

5th Capacity Building Seminar on IFRS 17 at Hotel Fairfield by Marriott, Mumbai 26 September 2025

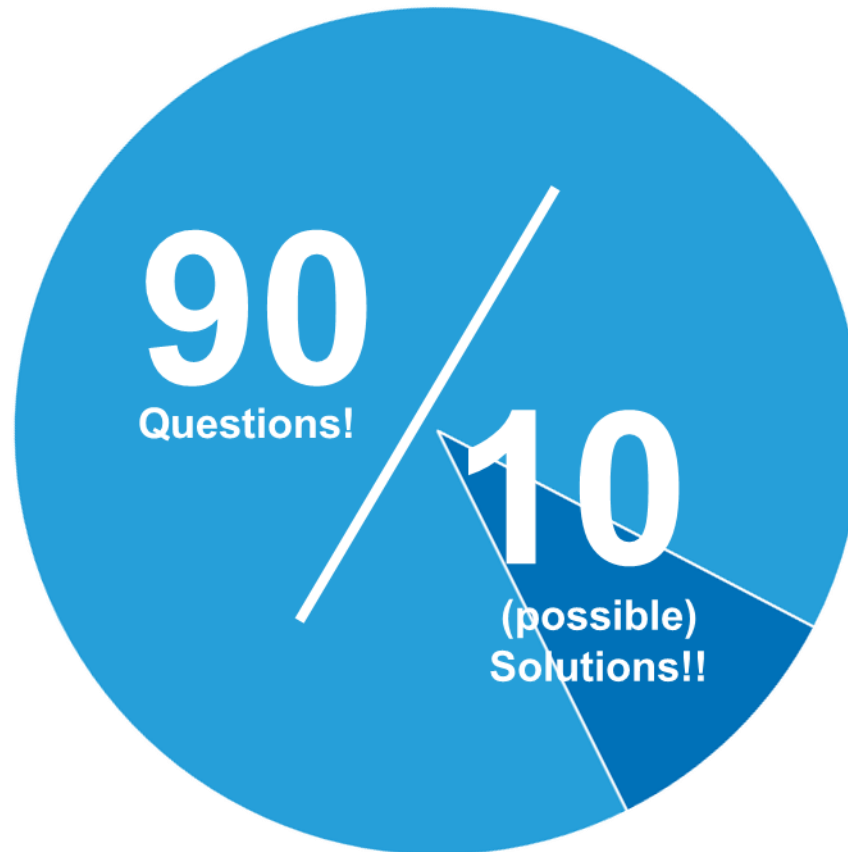
Treatment of participating business under Ind AS 117

Moderated by: Kunj Behari Maheshwari

**Discussion supported by: Kalpana N, Philip Jackson, Rajiv
Mukherjee, Keyur Parekh, Deepak BV**



Welcome!





What makes par-fund assessments under Ind AS 117 so *challenging* interesting?



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How is the surplus emergence & distribution different between IGAAP and Ind AS?

- No change in the “cash” surplus based on:
(premiums and investment income) *less* (expenses, commissions & benefits)
- Distribution of surplus to policyholders as bonus to continue based on bonus philosophy
(typically linked to assets shares)
- Physical asset-transfers to shareholders continue at 1/9th of cost of bonus
- **Key change:** Under IGAAP, any undistributed surplus gets allocated to:
Funds For Future Appropriation in IGAAP => no direct equivalent under Ind AS!
- **Under Ind AS with no direct equivalent of FFA; and all future service obligations and s/h profits thereof subsumed within Total Insurance Contract Liability (=PVCF + RA + CSM)**

With no FFA, how would the timing difference surplus emergence and distribution be captured?

As a component of liability:

- Policyholders' share (including current declared CoB and future declarations), regardless of whether those payments are expected to be made to **current or future policyholders** is captured within the fulfilment cash-flows.
- Shareholders' share is captured within the **CSM** (net of RA); and recognized in profits systematically over time - in line with coverage units.

Does this mean that profit recognition under Ind AS will not equal shareholder transfers?

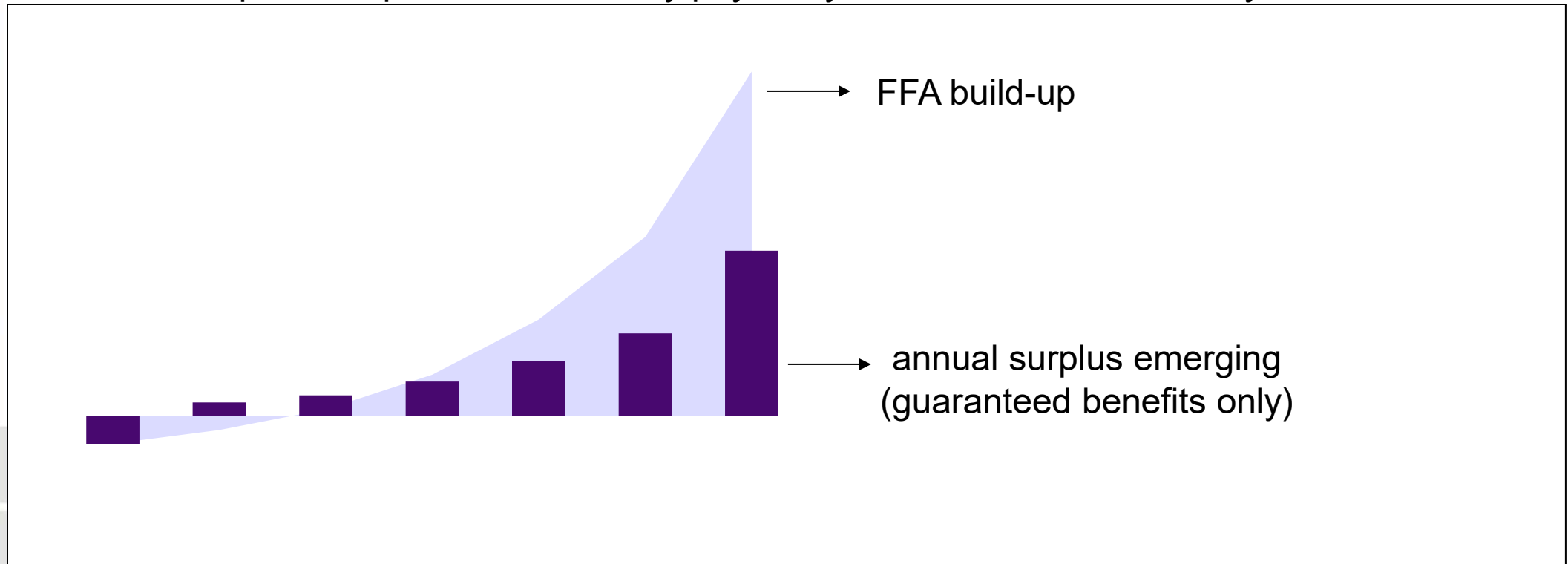
Yes! That is correct: profit recognition and shareholder transfers will not be the same.



