5th GCA
Deficit in Policyholder's Fund

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Deficit in Policyholder's Fund

- Focus on
  - Statutory Reporting
  - Policyholder Protection
  - Bonus Regulation
  - Solvency
  - Some Taxation Issues
  - NOT Realistic Reporting of profits

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Deficit in Policyholder's Fund

- Background
- Requirement of The 1938 Act and IRDA Regulations
- Methods of Dealing with Deficit
- Consequences for Indian Insurers and Actuaries
- Practice of Other Countries and View of Other Actuarial Bodies

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Background

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Background

- Indian Insurance Industry opened again for private participation in year 2000
- Participating business is marketed by new companies
  - Need for new life funds
  - New Life funds tend not to have retained profits or profits generated by existing business to mitigate cost of capital of new business
  - Expense overruns are high
  - Hence deficits occur

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Background

- However, deficits can still occur due to
  - Mis-pricing
  - Mismanagement
  - Inappropriate Asset Liability Management (ALM)
  - Therefore, deficits not unique to Indian environment

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Background

- Definition of Deficit - should be defined
  - Best estimate liability level or solvency?
    - What if life fund has no deficit at the best estimate level of liability?
  - What level of MAD and PAD?
  - What is the basis of asset valuation - marked to market or book?
  - Should deficit be eliminated only at balance sheet date?
  - Deficits calculated for each fund or aggregate of all funds?

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Requirement of The 1938 Act and IRDA Regulations

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Requirement of The 1938 Act and IRDA Regulations

- The IRDA Act 1999 amended the Insurance Act 1938
  - insurers are required to keep separate accounts for policyholders and shareholders
  - PREPARATION OF FINANCIAL STATEMENTS AND AUDITOR'S REPORT OF INSURANCE COMPANIES) REGULATIONS, 2002 requires the accounts to be shown separately.

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Methods of Dealing with Deficit

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Methods of Dealing with Deficit

- Allow the deficit to continue
- Transfer from shareholders fund to cover the deficit
- Earmark assets to cover the deficit
- Shareholder loaned funds to the policyholder
- Reinsurance with reinsurers
- Reinsurance between funds?

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Methods of Dealing with Deficit

- Allow the deficit to continue
  - As long as total company meets its solvency requirement
  - Other creditors (of the shareholders) should be made clearly subordinated to policyholders
  - ALM can be managed through the use of a "shadow portfolio"

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Methods of Dealing with Deficit

- Transfer from shareholders fund to cover the deficit
  - Straight forward but
    - 90/10 gate applies on the way out
    - capital injected into fund is NOT tax deductible

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Methods of Dealing with Deficit

- Earmark assets to cover the deficit
  - Assets must be of good quality
  - Other creditors (of the shareholders) should be made clearly subordinated to policyholders

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Methods of Dealing with Deficit

- Shareholder loaned funds to the policyholder
  - Through subordinated (sub) debt or other means
  - Legislation does seem to allow policyholder fund surplus to be used to service “Debentures”
  - Should interest on the loan be allowed and at what level?
  - Must avoid double counting of loan asset in both policyholder and shareholder funds

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Methods of Dealing with Deficit

- Reinsurance with reinsurers and/or Reinsurance between funds?
  - IRDA Reinsurance Regulations do not allow for reinsurance at original terms
  - Is reinsurance between funds allowed?
  - Reinsurance without true risk transfer should really be recognized as a loan?
    - Is a loan under US GAAP
    - The impact would then be on solvency margin only - as one liability is replaced by another one

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Consequences for Indian Insurers and Actuaries

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Consequences for Indian Insurers and Actuaries

- If deficit not covered by funds injection
  - Is the policyholder's interest really protected?
  - How to gauge Policyholder Reasonable Expectation?
    - Is subordinated debt truly subordinated?
    - Should deficit financing other than capital injection be disclosed to the policyholder?

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Consequences for Indian Insurers and Actuaries

- Capital
  - once capital in fund, 90/10 gate applies on the way out
- Taxation
  - although we are focusing on statutory and solvency reporting, tax is an issue
  - taxation should be consistent with statutory treatment
  - capital injected into fund is NOT tax deductible

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Consequences for Indian Insurers and Actuaries

- Insurance Act 1938
  - Only allows dividends/bonuses to be declared out of surplus
  - Indian insurers are limited therefore to two choices
    - Inject capital
    - Loan from shareholder’s fund (if allowed by the IRDA)

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Practice of Other Countries and View of Other Actuarial Bodies

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Practice of Other Countries and View of Other Actuarial Bodies

- Australia
  - Statutory funds are kept
  - Assets in each fund must be able to cover liabilities (and Capad) independently
  - Shareholder must transfer or retain (their share of) profits in the fund
  - But
    - shareholders can account for their interest in the fund
    - shareholders can transfer their interest out when not needed

