Indian Accounting Standard (Ind AS) 104

Insurance Contracts

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Indian Accounting Standard (Ind AS) 104

Insurance Contracts[1]

*(This Indian Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.).*

Objective

The objective of this Indian Accounting Standard is to specify the financial reporting for *insurance contracts* by any entity that issues such contracts (described in this Indian Accounting Standard as an *insurer*). In particular, this Indian Accounting Standard requires:

limited improvements to accounting by insurers for insurance contracts.

disclosure that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts.

Scope

An entity shall apply this Indian Accounting Standard to:

insurance contracts (including *reinsurance contracts*) that it issues and reinsurance contracts that it holds.

financial instruments that it issues with a *discretionary participation feature* (see paragraph 35). Ind AS 107 *Financial Instruments: Disclosures* requires disclosure about financial instruments, including financial instruments that contain such features.

This Indian Accounting Standard does not address other aspects of accounting by insurers, such as accounting for financial assets held by insurers and financial liabilities issued by insurers (see Ind AS 32 *Financial Instruments: Presentation*,Ind AS 39 *Financial Instruments: Recognition and Measurement* and Ind AS 107).

An entity shall not apply this Indian Accounting Standard to:

[1] This Indian Accounting Standard shall come into effect for insurance companies from the date to be separately announced.

product warranties issued directly by a manufacturer, dealer or retailer (see Ind AS 18 *Revenue* and Ind AS 37 *Provisions, Contingent Liabilities and Contingent Assets*).

employers' assets and liabilities under employee benefit plans (see Ind AS 19 *Employee Benefits* and Ind AS 102 *Share-based Payment*) and retirement benefit obligations reported by defined benefit retirement plans.

contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item (for example, some licence fees, royalties, contingent lease payments and similar items), as well as a lessee's residual value guarantee embedded in a finance lease (see Ind AS 17 *Leases*, Ind AS 18 *Revenue* and Ind AS 38 *Intangible Assets*).

financial guarantee contracts unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, in which case the issuer may elect to apply either Ind AS 39 , Ind AS 32 and Ind AS 107 or this Standard to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable.

contingent consideration payable or receivable in a business combination (see Ind AS 103 *Business Combinations*).

direct insurance contracts that the entity holds (ie direct insurance contracts in which the entity is the *policyholder*). However, a *cedant* shall apply this Standard to reinsurance contracts that it holds.

For ease of reference, this Indian Accounting Standard describes any entity that issues an insurance contract as an insurer, whether or not the issuer is regarded as an insurer for legal or supervisory purposes.

A reinsurance contract is a type of insurance contract. Accordingly, all references in this Indian Accounting Standard to insurance contracts also apply to reinsurance contracts.

Embedded derivatives

Ind AS 39 requires an entity to separate some embedded derivatives from their host contract, measure them at *fair value* and include changes in their fair value in profit or loss. Ind AS 39 applies to derivatives embedded in an insurance contract unless the embedded derivative is itself an insurance contract.

As an exception to the requirement in Ind AS 39, an insurer need not separate, and measure at fair value, a policyholder's option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate), even if the exercise price differs from the carrying amount of the host *insurance liability*. However, the requirement in Ind AS 39 does apply to a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in a financial variable (such as an equity or commodity price or index), or a non-financial variable that is not specific to a party to the contract. Furthermore, that requirement also applies if the holder's ability to exercise a put option or cash surrender option is triggered by a change in such a variable (for example, a put option that can be exercised if a stock market index reaches a specified level).

Paragraph 8 applies equally to options to surrender a financial instrument containing a discretionary participation feature.

Unbundling of deposit components

Some insurance contracts contain both an insurance component and a *deposit component.* In some cases, an insurer is required or permitted to *unbundle* those components:

unbundling is required if both the following conditions are met

the insurer can measure the deposit component (including any embedded surrender options) separately (ie without considering the insurance component).

the insurer's accounting policies do not otherwise require it to recognise all obligations and rights arising from the deposit component.

unbundling is permitted, but not required, if the insurer can measure the deposit component separately as in (a)(i) but its accounting policies require it to recognise all obligations and rights arising from the deposit component, regardless of the basis used to measure those rights and obligations.

unbundling is prohibited if an insurer cannot measure the deposit component separately as in (a)(i).

