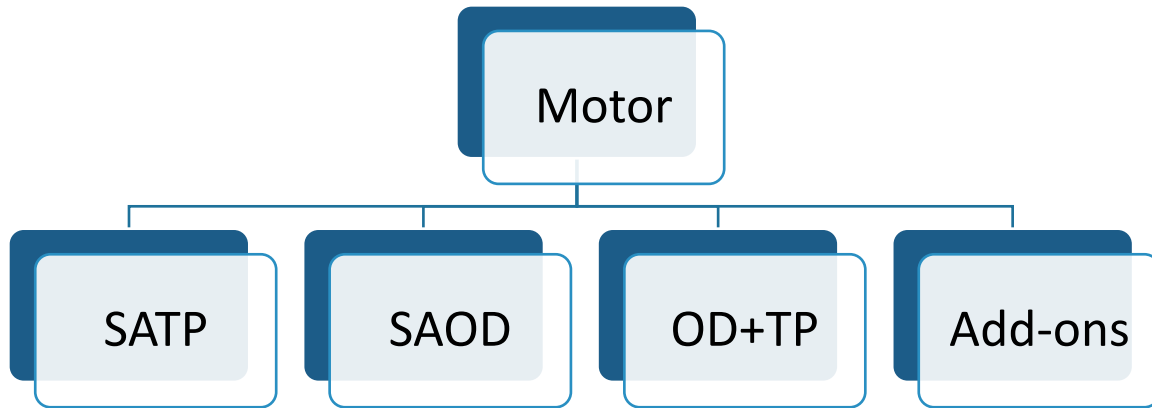
Practical ability to reassess the risks of the Portfolio



Exclude risk of the period after reassessment date

Lines of Business

Lines of Business - Motor



Measures	Considerations
Similar Risk	Perils similar, claims behavior similar across rating factors etc.
Managed Together	Combined UW i.e. commission and pricing, internal reporting etc.
Contract Boundary	Aligned with Policy period

Other Considerations

- Regulatory / Legislation constraints
 - Base Policy wordings for OD and TP tariffed
 - Pricing for TP tariffed; Minimum TP obligation required as per Insurance Act

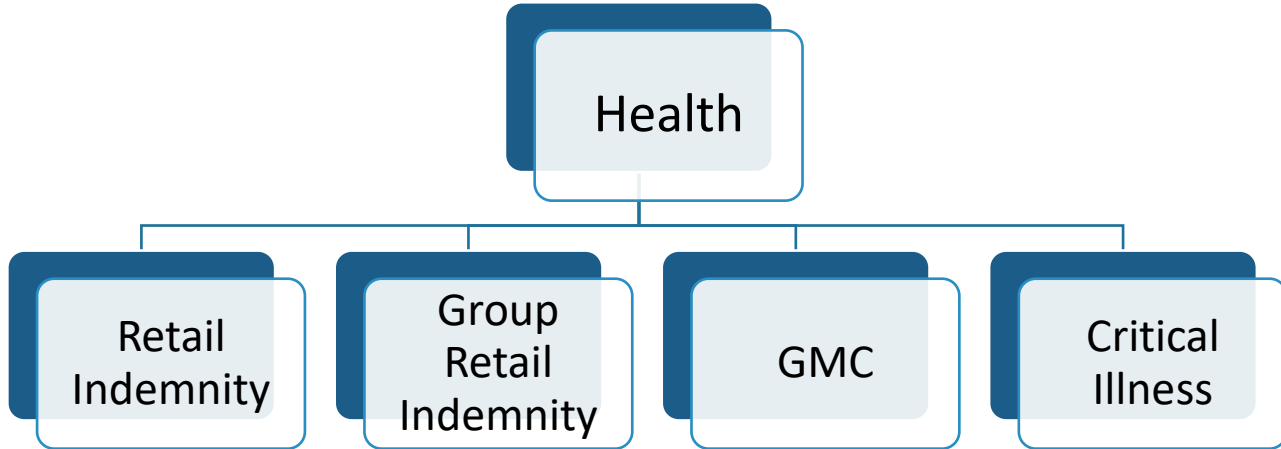
PIC & GIC

- Legal form is contract of substance i.e. no split required between OD and TP; Add-ons (including RSA) offering not distinct
- Largely entity specific
 - Private Car, 2W and GCV
 - Channels e.g. OEM, Agency, Bancassurance
 - Type of business e.g. New, Renewal or Rollover
 - etc..

