10th Capacity Building Seminar in General Insurance
Venue: Hotel Sea Princess, Mumbai
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Expense Allocation

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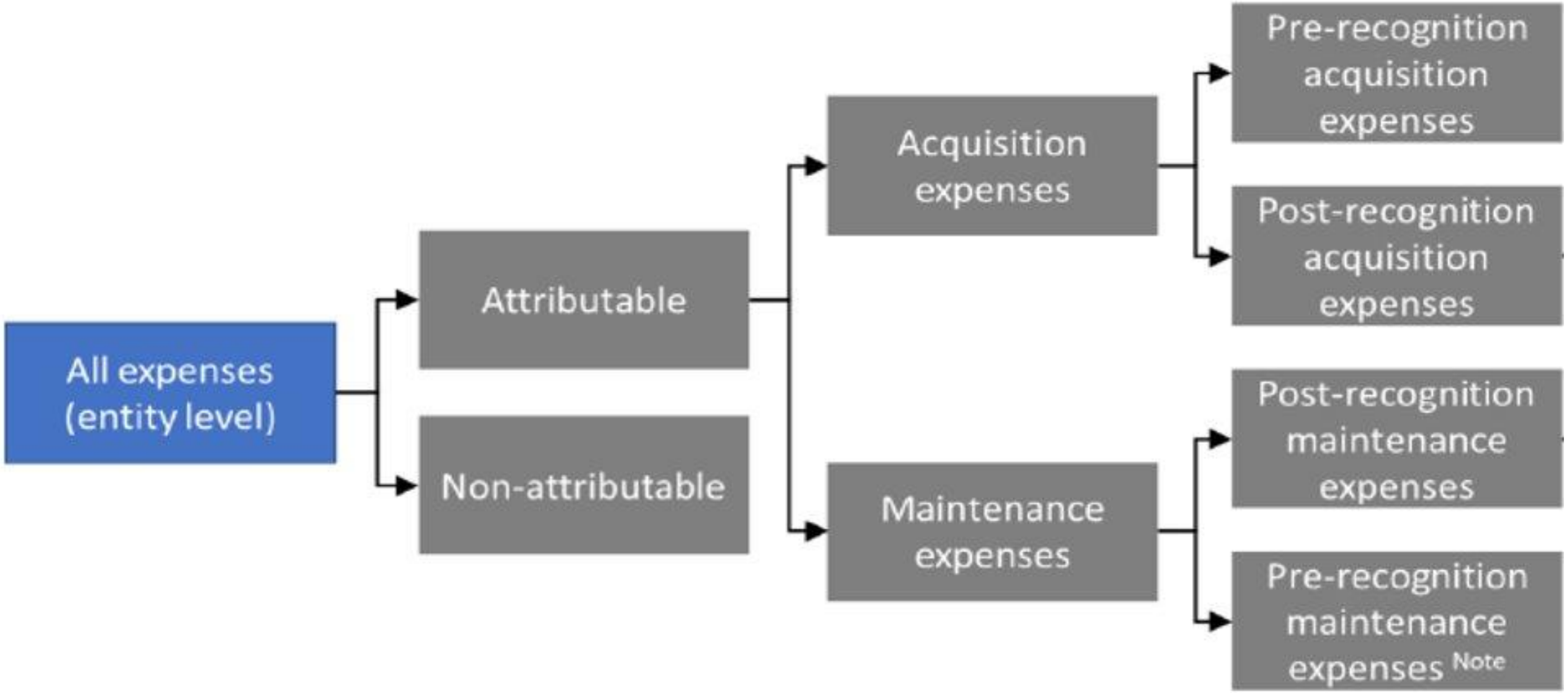
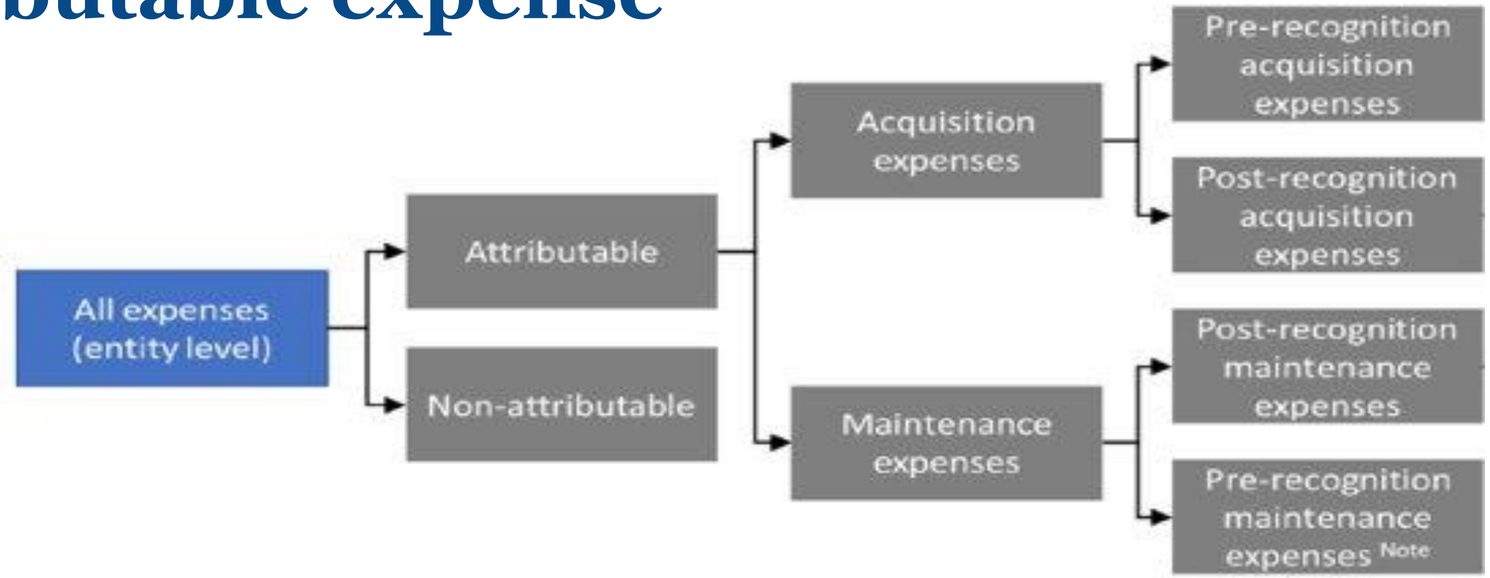
Expense Flow Chart