The following is an example of a case when an insurer's accounting policies do not require it to recognise all obligations arising from a deposit component. A cedant receives compensation for losses from a *reinsurer*, but the contract obliges the cedant to repay the compensation in future years. That obligation arises from a deposit component. If the cedant's accounting policies would otherwise permit it to recognise the compensation as income without recognising the resulting obligation, unbundling is required.

To unbundle a contract, an insurer shall:

apply this Indian Accounting Standard to the insurance component.

apply Ind AS 39 to the deposit component.

Recognition and measurement

Temporary exemption from some other Indian Accounting Standards

Paragraphs 10–12 of Ind AS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* specify criteria for an entity to use in developing an accounting policy if no Indian Accounting Standard applies specifically to an item. However, this Indian Accounting Standard exempts an insurer from applying those criteria to its accounting policies for:

insurance contracts that it issues (including related acquisition costs and related intangible assets, such as those described in paragraphs 31 and 32); and

reinsurance contracts that it holds.

Nevertheless, this Indian Accounting Standard does not exempt an insurer from some implications of the criteria in paragraphs 10–12 of Ind AS 8. Specifically, an insurer;

shall not recognise as a liability any provisions for possible future claims, if those claims arise under insurance contracts that are not in existence at the end of the reporting period (such as catastrophe provisions and equalisation provisions).

shall carry out the *liability adequacy test* described in paragraphs 15–19.

shall remove an insurance liability (or a part of an insurance liability) from its balance sheet when, and only when, it is extinguished—ie when the obligation specified in the contract is discharged or cancelled or expires.

shall not offset:

reinsurance assets against the related insurance liabilities; or

income or expense from reinsurance contracts against the expense or income from the related insurance contracts.

shall consider whether its reinsurance assets are impaired (see paragraph 20).

Liability adequacy test

An insurer shall assess at the end of each reporting period whether its recognised insurance liabilities are adequate, using current estimates of future cash flows under its insurance contracts. If that assessment shows that the carrying amount of its insurance liabilities (less related deferred acquisition costs and related intangible assets, such as those discussed in paragraphs 31 and 32) is inadequate in the light of the estimated future cash flows, the entire deficiency shall be recognised in profit or loss.

If an insurer applies a liability adequacy test that meets specified minimum requirements, this Indian Accounting Standard imposes no further requirements. The minimum requirements are the following:

The test considers current estimates of all contractual cash flows, and of related cash flows such as claims handling costs, as well as cash flows resulting from embedded options and guarantees.

If the test shows that the liability is inadequate, the entire deficiency is recognised in profit or loss.

If an insurer's accounting policies do not require a liability adequacy test that meets the minimum requirements of paragraph 16, the insurer shall:

determine the carrying amount of the relevant insurance liabilities[2] less the carrying amount of:

any related deferred acquisition costs; and

any related intangible assets, such as those acquired in a business combination or portfolio transfer (see paragraphs 31 and 32). However, related reinsurance assets are not considered because an insurer accounts for them separately (see paragraph 20).

determine whether the amount described in (a) is less than the carrying amount that would be required if the relevant insurance liabilities were within the scope of Ind AS 37. If it is less, the insurer shall recognise the entire difference in profit or loss and decrease the carrying amount of the related deferred acquisition costs or related intangible assets or increase the carrying amount of the relevant insurance liabilities.

If an insurer's liability adequacy test meets the minimum requirements of paragraph 16, the test is applied at the level of aggregation specified in that test. If its liability adequacy test does not meet those minimum requirements, the comparison described in paragraph 17 shall be made at the level of a portfolio of contracts that are subject to broadly similar risks and managed together as a single portfolio.

The amount described in paragraph 17(b) (ie the result of applying Ind AS 37) shall reflect future investment margins (see paragraphs 27–29) if, and only if, the amount described in paragraph 17(a) also reflects those margins.