Why is it appropriate for recognition under Ind AS to not equal shareholder transfers?

To allow for profit recognition over the lifetime as services are provided and not just at the times bonuses (and corresponding shareholder transfers) are paid.

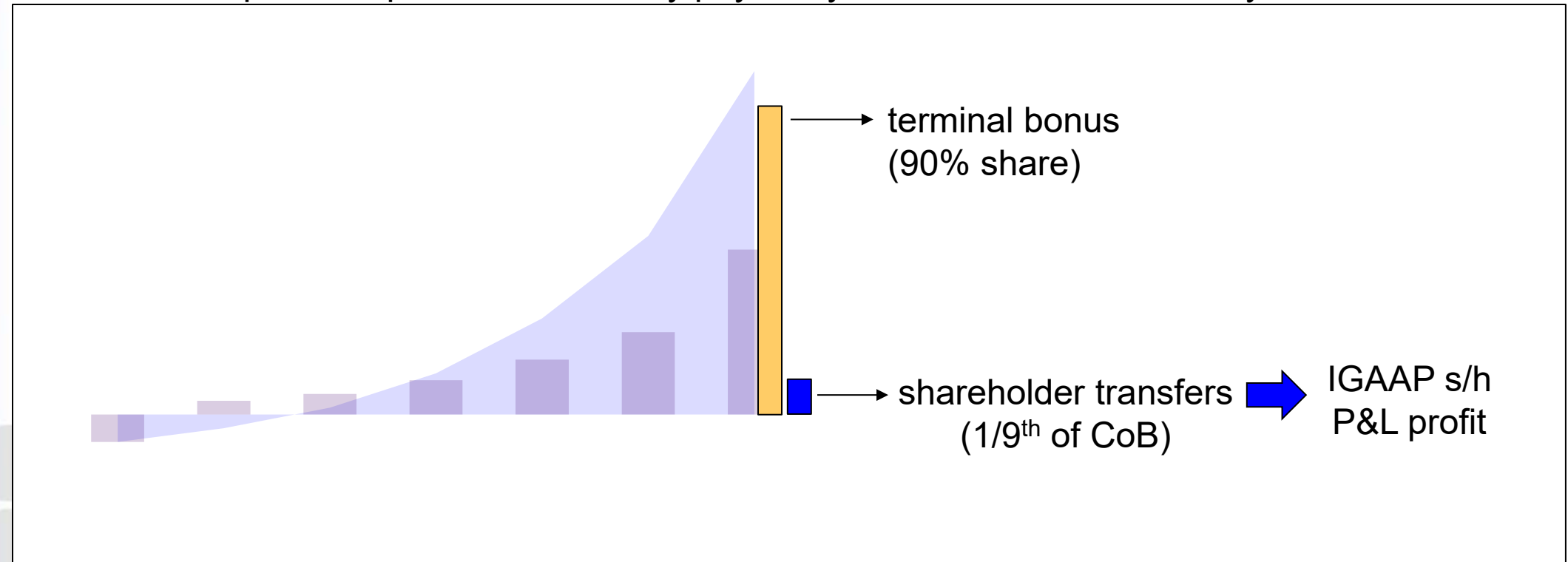
consider a simple example where an entity pays only terminal bonus at maturity:



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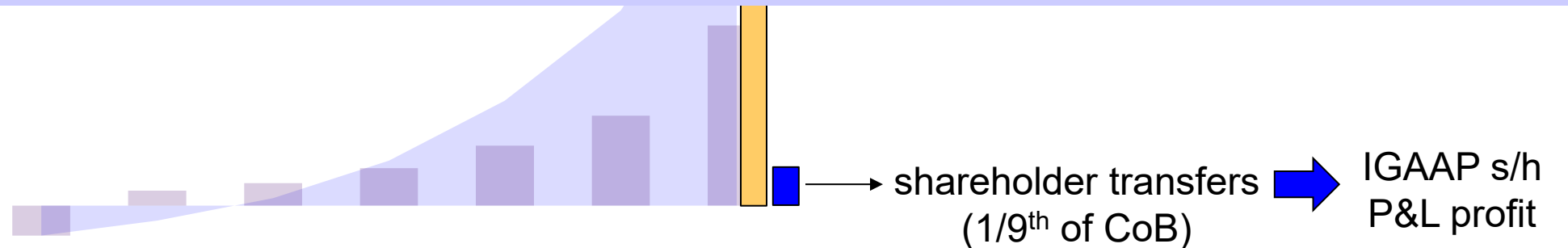


Why is it appropriate for recognition under Ind AS to not equal shareholder transfers?

To allow for profit recognition over the lifetime as services are provided and not just at the times bonuses (and corresponding shareholder transfers) are paid.

consider a simple example where an entity pays only terminal bonus at maturity:

Under IND AS, present value of shareholder transfers gets captured within the CSM (net of RA) at inception; and recognized as profits systematically over time based on coverage units: this aligns with IASB's intention of **faithful representation of earnings** as services are provided **on an accrual basis of accounting** as opposed to purely driven by choice of timing of payment of discretionary benefits.



What is the relationship between Ind AS profits and permitted shareholder transfers?

Over lifetime:

$$\sum_{\text{lifetime}} \text{shareholder transfers} = \sum_{\text{lifetime}} \text{Ind AS profits}$$

At initial recognition:

$$\text{PV shareholder transfers} = \text{CSM} + \text{RA}$$

At transition (under a Fair Value approach):

$$\begin{aligned} \text{PV shareholder transfers} &= \text{CSM} + \text{RA} \\ &+ \text{transition equity} \\ &\quad (\text{if any}) \end{aligned}$$



Would shareholder transfers equal Ind AS profits in each reporting period?



No. For each reporting period:

shareholder transfers = “variable fee”

The variable fee (or shareholder transfers) for a given reporting period may not equal the Ind AS profits recognized – following the principle of faithful recognition based on accrual principle of accounting.



What is “variable fee” ?

- B104 The conditions in paragraph B101 ensure that insurance contracts with direct participation features are contracts under which the entity’s obligation to the policyholder is the net of:
- (a) the obligation to pay the policyholder an amount equal to the fair value of the underlying items; and
 - (b) **a variable fee** (see paragraphs B110–B118) that the entity will deduct from (a) in exchange for the future service provided by the insurance contract, **comprising:**
 - (i) **the amount of the entity’s share of the fair value of the underlying items**; less
 - (ii) fulfilment cash flows that do not vary based on the returns on underlying items.

➔ **10% “shareholder share”
~ s/h transfers**



Quiz:

Q1: Can you think of an example of a situation when the shareholder transfer for a given year would **be higher than** the Ind AS profit?