Note: In the current market practices, no line item falls into this category at a broad level. Please suggest if your company has any such expense item that we can identify in this category.

Approach for Attributable V/s Non-Attributable expense



Below is the approach for Attributable V/s Non-Attributable expense

A. Assess at a minimum whether the listed non-insurance related expense types exist and define these as non-attributable expenses.

B. The overall purpose of an insurance company is to sell and fulfil insurance contracts and most expenses incurred are required to meet that objective, which is the basis for a top-down approach to identify non-attributable expenses.

C. Assess overhead expenses which are not clearly non-attributable as part of an annual expense study, to determine the split.

Note: In the current market practices, no line item falls into this category at a broad level. Please suggest if your company has any such expense item that we can identify in this category.

Attributable versus Non-Attributable (1/3)

A. The Below Table Sets out the Key Expenses which are not attributable:

Non-Attributable Exp	Description
Not in Scope of IFRS 17	•Expenses incurred relating to investment components or non-insurance services or goods which are separated from the host insurance contracts and accounted under different standard. (for e.g., IFRS 9 , IFRS 15) •Expenses which relate to non-insurance activities (for e.g., expenses related to investment contracts without discretionary participating features or contract which provide administrative services)
Income Taxes (Insurer is not in a fiduciary capacity)	•Tax payments that are not specifically chargeable to the policyholders under the terms of the contract.
R&D on products that did not launch	•Product development costs related to products which fail to launch.
Expenses which are not directly attributable to portfolio of insurance contract.	•Expenses for fines from regulators due to regulatory failings or similar expenses •Donations and corporate social responsibility expenses. •Training cost which are not linked to selling insurance contract (like soft skill trainings). •Investment related expenses that are not incurred for enhancing the benefits from insurance coverage.

Attributable versus Non-Attributable (2/3)

2. **Purpose of an insurance company is to sell and fulfil insurance contracts and the majority of expenses incurred are required to meet that objective, which is the basis for a top-down approach to identify non-attributable expenses.**

- Examples of certain overhead expense types (e.g., depreciation, information technology and support, rent, human resources, etc.) which possibly can be labelled as attributable. These examples support the view that all normal business operating costs are required to fulfil the insurance contracts.

- Identify expenses which are clearly attributable from those which are clearly non-attributable. All attributable expenses can broadly be classified into one of the following buckets:

Sales related expenses
Sales related expenses such as sales office expenses, advertising and promotion, medical and inspection, etc.