Impairment of reinsurance assets

If a cedant's reinsurance asset is impaired, the cedant shall reduce its carrying amount accordingly and recognise that impairment loss in profit or loss. A reinsurance asset is impaired if, and only if:

[2] The relevant insurance liabilities are those insurance liabilities (and related deferred acquisition costs and related intangible assets) for which the insurer's accounting policies do not require a liability adequacy test that meets the minimum requirements of paragraph 16.

there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the cedant may not receive all amounts due to it under the terms of the contract; and

that event has a reliably measurable impact on the amounts that the cedant will receive from the reinsurer.

Changes in accounting policies

Paragraphs 22-30 apply both to changes made by an insurer that already applies Ind ASs and to changes made by an insurer adopting Ind ASs for the first time.

An insurer may change its accounting policies for insurance contracts if, and only if, the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs. An insurer shall judge relevance and reliability by the criteria in Ind AS 8.

To justify changing its accounting policies for insurance contracts, an insurer shall show that the change brings its financial statements closer to meeting the criteria in Ind AS 8, but the change need not achieve full compliance with those criteria. The following specific issues are discussed below:

current interest rates (paragraph 24);

continuation of existing practices (paragraph 25);

prudence (paragraph 26);

future investment margins (paragraphs 27–29); and

shadow accounting (paragraph 30).

Current market interest rates

An insurer is permitted, but not required, to change its accounting policies so that it remeasures designated insurance liabilities[3] to reflect current market interest rates and recognises changes in those liabilities in profit or loss. At that time, it may also introduce accounting policies that require other current estimates

[3] In this paragraph, insurance liabilities include related deferred acquisition costs and related intangible assets, such as those discussed in paragraphs 31 and 32.

and assumptions for the designated liabilities. The election in this paragraph permits an insurer to change its accounting policies for designated liabilities, without applying those policies consistently to all similar liabilities as Ind AS 8 would otherwise require. If an insurer designates liabilities for this election, it shall continue to apply current market interest rates (and, if applicable, the other current estimates and assumptions) consistently in all periods to all these liabilities until they are extinguished.

Continuation of existing practices

An insurer may continue the following practices, but the introduction of any of them does not satisfy paragraph 22:

measuring insurance liabilities on an undiscounted basis.

measuring contractual rights to future investment management fees at an amount that exceeds their fair value as implied by a comparison with current fees charged by other market participants for similar services. It is likely that the fair value at inception of those contractual rights equals the origination costs paid, unless future investment management fees and related costs are out of line with market comparables.

using non-uniform accounting policies for the insurance contracts (and related deferred acquisition costs and related intangible assets, if any) of subsidiaries, except as permitted by paragraph 24. If those accounting policies are not uniform, an insurer may change them if the change does not make the accounting policies more diverse and also satisfies the other requirements in this Indian Accounting Standard.

Prudence

An insurer need not change its accounting policies for insurance contracts to eliminate excessive prudence. However, if an insurer already measures its insurance contracts with sufficient prudence, it shall not introduce additional prudence.

Future investment margins

An insurer need not change its accounting policies for insurance contracts to eliminate future investment margins. However, there is a rebuttable presumption that an insurer's financial statements will become less relevant and reliable if it introduces an accounting policy that reflects future investment margins in the measurement of insurance contracts, unless those margins affect the contractual payments. Two examples of accounting policies that reflect those margins are:

using a discount rate that reflects the estimated return on the insurer's assets; or

projecting the returns on those assets at an estimated rate of return, discounting those projected returns at a different rate and including the result in the measurement of the liability.

An insurer may overcome the rebuttable presumption described in paragraph 27 if, and only if, the other components of a change in accounting policies increase the relevance and reliability of its financial statements sufficiently to outweigh the decrease in relevance and reliability caused by the inclusion of future investment margins. For example, suppose that an insurer's existing accounting policies for insurance contracts involve excessively prudent assumptions set at inception and a discount rate prescribed by a regulator without direct reference to market conditions, and ignore some embedded options and guarantees. The insurer might make its financial statements more relevant and no less reliable by switching to a comprehensive investor-oriented basis of accounting that is widely used and involves:

current estimates and assumptions;

a reasonable (but not excessively prudent) adjustment to reflect risk and uncertainty;

measurements that reflect both the intrinsic value and time value of embedded options and guarantees; and

a current market discount rate, even if that discount rate reflects the estimated return on the insurer's assets.