Q2: Can you think of an example of a situation when the shareholder transfer for a given year would **be lower than** the Ind AS profit?

Illustration: emergence of Ind AS profits

Disclaimer:

Numerical illustrations have been simplified to focus solely on the first-order impacts of the primary topic under discussion. Specifically, the following simplifying assumptions have been made:

- Economic impacts from the accumulation of investment returns and discounting are excluded,
- Risk adjustments and related considerations are not included, and
- Similarly, other factors including investment components, reinsurance effects, loss components, taxation are also excluded

Simplified illustration: emergence of Ind AS profits

Fact Pattern and Initial Recognition CSM for an illustrative par fund cohort

	Y1	Y2	Y3
Fact pattern: underlying cash-flows			
CF - Premium income	10,000	10,000	10,000
Fact pattern: surplus distribution based on bonus policy			
Surplus emerging in the par fund ¹	10,000	10,000	10,000
Reversionary bonus declared (cost of bonus)	3,600	3,600	3,600
Terminal bonus declared			16,200

Notes:

1. Premium income is the only cash-flow assumed for simplicity. No other (guaranteed) cash-flows or investment income arise in the fund.

Simplified illustration: emergence of Ind AS profits

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Reversionary bonus declared (cost of bonus)	3,600	3,600	3,600
Terminal bonus declared			16,200
Shareholder transfers (1/9 th of CoB)	400	400	2200
CF - Maturity outgo ²	0	0	27,000

Notes:

1. Premium income is the only cash-flow assumed for simplicity. No other (guaranteed) cash-flows or investment income arise in the fund.
2. Non-guaranteed maturity outgo to policyholder is equal to the accumulated reversionary bonuses (3,600 x 3) and terminal bonus (16,200).

Simplified illustration: emergence of Ind AS profits

Fact Pattern and Initial Recognition CSM for an illustrative par fund cohort

	Y1	Y2	Y3
Fact " " " " " "			
CF - Premium income ¹			1,000
Fact " " " " " "			
Surplus			1,000
Reversionary bonus declared			600
Terminal bonus declared			16,200
Shareholder transfers (1/9 th of CoB)	400	400	2200
CF - Maturity outgo ²	0	0	27,000
Treatment under Ind AS 117:			
Fulfilment cash-flows at initial recognition ³	-3,000		
CSM at initial recognition	3,000		
CSM amortization to profits (assuming linear)	1,000	1,000	1,000

Key take-away: Timing of emergence of Ind AS profits (based on CSM amortization, and uniform 1,000 over the 3 years) differs from the timing of shareholder transfers (based on bonus declarations, being 400 / 400 / 2,200 over 3 years).

IGAAP profit

Ind AS profit

Notes:

1. Premium income is the only cash-flow assumed for simplicity. No other (guaranteed) cash-flows or investment income arise in the fund.
2. Non-guaranteed maturity outgo to policyholder is equal to the accumulated reversionary bonuses (3,600 x 3) and terminal bonus (16,200).
3. Fulfilment cash-flows represent the present value of future cashflows, ignoring risk adjustment, equal to expected maturity outgo minus premium incomes.



Would profit recognition based on coverage units be compliant with §49 of Insurance Act, 1938?



Not if the Ind AS profits were transferred to shareholders immediately each year:

Extract of relevant portion of Section 49 of the Insurance Act, 1938

¹[Provided further that the share of any such surplus allocated to or reserved for the shareholders, (including any amount for the payment of dividends guaranteed to them, whether by way of first charge or otherwise), shall not exceed such sums as may be specified by the Authority and such share shall in no case exceed ten per cent of such surplus in case of participating policies and in other cases the whole thereof.]

How to ensure compliance with §49 of Insurance Act, 1938 alongside Ind AS profit recognition?

Proposed solution (1):

IRDAI pro-forma reporting formats require separate columns for “policyholder” and “shareholder” accounts:

Key interpretation: The “policyholder” and “shareholder” columns to represent the profit or loss *as arising from each fund* within the Ind AS framework, rather than reflecting a ‘revenue account surplus’ in the policyholders’ column (that has no equivalence within the Ind AS framework). This would enable Indian insurers to present Ind AS profit and loss under the “policyholder” column for each segment / line of business *as arising from the application of Ind AS for that segment*; while the “shareholder” column would present permitted transfers from policyholder to shareholder funds and any additional sources of shareholder profits from within the shareholder fund

How to ensure compliance with §49 of Insurance Act, 1938 alongside Ind AS profit recognition?

Proposed solution (2):

Introduce a new 'below the line' item to account for transfers of profits or equity from the 'policyholder' to the 'shareholder' column. This reflects the amounts reported under Ind AS but transferable only after meeting the surplus distribution rules as per Insurance Act and relevant IRDAI regulations.

This would simultaneously ensure that a) reported profit and equity is computed as per the Ind AS requirements; and b) shareholder transfers and total physical assets within each fund remain as per the applicable regulatory requirements.

Simplified illustration: new lines to be inserted in the IRDAI pro-forma reporting formats for Ind AS

Table 2.2a: IRDAI reporting format for P&L with proposed presentation for transfers from policyholders to shareholder columns

Particulars	Year 1		
	Policyholders	Shareholders	Total
Insurance Service Result	1,000	0	1,000
Profit/(loss) for the period	1,000	0	1,000
Total Comprehensive Income	1,000	0	1,000
=> Additional lines to be added in IRDAI formats			
Transfers (from)/to policyholders' to/(from) shareholders'	-400	400	0
Total Comprehensive Income after transfers	600	400	1,000

Key take-away: Ind AS 117 comprehensive income arising from the par-fund is presented in the “policyholder” column; with actual shareholder transfers based on bonus distribution moved from “policyholder” to “shareholder” fund.

↑
Compliant with
§49 of Insurance
Act, 1938

↑
Compliant with
Ind AS profit
recognition

Simplified illustration: new lines to be inserted in the IRDAI pro-forma reporting formats for Ind AS

...extending to the remaining years:

Table 2.2a: IRDAI reporting format for P&L with proposed presentation for transfers from policyholders to shareholder columns

Particulars	Year 1			Year 2			Year 3		
	Policy-holders	Share-holders	Total	Policy-holders	Share-holders	Total	Policy-holders	Share-holders	Total
Insurance Service Result	1,000	0	1,000	1,000	0	1,000	1,000	0	1,000
Profit/(loss) for the period	1,000	0	1,000	1,000	0	1,000	1,000	0	1,000
Total Comprehensive Income	1,000	0	1,000	1,000	0	1,000	1,000	0	1,000
=> Additional lines to be added in IRDAI formats									
Transfers (from)/to policyholders' to/(from) shareholders'	-400	400	0	-400	400	0	-2,200	2,200	0
Total Comprehensive Income after transfers	600	400	1,000	600	400	1,000	-1,200	2,200	1,000

Key take-away: Over the projection period, policyholder column sums to zero (= 600+600-1200) with total Ind AS profits attributable to shareholders over time equal to the lifetime shareholder transfers (= 3,000)



Is there any international precedence for showing transfers between policyholder and shareholder columns as proposed?