Expenses for sales distribution channels
Sales distribution channels costs such as financing of new agents, allowances, sale incentives, amortization of bancassurance, etc.

Commission
Commission is incurred when acquiring contracts. This includes initial and renewal commission.

Management related expenses
General operating expenses including office expenses, financial expenses, recharges etc., where it might not be entirely clear whether certain expense types are directly attributable or not. Therefore, further analysis is required

Long term employee benefits
benefits which are part of the remuneration package of staff in the normal course of business and consist of long-term incentive plans and pensions

Attributable versus Non-Attributable (3/3)

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C. Assess overhead expenses which are not clearly non-attributable as part of an annual expense study, to determine the split.

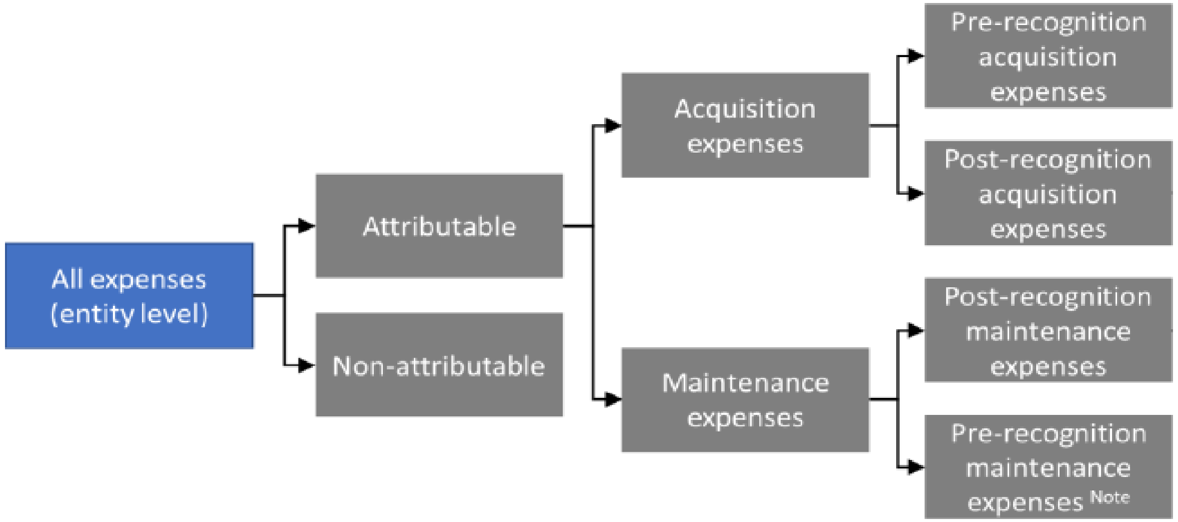
Overhead expense within the management related expense category should be analyzed provided the same has a material impact for determination of BEL/CSM or presentation of insurance service result.

Where an expense is mix of attributable and non-attributable expenses, the entity should analyze expenses based on the time spent and the nature of the expenses to determine appropriate split. The following ratios could be applicable :

- 100% attributable;
- 100% non-attributable; or
- Mixed in nature and a ratio is needed (e.g., if 40% is attributable, then the ratio is 40/60).

If there is any indication of a significant change in the allocation between attributable and non-attributable, it is allowed to update the split in any reporting period.

Principles to determine expenses as acquisition in nature and maintenance expenses



Split between acquisition and maintenance is important because the presentation, including timing and pattern of insurance service revenue, of acquisition cash flows as part of the insurance service result is different to maintenance expenses.

Below are the principle to determine Acquisition V/s Maintenance expense

A. Assess whether the listed acquisition expenses are applicable and classify all other expenses as maintenance.

B. Assess overhead expenses which are not clearly acquisition or maintenance as part of an annual expense study

C. Determine the amount for acquisition cash flow as insurance service revenue/expenses in a year.

Note: In the current market practices, no line item falls into this category at a broad level. Please suggest if your company has any such expense item that we can identify in this category.

Principles to determine expenses as acquisition in nature and maintenance expenses (1/3)

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A. ***Assess whether the listed acquisition expenses are applicable and classify all other expenses as maintenance.***

The standard describes insurance acquisition cash flows as expenses incurred to

i. Sell insurance contracts,
ii. underwrite insurance contracts and
iii. start of a new insurance contracts.