In some measurement approaches, the discount rate is used to determine the present value of a future profit margin. That profit margin is then attributed to different periods using a formula. In those approaches, the discount rate affects the measurement of the liability only indirectly. In particular, the use of a less appropriate discount rate has a limited or no effect on the measurement of the liability at inception. However, in other approaches, the discount rate determines the measurement of the liability directly. In the latter case, because the introduction of an asset-based discount rate has a more significant effect, it is highly unlikely that an insurer could overcome the rebuttable presumption described in paragraph 27.

Shadow accounting

In some accounting models, realised gains or losses on an insurer's assets have a direct effect on the measurement of some or all of (a) its insurance liabilities, (b) related deferred acquisition costs and (c) related intangible assets, such as those described in paragraphs 31 and 32. An insurer is permitted, but not required, to change its accounting policies so that a recognised but unrealised gain or loss on an asset affects those measurements in the same way that a realised gain or loss does. The related adjustment to the insurance liability (or deferred acquisition costs or intangible assets) shall be recognised in other comprehensive income if, and only if, the unrealised gains or losses are recognised in other comprehensive income. This practice is sometimes described as 'shadow accounting'.

Insurance contracts acquired in a business combination or portfolio transfer

To comply with Ind AS 103, an insurer shall, at the acquisition date, measure at fair value the insurance liabilities assumed and *insurance assets* acquired in a business combination. However, an insurer is permitted, but not required, to use an expanded presentation that splits the fair value of acquired insurance contracts into two components:

a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and

an intangible asset, representing the difference between (i) the fair value of the contractual insurance rights acquired and insurance obligations assumed and (ii) the amount described in (a). The subsequent measurement of this asset shall be consistent with the measurement of the related insurance liability.

An insurer acquiring a portfolio of insurance contracts may use the expanded presentation described in paragraph 31.

The intangible assets described in paragraphs 31 and 32 are excluded from the scope of Ind AS 38 and Ind AS 36 *Impairment of Assets*. However, Ind AS 38 and Ind AS 36 apply to customer lists and customer relationships reflecting the expectation of future contracts that are not part of the contractual insurance rights and contractual insurance obligations that existed at the date of a business combination or portfolio transfer.

Discretionary participation features

Discretionary participation features in insurance contracts

Some insurance contracts contain a discretionary participation feature as well as a *guaranteed element*. The issuer of such a contract:

may, but need not, recognise the guaranteed element separately from the discretionary participation feature. If the issuer does not recognise them separately, it shall classify the whole contract as a liability. If the issuer classifies them separately, it shall classify the guaranteed element as a liability.

shall, if it recognises the discretionary participation feature separately from the guaranteed element, classify that feature as either a liability or a separate component of equity. This Indian Accounting Standard does not specify how the issuer determines whether that feature is a liability or equity. The issuer may split that feature into liability and equity components and shall use a consistent accounting policy for that split. The issuer shall not classify that feature as an intermediate category that is neither liability nor equity.

may recognise all premiums received as revenue without separating any portion that relates to the equity component. The resulting changes in the guaranteed element and in the portion of the discretionary participation feature classified as a liability shall be recognised in profit or loss. If part or all of the discretionary participation feature is classified in equity, a portion of profit or loss may be attributable to that feature (in the same way that a portion may be attributable to non-controlling interests). The issuer shall recognise the portion of profit or loss attributable to any equity component of a discretionary participation feature as an allocation of profit or loss, not as expense or income (see Ind AS 1 *Presentation of Financial Statements*).

shall, if the contract contains an embedded derivative within the scope of Ind AS 39, apply Ind AS 39 to that embedded derivative.

shall, in all respects not described in paragraphs 14–20 and 34(a)–(d), continue its existing accounting policies for such contracts, unless it changes those accounting policies in a way that complies with paragraphs 21–30.