Not to our knowledge.

The existence of separate columns for “policyholder” and “shareholder” fund appears to be unique to India, arising out of requirement in §11(2) of Insurance Act, 1938

⁶[**11. Accounts and balance-sheet.** — (1) Every insurer, on or after the date of the commencement of the Insurance Laws (Amendment) Act, 2015 (5 of 2015), in respect of insurance business transacted by him and in respect of his shareholders’ funds, shall, at the expiration of each financial year, prepare with reference to that year, balance sheet, a profit and loss account, a separate account of receipts and payments, a revenue account in accordance with the regulations as may be specified.

(2) Every insurer shall keep separate accounts relating to funds of shareholders and policyholders.

Would the total comprehensive income from policyholders' column form shareholder equity?

Yes and No.

Yes – because this is part of “total comprehensive income” under Ind AS and may be recognized as shareholder equity within the financial statements.

No – because this is encumbered within the par-fund; and its actual distribution to shareholders is restricted until corresponding shareholder transfers have not been affected (that are linked to bonuses – as per requirements of the Insurance Act).





How would the comprehensive income, post-transfers be presented Shareholder Equity?

Proposed solution (3):

Introduce a new 'balance for untransferred equity' that is withheld within the participating fund (and not transferred to shareholder fund until corresponding shareholder transfers are affected).

Within the IRDAI pro-forma reporting formats, this can be done by utilizing the column for "others" within "other equity" for showing the balance and movements during the year; as well as utilize the line-item for transfer to retained earnings for the (eventual) shareholder transfers from the participating fund to shareholder fund.

We have labelled this "USE TEST", that is: Untransferred Shareholder Equity representing Timing Effects of Shareholder Transfers.

How would the comprehensive income-post transfers be presented Shareholder Equity?

	Year 1
--	--------

Table 2.2b: IRDAI reporting format for Statement of Changes in Equity with proposed presentation for "USE TEST"

Statement of Changes in Equity			
B. Other Equity	Reserves & Surplus:	Others:	Total
Particulars	Retained	"USE TEST"	
Balance at the beginning of the year	0	0	0
Profit for the year		1,000	1,000
Total Comprehensive Income for the year		1,000	1,000
Transfer to Retained Earnings	400	-400	0
Balance at the end of the year	400	600	1,000



In the first instance, the Profit/(loss) for the period and Total Comprehensive Income is recognized within the column for Others – “USE TEST” in the Statement of Changes in Equity. Thereafter, once shareholder transfers are affected as permissible under the distribution rules, a “Transfer to Retained Earnings” is shown – with the amounts balancing in each year between “Others – USE TEST” and the accumulation of “Reserves and Surplus – Retained Earnings”.

What is “USE TEST”?

“USE TEST” is a proposed acronym for –

**Untransferred Shareholder Equity representing
Timing Effects of Shareholder Transfers**

USE TEST represents:

- an accounting balance arising from the timing mismatch of physical asset transfers from participating fund to shareholder fund (governed by surplus distribution requirements linked to policyholder bonuses as required by The Insurance Act, 1938 and IRDAI regulations) and the timing of recognition of profits under Ind AS (governed by amortization principle under the accounting standard)
- amounts reported as Ind AS profits but withheld within the participating fund
- a restricted shareholder equity

Is the “USE TEST” then same as FFA?

No.

This balance is distinct from the existing Funds for Future Appropriation (FFA) which will have not equivalence under Ind AS. While the FFA represents the undistributed surplus of the participating fund under IGAAP - available for future distribution to both policyholders and shareholders; the USE TEST pertains specifically to untransferred or excess transferred shareholder balances vis-à-vis the participating fund.

Why are we calling this “USE TEST”?

Other names for this amount include: “retained surplus – life fund” or “unallocated surplus of participating fund”.

The sole reason for not proposing a nomenclature with an equivalent taxonomy as “retained earnings” or “surplus” is to allow for the possibility where this balance is negative (for example, in a situation where the shareholder transfers are greater than the recognition of CSM in the period). In such situations, this balance does not represent “retained earnings”. Instead, it represents an amount already transferred to shareholder funds through bonus distribution but not yet recognised as earnings under Ind AS.

Therefore, we have (provisionally) labeled this simply as “**timing effects of shareholder transfers**” rather than “retained earnings”.