Examples of Acquisition Expense are

- Initial Commission
- Sales bonus (linked to sales performance)
- Distribution fees
- Underwriting costs
- marketing and advertising expenses that are directly attributable
- overhead expenses for departments and staff involved directly in acquisition tasks

- Expenses not in this list above would be considered as **maintenance expenses** and thus be included in the fulfilment cash flows if considered attributable.
- Renewal, recurring commissions or commissions on endorsement of a contract meeting the definition of insurance acquisition cash flows qualify as acquisition expenses despite the recurring nature.

Principles to determine expenses as acquisition in nature and maintenance expenses (2/3)

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B. ***Assess overhead expenses which are not clearly acquisition or maintenance as part of an annual expense study***

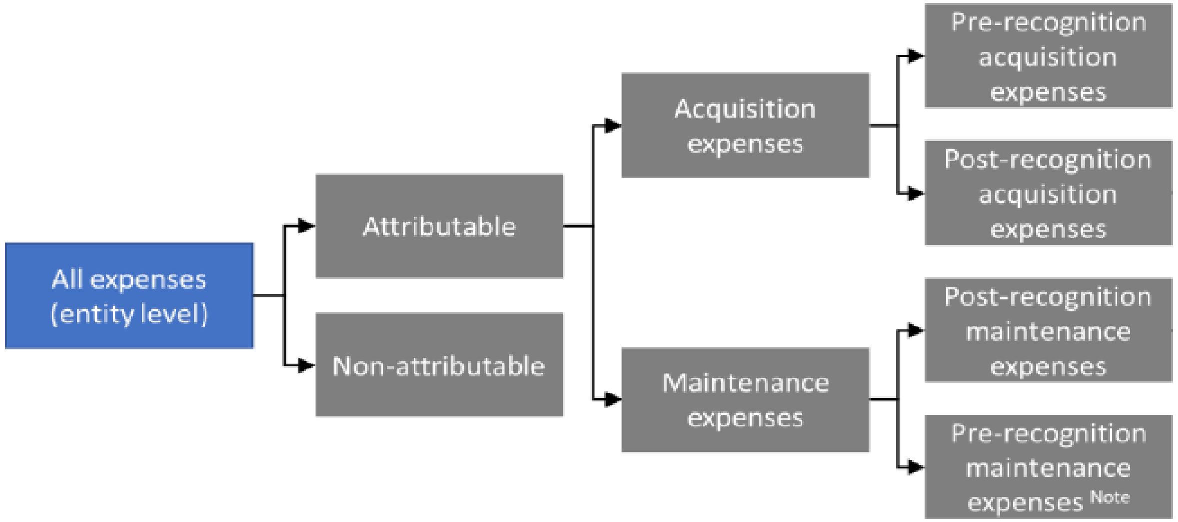
- Where it is not clear whether an expense is acquisition in nature or not, it should be analyzed further . Only if it has a material impact on the insurance service results entity should analyze it further. For e.g. staff cost, office overhead, group recharges, sales related overhead.
- Where an expense is mix of acquisition and maintenance expenses, the entity should analyze expenses based on the allocation driver to determine appropriate split. A ratio is then determined to split the expense. The following ratios could be applicable :
  - 100% acquisition;
  - 100% maintenance; or
  - Mixed in nature and a ratio is needed (e.g., if 40% is attributable, then the ratio is 40/60).
- Below are the allocation drivers.

Allocation Drivers	**Expense types**
Annual premium equivalent v/s renewal premium	Sales distribution costs, sales related salary
Number of policies for new business v/s in force business	Policy processing, premium collection etc.
Time spent on acquisition versus maintenance	Non-sales related salary

P&L Presentation

Insurance Revenue	
Expected claims and other expenses (excluding investment components and amounts allocated to loss component)	Expected directly attributable maintenance expenses
Release of the risk adjustment (excluding amounts allocated to loss component)	
CSM recognized for services provided	
Amortization of insurance acquisition cash flows	Equal to amount below in expenses
Premium experience adjustments	
Total Insurance Revenue	
Insurance Service Expenses	
Incurred claims (excluding investment components) and other incurred insurance service expenses	Actual directly attributable maintenance expenses
Amortization of insurance acquisition cash flows	Equal to amount above in revenue
Changes related to future service (losses on onerous groups and reversals of such losses)	
Changes related to past service (changes in FCF related to incurred claims liability)	
Total Insurance Service Expenses	
Insurance Service Result	
Other Expenses	Non directly attributable expenses
Profits / Losses	

Identify pre-recognition attributable expenses



- Pre-recognition cash flows (both inflows and outflows) are attributable expenses incurred before the group of insurance contracts is recognized (‘initial recognition date’

Step	Pre recognition acquisition CF	Pre recognition maintenance CF
1	Expenses are capitalized on the balance sheet as an asset.	Expenses are capitalized on the balance sheet as an asset.
2	Derecognize when the CSM group to which it pertains is recognized, the BEL and CSM is adjusted accordingly	Fully derecognize when the CSM group to which it pertains is recognized and charged to P&L.