Discretionary participation features in financial instruments

The requirements in paragraph 34 also apply to a financial instrument that contains a discretionary participation feature. In addition:

if the issuer classifies the entire discretionary participation feature as a liability, it shall apply the liability adequacy test in paragraphs 15–19 to the whole contract (ie both the guaranteed element and the discretionary participation feature). The issuer need not determine the amount that would result from applying Ind AS 39 to the guaranteed element.

if the issuer classifies part or all of that feature as a separate component of equity, the liability recognised for the whole contract shall not be less than the amount that would result from applying Ind AS 39 to the guaranteed element. That amount shall include the intrinsic value of an option to surrender the contract, but need not include its time value if paragraph 9 exempts that option from measurement at fair value. The issuer need not disclose the amount that would result from applying Ind AS 39 to the guaranteed element, nor need it present that amount separately. Furthermore, the issuer need not determine that amount if the total liability recognised is clearly higher.

although these contracts are financial instruments, the issuer may continue to recognise the premiums for those contracts as revenue and recognise as an expense the resulting increase in the carrying amount of the liability.

although these contracts are financial instruments, an issuer applying paragraph 20(b) of Ind AS 107 to contracts with a discretionary participation feature shall disclose the total interest expense recognised in profit or loss, but need not calculate such interest expense using the effective interest method.

Disclosure

Explanation of recognised amounts

An insurer shall disclose information that identifies and explains the amounts in its financial statements arising from insurance contracts.

To comply with paragraph 36, an insurer shall disclose:

its accounting policies for insurance contracts and related assets, liabilities, income and expense.

the recognised assets, liabilities, income and expense (and, if it presents its statement of cash flows using the direct method, cash flows) arising from insurance contracts. Furthermore, if the insurer is a cedant, it shall disclose:

gains and losses recognised in profit or loss on buying reinsurance; and

if the cedant defers and amortises gains and losses arising on buying reinsurance, the amortisation for the period and the amounts remaining unamortised at the beginning and end of the period.

the process used to determine the assumptions that have the greatest effect on the measurement of the recognised amounts described in (b). When practicable, an insurer shall also give quantified disclosure of those assumptions.

the effect of changes in assumptions used to measure insurance assets and insurance liabilities, showing separately the effect of each change that has a material effect on the financial statements.

reconciliations of changes in insurance liabilities, reinsurance assets and, if any, related deferred acquisition costs.

Nature and extent of risks arising from insurance contracts

An insurer shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from insurance contracts.

To comply with paragraph 38, an insurer shall disclose:

its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks.

[Refer to Appendix 1]

information about *insurance risk* (both before and after risk mitigation by reinsurance), including information about:

sensitivity to insurance risk (see paragraph 39A).

concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared characteristic that identifies each concentration (eg type of insured event, geographical area, or currency).

actual claims compared with previous estimates (ie claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. An insurer need not disclose this information for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year.

information about credit risk, liquidity risk and market risk that paragraphs 31–42 of Ind AS 107 would require if the insurance contracts were within the scope of Ind AS 107. However:

an insurer need not provide the maturity analysis required by paragraph 39(a) of Ind AS 107 if it discloses information about the estimated timing of the net cash outflows resulting from recognised insurance liabilities instead. This may take the form of an analysis, by estimated timing, of the amounts recognised in the balance sheet.

if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may use that sensitivity analysis to meet the requirement in paragraph 40(a) of Ind AS 107. Such an insurer shall also provide the disclosures required by paragraph 41 of Ind AS 107.

information about exposures to market risk arising from embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivatives at fair value.

39A To comply with paragraph 39(c)(i), an insurer shall disclose either (a) or (b) as follows:

a sensitivity analysis that shows how profit or loss and equity would have been affected if changes in the relevant risk variable that were reasonably possible at the end of the reporting period had occurred; the methods and assumptions used in preparing the sensitivity analysis; and any changes from the previous period in the methods and assumptions used. However, if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may meet this requirement by disclosing that alternative sensitivity analysis and the disclosures required by paragraph 41 of Ind AS 107.

qualitative information about sensitivity, and information about those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows.

Appendix A
Defined terms

This appendix is an integral part of the Indian Accounting Standard.