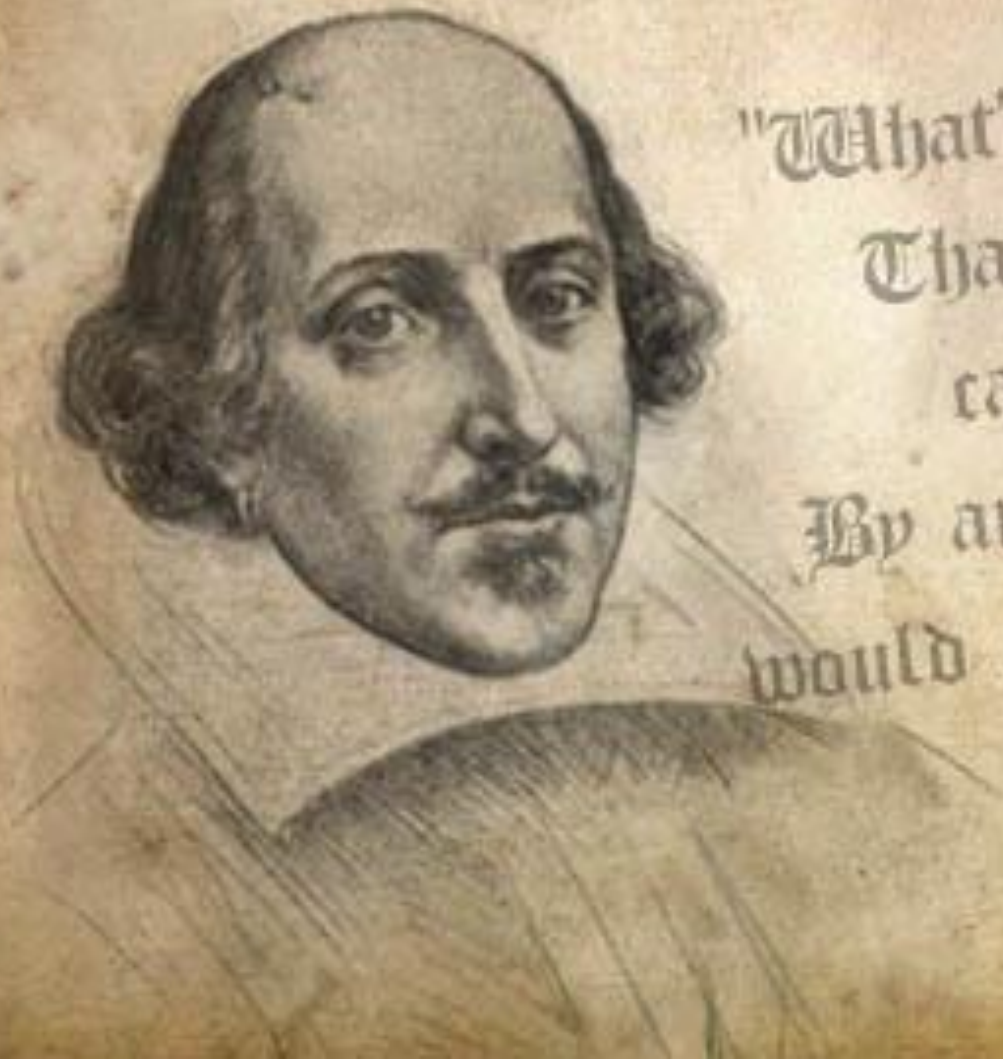
90

Questions!

10

(possible)
Solutions!

What's in a name?



"What's in a name?

That which we
call a rose

By any other name
would smell as sweet."





Quiz:

Q1: Can USE TEST be negative? In which situations would that arise?

Q2: Is USE TEST unique to participating fund only or could it potentially arise in non-par and unit-linked funds also?

How would the “USE TEST” evolve over time?

	Year 1			Year 2			Year 3		
Table 2.2b: IRDAI reporting format for Statement of Changes in Equity with proposed presentation for "USE TEST"									
Statement of Changes in Equity									
B. Other Equity	Reserves & Surplus: Retained	Others: "USE TEST"	Total	Reserves & Surplus: Retained	Others: "USE TEST"	Total	Reserves & Surplus: Retained	Others: "USE TEST"	Total
Particulars									
Balance at the beginning of the year	0	0	0	400	600	1,000	800	1,200	2,000
Profit for the year		1,000	1,000		1,000	1,000		1,000	1,000
Total Comprehensive Income for the year		1,000	1,000		1,000	1,000		1,000	1,000
Transfer to Retained Earnings	400	-400	0	400	-400	0	2,200	-2,200	0
Balance at the end of the year	400	600	1,000	800	1,200	2,000	3,000	0	3,000

Key take-away: At the end of the projection period, the balance of “USE TEST” should be nil, once all related policyholder payouts and shareholder transfers have been undertaken. This reflects the position that over the lifetime, the earnings recognized under Ind AS will equal the total shareholder transfers.

How is the Balance Sheet prepared with the introduction of the USE TEST?

Table 2.3: Proposed Balance Sheet presentation with “USE TEST”

	Y1	Y2	Y3
End of period balance sheet under Ind AS			
Total Assets¹	10,000	20,000	3,000
...of which, assets in the Life Fund ²	9,600	19,200	0
...of which, assets in the Shareholder Fund ³	400	800	3,000
Liabilities	9,000	18,000	0
Fulfilment cash-flows, FCF (= PVCF) ⁴	7,000	17,000	0
Contractual Service Margin (CSM)	2,000	1,000	0
Equity	1,000	2,000	3,000
Retained earnings within s/h fund	400	800	3,000
“USE TEST” within p/h fund	600	1,200	0

Notes:

1. Total assets represent the accumulation of premium incomes *minus* outgoes till date.
2. Life Fund assets within the participating fund equal to accumulated surpluses *minus* shareholder transfers
3. Accumulated shareholder transfers are based on annual bonus declarations.
4. End-of-period “best estimate liability” is calculated as expected maturity outgo (27,000) minus incomes (10,000 annual premiums).

Key take-away:

Total shareholder equity is divided into:

- retained earnings within shareholder funds; and
- “USE TEST” within the participating fund (encumbered due to timing effects of shareholder transfers).

Is there any international precedence for a balance equivalent to “USE TEST”?

Yes – some multinationals operating in jurisdictions with similar shareholder transfer restrictions have applied similar methods:

Exhibit 2A: Presentation of changes in equity for a large multinational with “Retained Earnings – Life Fund”

Statement of changes in equity for the year ended 31 December 2023 (continued)

	Attributable to owner of the Company					Distributable	
	Non-distributable						
	Other reserves						
	Share capital	FVOCI reserves	Insurance finance reserves	Other reserves	Total Other reserves	Retained earnings Life fund*	Total equity
	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
At 31 December 2022, as previously reported	236,600	(1,960)	-	2,891	931	365,229	1,695,783
Impact arising from adoption of MFRS 17 and MFRS 9	-	(16,153)	(39,663)	6,990	(48,826)	326,792	328,073
At 1 January 2023, Restated	236,600	(18,113)	(39,663)	9,881	(47,895)	1,692,021	2,023,856
Net losses on investments in debt securities measured at FVOCI	-	155,984	-	-	155,984	-	155,984
Net realised losses transferred to profit or loss	-	(4,384)	-	-	(4,384)	-	(4,384)
Fair value losses on cash flow hedge	-	(5,365)	-	-	(5,365)	-	(5,365)
Finance income from insurance contract issued	-	-	(87,859)	-	(87,859)	-	(87,859)
Finance expense from reinsurance contract held	-	-	(2,262)	-	(2,262)	-	(2,262)
Changes in expected credit losses	-	(80)	-	-	(80)	-	(80)
Net losses on investments in equity instruments measured at FVOCI	-	3,294	-	-	3,294	-	3,294
Revaluation of property, plant and equipment	-	-	-	3,947	3,947	-	3,947
Profit for the year	-	-	-	-	-	147,751	318,964
Total comprehensive income/(loss) for the year	-	149,449	(90,121)	3,947	63,275	147,751	382,239
Dividends to the owner of the Company (Note 23)	-	-	-	-	-	(108,126)	(108,126)
At 31 December 2023	236,600	131,336	(129,784)	13,828	15,380	1,839,772	2,297,969
	Note 9				Note 10	Note 10	

* Non-distributable retained earnings comprise life fund surplus (which includes Participating and Non-Participating funds), net of deferred tax, which is wholly attributable to the shareholders. This amount is only distributable upon the actual transfer of surplus from the Life fund to the Shareholder's fund as recommended by the Appointed Actuary and approved by the Board of Directors of the Company.