Onerosity requirements

- Regulatory constraints in TP pricing -> grouping based on profitability need not be considered
- Business consideration beyond TP obligation i.e. grouping based on profitability might be required for incremental business

Lines of Business - Health



Measures	Considerations
Similar Risk	linked to health of individual, claims behavior similar across rating factors etc.
Managed Together	Entity specific – usually separate UW, reinsurance, pricing, internal reporting etc.
Contract Boundary	Usually policy period but considerations to be given in respect of pricing for future risks

Other Considerations

- Regulatory / Legislation constraints
 - Premiums ordinarily not to be changed until three years in case of new products
 - Life-long renewal guarantees including portability / migration
 - 3-month notice before revisions
- Market expectations of price revisions; pricing methodology accounting for coverage for future years
- Separating claims processing services from a stop-loss contract in case of GMC; accounted under Ind-AS 115

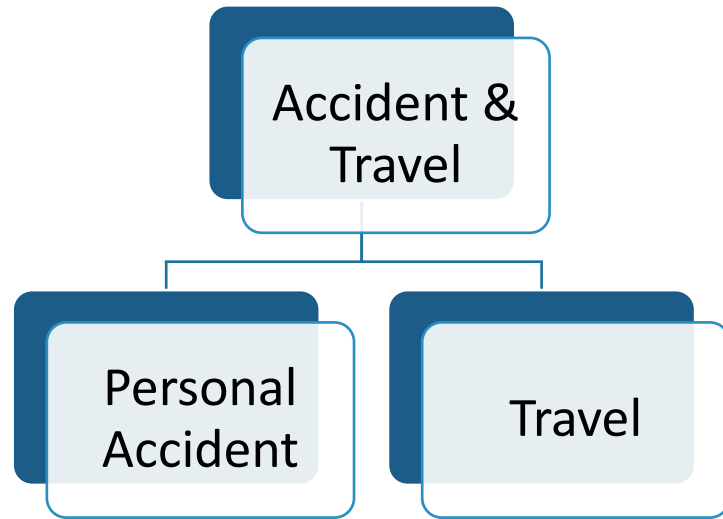
PIC & GIC

- Largely entity specific
 - Retail Health, GMC, Group Retail Health, CI etc.
 - Policy Tenure (Annual v/s multi-year)
 - Channels e.g. Online, Agency, Bancassurance
 - etc..

Contract Boundary

- GMC policies – aligned with policy period
- Consideration towards pricing basis / methodology used

Lines of Business – Accident & Travel



Other Considerations

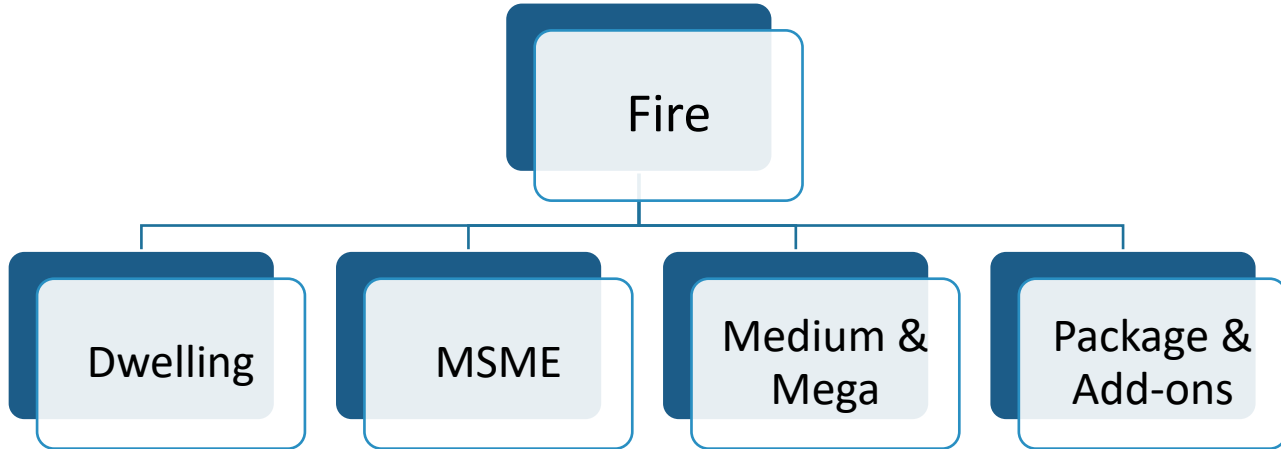
- Regulatory / Legislation constraints
 - Premiums ordinarily not to be changed until three years in case of new products for PA
 - Life-long renewal guarantees including portability / migration
 - 3-month notice before revisions
- Pricing methodology accounting for coverage for future years

PIC & GIC

- Personal Accident and Travel to be separate
- Entity specific GIC
 - Retail PA, Group PA, Credit Linked PA, Single trip, annual trip etc.
 - Policy Tenure (Annual v/s multi-year)
 - Channels e.g. Online, Agency, Bancassurance
 - etc..