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Practice of Other Countries and View of Other Actuarial Bodies

- Australia
  - Advantage
    - safety of policyholder's interest
    - recognizing shareholders can transfer their interest out when not needed

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Practice of Other Countries and View of Other Actuarial Bodies

- Singapore and Malaysia
  - No deficit allowed in fund
  - Shareholder must transfer to cover deficit
  - Shareholder can only recover the capital through the bonus declaration method (and share 90/10 with the policyholders)

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Practice of Other Countries and View of Other Actuarial Bodies

- Japan
  - Most Large companies are mutual companies
    - selling par and non-par business
  - No Life fund concept, solvency at the company level
  - Many companies have run into solvency problems and
    - haven been taken over
    - rescued by "group companies" through subordinated debt which counts a capital
    - taken over by industry protection fund and subsequently sold

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Practice of Other Countries and View of Other Actuarial Bodies

- Korea
  - No Life fund concept, solvency at the company level
  - Par business have a separate income statement and balance sheet
    - no segregation of assets, separate bank accounts,..
    - Allocation of expenses and investment income defined by regulations
    - deficits of par business is allowed to be carried forward
    - dividends can be declared even with deficits in par business
  - Companies have been in trouble and being supported by subordinated debt of parent/group companies

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Practice of Other Countries and View of Other Actuarial Bodies

- UK
  - Falling equity prices have resulted in support from shareholders in the policyholder's fund
  - Use of subordinated debt is common
  - Use of reinsurance is also common
  - UK actuarial profession is in active discussion regarding PRE, disclosure and solvency issues

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Practice of Other Countries and View of Other Actuarial Bodies

- USA
  - National Association of Insurance Commissioners (NAIC), the de facto regulator do not require assets and liabilities of life fund be separate from shareholder's fund
  - Solvency is looked at from a total company perspective
  - Demutualized companies set up a "par fund" to ensure that policyholders are protected
  - Par fund must be solvent

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Thank You

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Responsible for actuarial issues related to the Acquisition of License of the new life insurance venture between AIG and TATA Sons.

Appointed Actuary responsible for financial reporting (Indian statutory and US GAAP), capital analysis, regulatory product approval and is a member of the Investment Committee.

Formerly a Consultant, Tillinghast - Towers Perrin
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Head of financial reporting practice (US GAAP, IAS, statutory) for Asia.

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Also Developed variable and derivative linked products for the US and Canadian insurance markets.

About the Author :

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An originator of change with an excellent record of delivering commercial developments in insurance, and with particular specialisms in the development of insurance business by banks and savings banks, and in the construction of insurance business in developing markets.

Career

Sun Life of Canada (2001 – Present)

One of the world's foremost life assurance companies. Recently demutualised and now US listed.

Chief Financial Officer and Appointed Actuary **at Birla Sun Life Insurance Company, the start-up life insurer joint venture between India's Aditya Birla Group and Sun Life Financial, based in Mumbai (Bombay).**

KPMG (1993 – 2000)

One of the UK's leading professional advisory firms. Partners 600. Staff 10,000. Turnover £1bn.
Consultant **and** Partner **(1995) in KPMG's Financial Sector consulting practice.**

Abbey National Plc (1988 - 1993)

One of the country's leading retail banks, having converted from the building society sector. Assets £181bn, staff 29,000, market capitalisation £14bn, the UK's 21st largest quoted company.

Development Manager reporting to Deputy Chairman, responsible for developing general insurance business and leading the team negotiating a joint venture. Previously reporting to MD of Insurance and responsible for the development of the group's life & pensions business.

The Canada Life Assurance Company (1982 – 1988)

Marketing Actuary **(UK & RoI) reporting to board director, responsible for all marketing activity. Previously Assistant Actuary and manager of the Actuarial Department, then Product Development Actuary.**

National Provident Institution (1974 – 1982)

Line responsibility for group pensions actuarial function having held various management positions in the pension operation. Initial three years spent gaining foundation actuarial training and experience in long range planning.

Education & Qualifications

Institute of Actuaries
Actuarial Society of India Fellow (FIA**)**
Fellow (FASI**) 1981**
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University of London, Royal Holloway College
BSc (2:1) 1971 – 1974
William Hulme's Grammar School, Manchester 3 'A' levels, 7 'O' levels 1964 – 1971

Professional involvement in development of Actuarial Society of India (joint examiner for Non-Life Insurance). Member of Appointed Actuaries Forum.

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Andrew is Chief Actuary of Allianz Bajaj Life Insurance Company, one of the new fast growing entrants to the Indian life market. He is an affiliate member of the Actuarial Society of India and a fellow of the (UK) Institute of Actuaries and of the Institute of Actuaries of Australia

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