Cedant The policyholder under a reinsurance contract.

deposit component A contractual component that is not accounted for as a derivative under Ind AS 39 and would be within the scope of Ind AS 39 if it were a separate instrument.

direct insurance contract An insurance contract that is not a reinsurance contract.

discretionary participation feature A contractual right to receive, as a supplement to guaranteed benefits, additional benefits:

(a) that are likely to be a significant portion of the total contractual benefits;

(b) whose amount or timing is contractually at the discretion of the issuer; and

(c) that are contractually based on:

(i) the performance of a specified pool of contracts or a specified type of contract;

(ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or

(iii) the profit or loss of the company, fund or other entity that issues the contract.

fair value The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

financial guarantee contract A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

financial risk The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

guaranteed benefits Payments or other benefits to which a particular policyholder or investor has an unconditional right that is not subject to the contractual discretion of the issuer.

guaranteed element An obligation to pay guaranteed benefits, included in a contract that contains a discretionary participation feature.

insurance asset An insurer's net contractual rights under an insurance contract.

insurance contract A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder. (See Appendix B for guidance on this definition.)

insurance liability An insurer's net contractual obligations under an insurance contract.

insurance risk Risk, other than financial risk, transferred from the holder of a contract to the issuer.

insured event An uncertain future event that is covered by an insurance contract and creates insurance risk.

Insurer The party that has an obligation under an insurance contract to compensate a policyholder if an insured event occurs.

liability adequacy test An assessment of whether the carrying amount of an insurance liability needs to be increased (or the carrying amount of related deferred acquisition costs or related intangible assets decreased), based on a review of future cash flows.

policyholder A party that has a right to compensation under an insurance contract if an insured event occurs.

reinsurance assets A cedant's net contractual rights under a reinsurance contract.

reinsurance contract An insurance contract issued by one insurer (the reinsurer) to compensate another insurer (the cedant) for losses on one or more contracts issued by the cedant.

reinsurer The party that has an obligation under a reinsurance contract to compensate a cedant if an insured event occurs.

unbundle Account for the components of a contract as if they were separate contracts.

Appendix B
Definition of an insurance contract

This appendix is an integral part of the Indian Accounting Standard.

This appendix gives guidance on the definition of an insurance contract in Appendix A. It addresses the following issues:

the term 'uncertain future event' (paragraphs B2–B4);

payments in kind (paragraphs B5–B7);

insurance risk and other risks (paragraphs B8–B17);

examples of insurance contracts (paragraphs B18–B21);

significant insurance risk (paragraphs B22–B28); and

changes in the level of insurance risk (paragraphs B29 and B30).

Uncertain future event

Uncertainty (or risk) is the essence of an insurance contract. Accordingly, at least one of the following is uncertain at the inception of an insurance contract:

whether an *insured event* will occur;

when it will occur; or

how much the insurer will need to pay if it occurs.

In some insurance contracts, the insured event is the discovery of a loss during the term of the contract, even if the loss arises from an event that occurred before the inception of the contract. In other insurance contracts, the insured event is an event that occurs during the term of the contract, even if the resulting loss is discovered after the end of the contract term.

Some insurance contracts cover events that have already occurred, but whose financial effect is still uncertain. An example is a reinsurance contract that covers the direct insurer against adverse development of claims already reported by policyholders. In such contracts, the insured event is the discovery of the ultimate cost of those claims.

Payments in kind

Some insurance contracts require or permit payments to be made in kind. An example is when the insurer replaces a stolen article directly, instead of reimbursing the policyholder. Another example is when an insurer uses its own hospitals and medical staff to provide medical services covered by the contracts.

Some fixed-fee service contracts in which the level of service depends on an uncertain event meet the definition of an insurance contract in this Indian Accounting Standard but are not regulated as insurance contracts in some countries. One example is a maintenance contract in which the service provider agrees to repair specified equipment after a malfunction. The fixed service fee is based on the expected number of malfunctions, but it is uncertain whether a particular machine will break down. The malfunction of the equipment adversely affects its owner and the contract compensates the owner (in kind, rather than cash). Another example is a contract for car breakdown services in which the provider agrees, for a fixed annual fee, to provide roadside assistance or tow the car to a nearby garage. The latter contract could meet the definition of an insurance contract even if the provider does not agree to carry out repairs or replace parts.