Measures	Considerations
Similar Risk	Different benefits, perils and coverages
Managed Together	Separate UW, commission, pricing, internal reporting etc.
Contract Boundary	Usually policy period but considerations to be given in respect of pricing for future risks

Lines of Business - Fire

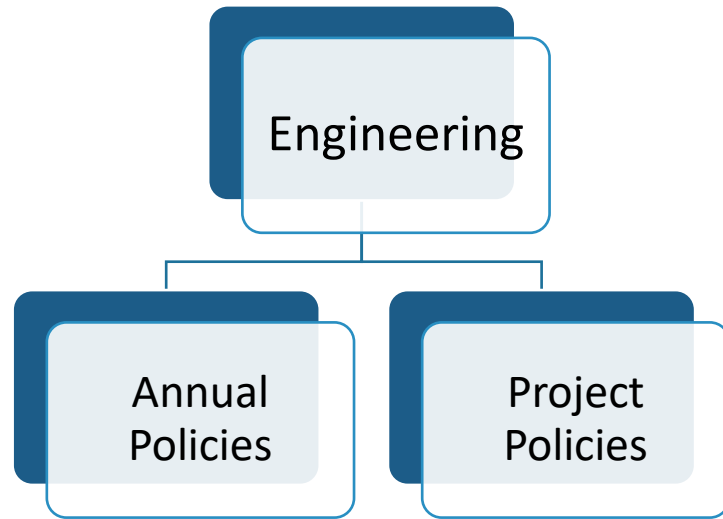


Measures	Considerations
Similar Risk	perils and coverages similar, claims behavior similar across rating factors etc.
Managed Together	Entity specific – usually combined UW, reinsurance, pricing etc. Internal reporting needs consideration
Contract Boundary	Usually policy period

PIC & GIC

- Legal form is contract of substance; Add-ons offering not distinct
 - Further breakdown in case of Package product offering requires careful judgement e.g. interrelated contracts, individual rights and obligations etc.
- Largely entity specific
 - Dwelling, MSME, Medium & Mega, Package products etc.
 - Policy Tenure (Annual v/s multi-year)
 - Channels e.g. Online, Agency, Bancassurance
 - etc..

Lines of Business - Engineering

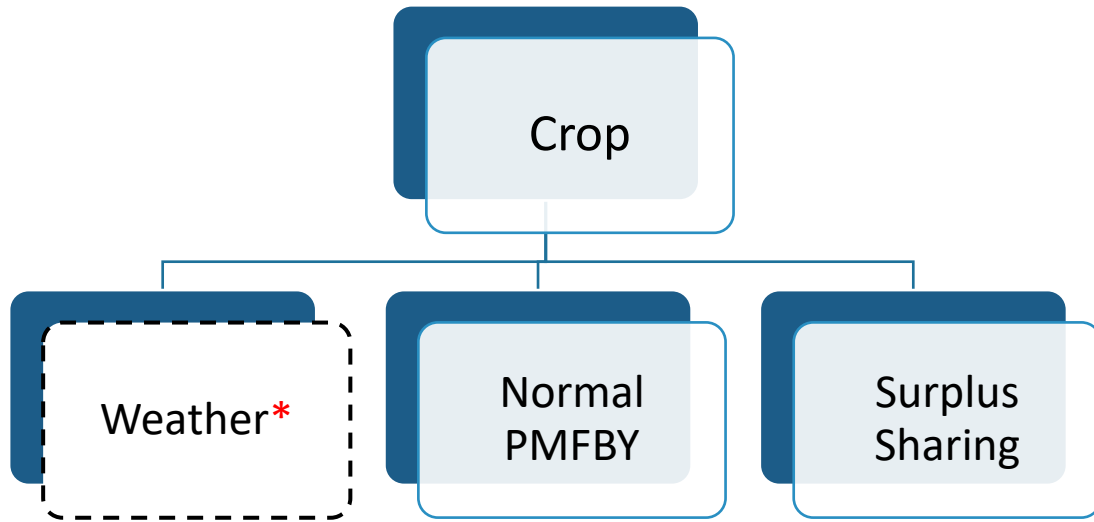


Measures	Considerations
Similar Risk	perils and coverages similar, claims behavior similar across rating factors etc.
Managed Together	Entity specific – usually combined UW, reinsurance, pricing etc. Internal reporting needs consideration
Contract Boundary	Usually policy period

PIC & GIC

- Legal form is contract of substance; Add-ons offering not distinct
 - Further breakdown in case of Package product offering requires careful judgement e.g. interrelated contracts, individual rights and obligations etc.
- Largely entity specific
 - Annual, Project etc.
 - Channels e.g. Online, Agency, Bancassurance
 - etc..

Lines of Business – Crop Insurance



Measures	Considerations
Similar Risk	perils and coverages similar across schemes
Managed Together	Entity specific – usually combined UW, pricing. Internal reporting, Re-insurance needs consideration
Contract Boundary	Usually the legal contract period (annual or 3-years)

Other Considerations

- **Normal PMFBY**
 - Adverse effect on p/h contractual pre-condition not usually met
 - Increased technology based claim settlement similar to derivatives
- **Surplus Sharing**
 - Usually non-distinct Investment component i.e. required to repay an amount to the policyholder in all circumstances
 - Returns significant insurance risk to p/h adjusting future payments on account of Insured losses
- Ind-AS 109 / Ind-AS 115 standards needs to be applied
- Alternatively, apply Ind-AS 117 as follows:
 - Incurred claims recognised as insurance service expenses
 - Investment components excluded from insurance revenue and insurance service expenses

**Weather schemes are equivalent to embedded derivatives and needs to be accounted basis Ind AS 109 allowing for materiality.*



Thank You