Note: In the current market practices, no line item falls into this category at a broad level. Please suggest if your company has any such expense item that we can identify in this category.

Identify pre-recognition attributable expenses (1/3)

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A. Assess whether the listed pre-recognition cash flow types apply. All identified pre-recognition cash flows are accounted for as a monetary asset

If a pre-recognition cash outflows does not meet the definition of insurance acquisition cash flows, they **should not** follow the accounting four-step approach , instead, they should be fully derecognized when the related group of contracts is recognized.

Below are few of the significant pre-recognition acquisition cash flow :

- Payments of **amounts to agents** (signing fees, bonuses, etc.) which are conditional on meeting sales targets;
- Acquisition expenses on bounded contracts (e.g., commissions) where the acquisition expenditures also cover future anticipated renewals, which are outside of the contract boundary. Therefore, a part of these **acquisition expenditures** relates to the current group of contracts and a part to future groups of contracts; or
- **Product development costs and training** cost that are **directly attributable** to fulfilling insurance contracts.

Identify pre-recognition attributable expenses (2/3)

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B. Three Step approach to account for Pre recognition acquisition expense.

Step 1: Allocation of insurance acquisition cash flows to a group of contracts (future and current cohorts)

- When pre-recognition acquisition cash flows are incurred, these need to be allocated over the anticipated groups of contracts which are expected to absorb these expenses.
- The standard is silent on how the same needs to be done but states that it should be done in a systematic manner.
- Entity can use any expense allocation method anticipated premium, expense loading etc. and the same needs to be justified to the auditor.

Step 2: Derecognition of pre-recognition acquisition cash flows when the group is recognized

Approach to derecognize pre-recognition asset to CSM is as follows

- Once the pre-recognition asset is derecognized and allocated to NB CSM upon initial recognition (e.g., quarterly), this cannot be reversed in subsequent periods.
- During the calendar year when the cohort/group is open for new business, every time CSM is recognized (e.g., quarterly) ,the allocated pre-recognition acquisition cash flow asset is partly derecognized based on actual premiums/anticipated premiums for the period
- At the ending of each reporting period it may be observed that the actual premium is higher than anticipated, that would mean that using the described derecognition method (pre-recognition acquisition cash flows asset x (actual/anticipated premium) leads to derecognizing more acquisition cash flows .Conversely if actual premium is lower than anticipated, then more is derecognized in earlier years

Identify pre-recognition attributable expenses (3/3)

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- A difference between actual premium and anticipated premium can be broadly because of timing differences, a change in business volumes or a mix of both changes in business volumes and timing of cash flows. At each reporting period entity needs to assess whether there is an indication for impairment.

- Before performing the impairment assessment, it is important the entity updates the allocation to future periods to reflect timing differences and/or changes in business volumes. For example, in case the actual premium is higher than anticipated, an entity has to assess whether anticipated premiums in future periods need to be decreased (because of timing differences – e.g. new business incepted earlier but total expected anticipated premium does not change) or increased (because total business volumes is higher). No re-allocation can take place after closure of the CSM group.

Step 3: Amortization of acquisition cash flows

Allocation of Acquisition expense year on year should be done on a systematic way based on passage of time. Below is the principle for systematic allocation by using CUA.

- Determine the appropriate coverage units for the group of contracts;
- Amortize the acquisition cash flows of that group based on the proportion of total coverage units, computed according to the step above, and allocated to the current period;

List of current expense/charges item and considerations

Sr No.	List of Expense items as Per Schedule 7
1	Employees' remuneration & welfare benefits
2	Travel, conveyance and vehicle running expenses
3	Training expenses
4	Rents, rates & taxes
5	Repairs
6	Printing & stationery
7	Communication
8	Legal & professional charges
9	Auditors' fees, expenses etc.
10	Advertisement and publicity
11	Interest & Bank Charges
12	Depreciation
13	Outsourcing Expenses
14	Information & technology expenses

Majority of the expense items on the right, will not have a clear tagging of attributable/non-attributable expense.