Source: Allianz Life Insurance Malaysia Berhad Financial statements for the year ended 31 December 2023

Recap

Core
problem

How to ensure compliance with surplus distribution rules (as per Section 49 of the Insurance Act) alongside systematic profit recognition over time (as per Ind AS 117)

Proposed
solution

- ➔ **1** Treat “policyholder” and “shareholder” columns to represent the profit or loss *as arising from each fund* within the Ind AS framework
- ➔ **2** Introduce a new ‘below the line’ item to account for transfers of profits from the ‘policyholder’ to the ‘shareholder’ column
- ➔ **3** Introduce a new ‘USE TEST’ that is withheld within the participating fund (and not transferred to shareholder fund until corresponding shareholder transfers are affected).

IRDAI Pro-
forma formats

P&L: additional
lines

Balance Sheet
& Equity

What happens to FCF and CSM when there is a variance between actual versus expected CFs?

Table 3.1: Impact of experience variance shared “90/10”: First Principles

	Y1	Y2	Y3
Fact pattern: underlying cash-flows			
CF - Premium income		10,000	10,000
Additional (unexpected) outgo – variance ¹		1,000	
Fact pattern: surplus distribution based on bonus policy			
Surplus emerging in the par fund ²		9,000	10,000
Reversionary bonus declared (cost of bonus)		3,600	3,600
Terminal bonus ²			15,300
Shareholder transfers (1/9 th of CoB) ³		400	2,100
Maturity outgo ²		0	26,100
Treatment under Ind AS 117:			
Fulfilment cash-flows, FCF (= PVCF)		16,100	0
CSM balance before amortization ⁴		1,900	950
CSM amortization to profits (assuming linear) ⁵		950	950

Key take-away:

Variance of 1,000 is attributable 90% to policyholders and 10% to shareholders – as per the par-fund management principles; with policyholders’ reduction in (future) bonuses representing future service (hence, reduction to FCF) and shareholders’ reduction to profits emerging from lower CSM amortization

Notes:

1. Variance due to an excess of 1,000 “actual” payouts (expense, claims etc.) than expected.
2. reversionary bonuses are assumed to remain unchanged and terminal bonus is revised to payout the asset shares, now lower by 1,000 – therefore accumulated surplus reduce by 1,000 resulting lower terminal bonuses by 900: from 16,200 to 15,300; and total maturity outgo reducing from 27,000 to 26,100 – thereby 90% of 1,000 variance being absorbed by policyholder fund.
3. 10% of 1,000 variance is attributable to shareholder, resulting in shareholder transfer reducing from 2,200 to 2,100
4. CSM before amortization reduces by 100 (being the entity’s share of the change in fair value of underlying items), applying Paragraph B112
5. CSM amortization implies that the reduction of 100 is recognized over the remaining years (current, Y2 and Y3) with net P&L impact of adverse variance of 1,000 being a reduction in lifetime profits by 100 (being 10% shareholder share); and current year profits reduce by only 50 (due to CSM amortization).

Don't economic variances impact CSM under VFA; while mortality/expense variance go to P&L?

Generally, yes. However, application of the following paragraphs result in all changes that affect “underlying items” being deemed as “economic impacts”

B112 Changes in the amount of the entity's share of the fair value of the underlying items (paragraph B104(b)(i)) relate to future service and adjust the contractual service margin, applying paragraph 45(b).

B128 (c) changes in the measurement of a group of insurance contracts caused by changes in the value of underlying items (excluding additions and withdrawals) are changes arising from the effect of the time value of money and financial risk and changes therein.





How do we ensure only 10%, being the shareholders' share is reflected in the P&L?

Proposed solution (4):

Introduce a “reversal” of experience variances observed in Insurance Service Result!

Paragraph 80 and 103b(i) of Ind AS 117 requires that the entity presents within the Insurance Service Expenses all incurred claims and expenses for the year, therefore the additional variance of 1,000 in the example above will need to be booked under Insurance Service Expense in entirety.

However, to achieve the result from the entity's / shareholder's perspective whereby only 10% of the variance impacts shareholder outcomes, a reversal is required in the profit and loss statement of the 100% variance booked in Insurance Service Expense.

“Reversing” the effect of variances from P&L sounds a bit arbitrary? How do we justify this?

The logic-chain behind the proposed reversal is as follows:

- **Incurred Claims and Expenses:** These are recorded under Insurance Service Expenses, while expected amounts are booked under Insurance Service Revenue. Any experience variances impact the Insurance Service Result.
- **Effect on Underlying Items:** Experience variances also cause changes to the associated asset shares or participating policy funds, leading to changes in the value of the underlying items.
- **Profit or Loss Reversal (Paragraph B134):** As required by Paragraph B134, the entity must recognize income or expenses in profit or loss that exactly offset the corresponding impact on the underlying items. This ensures that the net effect of the separately presented items in the profit and loss statement is nil, reversing the impact of the Insurance Service Result.
- **Measurement Changes (Paragraph B128c):** According to Paragraph B128c, changes in the measurement of a group of insurance contracts due to changes in the value of underlying items (excluding additions and withdrawals) are treated as arising from the effect of time value of money and financial risk. Consequently, the Insurance Service Result impact (equal to the experience variance) is reversed through an equal and opposite entry under Insurance Finance Income/Expense, reflecting the change in the value of the underlying items.

What is the P&L presentation of such reversals?

Table 3.3: Proposed P&L presentation under Ind AS 117 for par fund experience variance under the “90/10” gate

	Y1	Y2	Y3
Statement of Profit and Loss of Policyholders Funds			
Insurance Revenue ¹	1,000	950	950
Insurance Service Expense ²	0	- 1,000	0
Insurance Service Result	1,000	- 50	950
Insurance Finance Income/Expense ³	0	1,000	0
Net Finance Result	0	1,000	0
Profit/(loss) before tax	1,000	950	950

Notes:

1. In this simplified numerical example, Insurance Revenue reflects only the CSM amortization for each year, with expected claims and expenses being nil.
2. The 1,000 of Insurance Service Expense represents the variance, calculated as the difference between the actual amount (1,000) and the expected amount (0). It should be noted that incurred claims and expenses are recognized in full.
3. An Insurance Finance Income/Expense entry is recorded for an amount exactly equal to, but opposite of, the observed variance, as required by Paragraph B134. This ensures that the overall profit and loss impact from changes affecting the underlying item is nil.

Key take-away:

The reported profit for the year equals the CSM amortization, representing the recognition of shareholder transfers over the coverage period in proportion to coverage units. All other variances, both economic and non-economic, are ultimately “reversed” through Insurance Finance Income/Expense.

It was understood that finance result under VFA would be nil. However, this is not the case now. Why?

The IASB amended IFRS 17 Standard to address this and clarify that the intended “reversals” in IFIE were not just to make IFIE nil; but the impact to P&L as a whole nil!

B134 ... If an entity chooses to disaggregate insurance finance income or expenses applying paragraph 89(b), it shall include in profit or loss expenses or income that exactly match the income or expenses included in profit or loss for the underlying items, resulting in the net of the ~~two~~ separately presented items being nil.

Explanation by IASB staff: [...] requirement in paragraph B134 of IFRS 17 avoids an accounting mismatch in profit or loss **as a whole**, and the amount included for the insurance contracts is determined applying paragraph B134 of IFRS 17 by considering all income or expenses included in profit or loss for the underlying items, **wherever in profit or loss the income or expenses are presented.**

If such variances are “future service” and adjust the CSM, how is the Balance Sheet impacted?

Table 3.2: Proposed Balance Sheet presentation under Ind AS 117 for par fund experience variance under the “90/10” gate

	Y1	Y2	Y3
End of period balance sheet under Ind AS			
Total Assets¹	10,000	19,000	2,900
...of which, assets in the Life Fund ²	9,600	18,200	0
...of which, assets in the Shareholder Fund ³	400	800	2,900
Liabilities	9,000	17,050	0
Fulfilment cash-flows, FCF (= PVCF) ⁴	7,000	16,100	0
Contractual Service Margin (CSM)	2,000	950	0
Equity	1,000	1,950	2,900
Retained earnings within s/h fund	400	800	2,900
“USE TEST” within p/h fund	600	1,150	0

Notes:

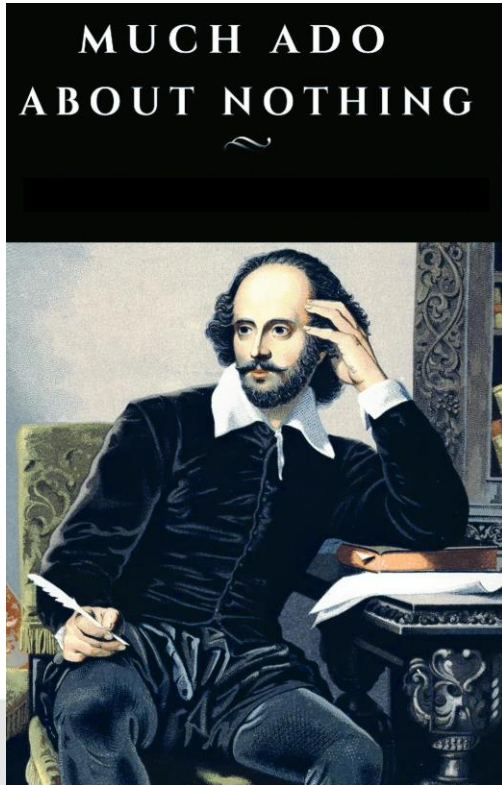
1. Assets at the end of Y2 are lower by 1,000 from 20,000 to 19,000 due to the variance; whereas at the end of Y3, assets are lower by only 100 due to 900 being absorbed by lower policyholder payouts.
2. In the first instance, payouts are met from the available assets within the par fund, hence lower by 1,000.
3. Y2 s/h transfers remain unchanged due to no change in reversionary bonuses; Y3 transfers are now 100 lower.
4. PVCF reduces from 17,000 to 16,100 – representing 90% of the variance attributable to policyholders in respect of lower future service (a la lower terminal bonus / maturity payout).

Key take-away:

Variance of 1,000 in Y2 impacts each of the three components of liability and equity: 900 lower FCF (policyholder liabilities); 50 lower CSM (future earned profits) and 50 lower shareholder equity (current period recognition of shareholder’s share). The shareholder transfers from cost of bonus – and hence distributable equity – in the current year remains unaffected (unless current period bonus declaration is changed).

Does this mean that the profits from par business are not simply the release of CSM and RA?

Yes! And this is a key implication of the proposed solution



Key take-away:

Our proposed approach **materially simplifies profit and loss reporting for participating businesses**. Under this treatment, profits for the year are simply the CSM amortization for the year. The remaining amounts result in a net balance of nil for separately presented items, as envisaged by Paragraph B134.

What happens if we do not reverse the variances impacts from the P&L?

Table 3.4: Balance Sheet and P&L presentation if variance was not “reversed”

	Y1	Y2	Y3
End of period balance sheet under Ind AS			
Total Assets¹	10,000	19,000	2,900
...of which, assets in the Life Fund	9,600	18,200	0
...of which, assets in the Shareholder Fund	400	800	2,900
Liabilities	9,000	17,550	0
Fulfilment cash-flows, FCF (= PVCF) ⁵	7,000	16,100	0
Contractual Service Margin (CSM) ⁸	2,000	1,450	0
Equity	1,000	1,450	2,900
Retained earnings within s/h fund	400	800	2,900
“USE TEST” within p/h fund	600	650	0
Statement of Profit and Loss of Policyholders Funds			
Insurance Revenue ⁷	1,000	1,450	1,450
Insurance Service Expense ²	0	-1,000	0
Insurance Service Result	1,000	450	1,450
Insurance Finance Income/Expense ³	0	0	0
Net Finance Result	0	0	0
Profit/(loss) before tax⁵	1,000	450	1,450

Notes:

1. Asset position remains unchanged.
2. Incurred claims and expenses are recognized in full: and represent the variance
3. IFIE remains nil and no offsetting adjustment of +1,000 is carried out in the Net Finance Result.
4. First order: profit for the year is reduced by 1,000.
5. Second-order: future terminal bonuses are reduced by 900 and future shareholder transfers reduce by 100. The reduction of 900 is reflected in a lower PVCF (=16,100 as opposed to 17,000).
6. Reduction in PVCF gets reflected in a higher CSM before amortization (since, we are treating all second-order impacts as future service): which results in a CSM increase of 900. The higher CSM is released to profit based on coverage units over time.
Therefore, the net impact to the P&L is: a reduction of 1,000 in current period due to variance; and an increase in CSM by 900 realised over time, resulting in a net lifetime impact to earnings of 100 – being the shareholder’s share; alongside a lower terminal bonus by 900, being the policyholder’s share, as expected under the “90/10” par fund.
7. CSM release in current year contributing to revenue is therefore 1,450, being 1,000 from the original CSM and 900/2 in each of Y2 and Y3, assuming linear amortization from the variance. This results in a higher insurance service revenue.
8. Lastly, the residual balance of CSM at the end of the year is = 2,000 (prior year balance) + 900 (increased due to variance resulting in lower PVCF), released 1,450 in the current year; and balance 1,450 carried over to next year.

It has so far been assumed that all surpluses are modelled and there are no “residual surpluses”. Is that too simplistic?