There will be a portion of each line item which can be directly tagged as attributable. For e.g., salaries of underwriting team/claims team, commissions of agents, filing of products, product brochures, renewal communication, pricing tools, sales software, claims processing system, etc.

Then, there will be items that are essential for business but be considered either directly or not directly attributable expenses. For e.g., Auditor's expense, brand awareness, Executive office costs, Depreciation.

The objective of the classification is to identify expenses that can have affect the future cashflow valuations (FCF)/CSM.

- As per the standard, contracts valued under PAA with a duration of 1 year or less, attributable expenses can be recognized when incurred.
- For GMM, attributable expenses will have an impact on FCF valuations and non-attributable will have to be recognized when incurred.

ACQ	Acquisition Expenses - to be capitalised
Main - ISE	Maintainance Expenses part of Insurance Service Expenses (P&L)
OE - ISE	Other Support Function Expenses part of Insurance Service Expenses (P&L)
CH - ISE	Claim Handling Expenses part of Insurance Service Expenses (P&L)

Cost Heads	**Direct/Allocation**	**Classification by Cost Head**	**Underwriting**	**Agency Management**	**IT and Infrastrcture**	**Legal & Compliance**	**Finance**	**Actuarial**	**Human Resources & Operations Department**	**Claims**	**Reinsurance**
STAFF SALARIES	Direct	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
BENEFITS	Direct	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
PENSIONS	Direct	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
INCENTIVE COMPENSATION	Direct	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
SALARY & RELATED											
TRAINING	Allocation	Other expenses	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE
TEMPORARY HELP SALARIES	Allocation	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
PAYROLL TAXES	Allocation	Other expenses	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE
RELOCATION EXPENSES	Allocation	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
RECRUITMENT FEES	Allocation	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
OTHER STAFF EXPENSES- CLUB FEES	Direct	Other expenses	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE
OTHER STAFF EXPENSES											
RENT AND RENT ITEMS	Allocation	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
EQUIPMENT REPAIRS AND RENTALS	Allocation	Maintainance	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	Main - ISE
INSURANCE CHARGES	Allocation	Maintainance	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	Main - ISE
DEPRECIATION - FURN/EQUIP	Allocation	Maintainance	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	Main - ISE
RENT / PROPERTY											
TRAVEL CHARGES	Allocation	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
ENTERTAINMENT - BUSINESS	Direct	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
ENTERTAINMENT- INTERNAL	Direct	Other Expenses	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE
DEPREIATION - AUTO	Allocation	Maintainance	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	Main - ISE
TRAVEL- RELATED											
ADVERTISING AND RELATED - GENERAL	Direct	Other Expenses	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE
ADVERTISING AND RELATED - PRODUCT	Allocation	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
ADVERTISING											
CONSULTING SERVICES	Allocation	Other Expenses	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE
COMPUTER SERVICES - REPAIRS AND MAINTAINANCE	Direct	Other Expenses	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE
LEGAL FEE	Direct	Other Expenses	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE
OUTSOURCED THIRD PARTY SERVICES	Allocation	Other Expenses	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE
SURVEY & INSPECTION REPORTS FEE	Direct	Maintainance	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	Main - ISE
OUTSIDE SERVICES											
HARDWARE EXPENSES	Allocation	Maintainance	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	Main - ISE
HARDWARE DEPRECIATION	Allocation	Maintainance	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	Main - ISE
DATA COMMUNICTION	Allocation	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
GLOBAL IT CHARGES	Allocation	Maintainance	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	Main - ISE
DATA COMMUNICATION	Allocation	Maintainance	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	Main - ISE
SOFTWARE EXPENSES	Allocation	Maintainance	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	Main - ISE
SOFTWARE DEPRECIATION	Allocation	Maintainance	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	Main - ISE
INFO TECH - ISENOLOGY											
BANK FEES & CHARGES	Direct	Other Expenses	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE
POSTAGE/COURIER	Allocation	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
PRINTING & STATIONERY	Allocation	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
TELEPHONE/ FAX	Allocation	Mixed	ACQ	ACQ	Main - ISE	Main - ISE	Main - ISE	Main - ISE	Main - ISE	CH - ISE	ACQ
PRINTING & POSTAGE											
MISCELLANEOUS EXPENSES	Direct/Allocation	Other Expenses	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE	OE - ISE
OTHERS											

Thank You