Yes. In practice, there are situations where the total value of assets in the par-fund may be higher than “modelled liabilities” due to several reasons:

- **Model simplifications:** Liability cash flow modelling may be based on an input bonus assumption that does not fully account for the entirety of the surpluses emerging from the projection of asset share.
- **Asset share and bonus distribution policy:**
 - Certain charges, such as a cost of capital or a cost of guarantee charge, may be deducted over time from the asset share and allocated to the “par fund estate”.
 - Bonus philosophy may dictate that some surpluses or deficits are not allocated to asset shares over the projection but instead funded by the par estate. For example, incurred expenses exceeding the “loaded” amount may be met by the estate, rather than impacting the asset shares or underlying items.
 - Similarly, surrender profits or surpluses from paid-up policies or riders attached to participating policies may not directly contribute to asset shares but may instead be allocated to the par fund estate, depending on the Company’s asset share framework.
 - Further, a Company may smoothen maturity or other payouts or may systematically overpay or underpay policyholders in order to build or exhaust the par-fund estate.

How would such residual surplus or par-fund estate be captured if not modelled as part of CFs?

By allowing for mutualization (B68 – B70) and holding a liability for the residual CFs (B71)

Different practical approaches are possible to set this up: with the principal tenets being:

- **Permitted interactions across groups of insurance contracts / cohorts.**
- **Intergenerational interactions: including liability for fulfilment cash-flows assessed in regardless of whether those payments are expected to be made to current or future policyholders.**
- **Permitted assessment of a liability against fulfilment cash-flows “at an aggregate level” without the need to allocate to individual cohorts.**

Risk adjustment: Can (partial) benefit of impacts being absorbed by the par-fund be taken?

Yes.

The impact of non-financial risks may partly be absorbed within the participating fund due to availability of the estate and/or the ability of the insurer to reduce future bonuses to policyholders, where bonus philosophy of the entity reflects the asset shares after allowing for emerging experience, including any adverse impacts from non-financial risk events. Nevertheless, residual risk from entity's perspective remains to the extent of a) lower shareholder transfers – arising due to lower associated policyholder bonuses and distribution of the current and future of estate; and b) possibility of shareholders funding burn-through costs in case available assets within the participating fund are insufficient to meet the guaranteed cash-flows.

Therefore, risk adjustment may be measured from the entity's perspective to the extent of such residual risks. For practical purposes, the estimates of risk adjustments may be derived as the impact of present value of shareholder transfers after allowing for (reduced) future bonuses and distribution of current and future estate under scenarios for which non-financial risks are assessed. This allows for both, the partial absorption of non-financial risk impacts within the par fund (due to lower bonuses and loss absorption by the projected estate) as well as the shareholder perspective (due to lower future shareholder transfers).

Reinsurance: how do reinsurance profits/losses get captured as they comprise “asset shares” too?

Reinsurance surplus/deficits would also form part of the underlying items for the gross contracts; and any variances thereby may also be “reversed” in the P&L via IFIE.

This treatment may be implemented in one of two ways:

- **Explicitly (appropriate when reinsurance surplus is shared with asset shares):** by modelling the interactions between gross and reinsurance cohorts, so that reversals of current-period reinsurance variances are passed back to the future service impacts under gross-cohort PVCF and CSM; or
- **Implicitly (appropriate when reinsurance surplus forms part of the estate):** by capturing such impacts within residual balances under the B71 liability. The change in shareholder transfer should be attributed back to the cohorts that generated those respective reinsurance cash flows in their respective amounts

Par fund taxes: would these be part of FCF?

Policyholder taxes that are payable on the cost of bonuses or on policyholder surpluses, but settled by the entity in a fiduciary capacity, form part of fulfilment cash flows in accordance with Paragraph B65(j). These should therefore be modelled and captured within the PVCF.

By contrast, shareholder transfers and CSM balances may need to be assessed on a gross-of-tax basis. Taxes on shareholder transfers (or on shareholders' share of surpluses) may be assumed to be paid from the release or emergence of the CSM. This ensures consistency with the recognition of profit emergence and CSM release in other lines of business.



Can there be onerous contracts in par-fund?

Where the entity's internal bonus distribution policy and policyholder contracts permit intergenerational cross-subsidization of surplus and support mutualization, Ind AS allows cash flows from one group of contracts to be reduced in order to meet the obligations of another group.

Consequently, once mutualization is applied—particularly after allowing for the distribution of current and future estate — **it is possible that no onerous contracts exist within the participating fund.**

This interpretation is supported by two considerations: a) financial statements are prepared from the entity's perspective; and b) the emergence of loss components is recognized immediately in the P&L, implying an immediate loss to the entity. Within the financial statements, this would imply a “capital injection” from shareholder into the participating fund and/or reduced shareholder transfers, to the extent of such.

Insofar as such losses are not borne by the entity but instead by the residual surplus in the participating fund, it may be reasonable to conclude that no loss components or onerous contracts arise in the participating fund after mutualization and estate consumption.

Are all expenses allocated to par-fund “attributable” ?

Generally, yes. Paragraph B65 requires that all acquisition, policy administration, and maintenance expenses, as well as a portion of fixed and overhead costs directly attributable to fulfilling insurance contracts, be included as part of fulfilment cash flows.

Where the entire participating fund is treated as the “underlying item,” or where all sources of surplus—including expenses allocated to the participating fund or asset shares—affect policyholder bonuses, the full expenses allocated to the participating fund or asset shares directly influence the benefits arising from the contracts, and therefore their “fulfilment”. In such cases, these expenses may be considered “attributable”.

If any “non-attributable” expenses are identified—i.e., those allocated to the participating fund but not to specific groups of insurance contracts—further consideration may be given to whether such expenses are ultimately adjusted through B71 balances. In that case, they would implicitly become attributable, albeit to an unspecified cohort. B65(m) specifically requires considering any other costs specifically chargeable to the policyholder under the terms of the contract - hence while nature of costs may be “non-attributable”, these may form part of the fulfilment cash flows.



Summary: key take-away's from the proposed solutions



① Treat “policyholder” and “shareholder” columns to represent the profit or loss as arising from each fund within the Ind AS framework	⑥ Risk Adjustment is computed from entity’s perspective only; with loss absorbency within the par-fund permitted
② Introduce a new ‘below the line’ item to account for transfers of profits from the ‘policyholder’ to the ‘shareholder’ column	⑦ Reinsurance profits / losses plough back to “direct contract” underlying items (and hence, 90% to direct contract PVCF and 10% CSM)
③ Introduce a new ‘USE TEST’ to represent equity withheld within the par fund until corresponding shareholder transfers are affected.	⑧ Policyholder taxes form part of FCF; shareholder taxes do not – with CSM gross of tax.
④ Reverse all sources of variances (including economic and operating variances) in the P&L via IFIE with 10% impact to CSM	⑨ (potentially) no onerous contracts in the par-fund
⑤ Capture “residual” estate items via mutualisation and B71 liability	⑩ (potentially) 100% expenses allocated to the par-fund are attributable.



Any further questions and discussion?