Applying this Standard to the contracts described in paragraph B6 is likely to be no more burdensome than applying the Indian Accounting Standards that would be applicable if such contracts were outside the scope of this Indian Accounting Standard:

There are unlikely to be material liabilities for malfunctions and breakdowns that have already occurred.

If Ind AS 18 *Revenue* applied, the service provider would recognise revenue by reference to the stage of completion (and subject to other specified criteria). That approach is also acceptable under this Indian Accounting Standard, which permits the service provider (i) to continue its existing accounting policies for these contracts unless they involve practices prohibited by paragraph 14 and (ii) to improve its accounting policies if so permitted by paragraphs 22–30.

The service provider considers whether the cost of meeting its contractual obligation to provide services exceeds the revenue received in advance. To do this, it applies the liability adequacy test described in paragraphs 15–19 of this Indian Accounting Standard. If this Accounting Standard did not apply to these contracts, the service provider would apply Ind AS 37 to determine whether the contracts are onerous.

For these contracts, the disclosure requirements in this Indian Accounting Standard are unlikely to add significantly to disclosures required by other Indian Accounting Standards.

Distinction between insurance risk and other risks

The definition of an insurance contract refers to insurance risk, which this Indian Accounting Standard defines as risk, other than *financial risk*, transferred from the holder of a contract to the issuer. A contract that exposes the issuer to financial risk without significant insurance risk is not an insurance contract.

The definition of financial risk in Appendix A includes a list of financial and non-financial variables. That list includes non-financial variables that are not specific to a party to the contract, such as an index of earthquake losses in a particular region or an index of temperatures in a particular city. It excludes non-financial variables that are specific to a party to the contract, such as the occurrence or non-occurrence of a fire that damages or destroys an asset of that party. Furthermore, the risk of changes in the fair value of a non-financial asset is not a financial risk if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of a specific non-financial asset held by a party to a contract (a non-financial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car's physical condition, that risk is insurance risk, not financial risk.

Some contracts expose the issuer to financial risk, in addition to significant insurance risk. For example, many life insurance contracts both guarantee a minimum rate of return to policyholders (creating financial risk) and promise death benefits that at some times significantly exceed the policyholder's account balance (creating insurance risk in the form of mortality risk). Such contracts are insurance contracts.

Under some contracts, an insured event triggers the payment of an amount linked to a price index. Such contracts are insurance contracts, provided the payment that is contingent on the insured event can be significant. For example, a life-contingent annuity linked to a cost-of-living index transfers insurance risk because payment is triggered by an uncertain event—the survival of the annuitant. The link to the price index is an embedded derivative, but it also transfers insurance risk. If the resulting transfer of insurance risk is significant, the embedded derivative meets the definition of an insurance contract, in which case it need not be separated and measured at fair value (see paragraph 7 of this Indian Accounting Standard).

The definition of insurance risk refers to risk that the insurer accepts from the policyholder. In other words, insurance risk is a pre-existing risk transferred from the policyholder to the insurer. Thus, a new risk created by the contract is not insurance risk.

The definition of an insurance contract refers to an adverse effect on the policyholder. The definition does not limit the payment by the insurer to an amount equal to the financial impact of the adverse event. For example, the definition does not exclude 'new-for-old' coverage that pays the policyholder sufficient to permit replacement of a damaged old asset by a new asset. Similarly, the definition does not limit payment under a term life insurance contract to the financial loss suffered by the deceased's dependants, nor does it preclude the payment of predetermined amounts to quantify the loss caused by death or an accident.

Some contracts require a payment if a specified uncertain event occurs, but do not require an adverse effect on the policyholder as a precondition for payment. Such a contract is not an insurance contract even if the holder uses the contract to mitigate an underlying risk exposure. For example, if the holder uses a derivative to hedge an underlying non-financial variable that is correlated with cash flows from an asset of the entity, the derivative is not an insurance contract because payment is not conditional on whether the holder is adversely affected by a reduction in the cash flows from the asset. Conversely, the definition of an insurance contract refers to an uncertain event for which an adverse effect on the policyholder is a contractual precondition for payment. This contractual precondition does not require the insurer to investigate whether the event actually caused an adverse effect, but permits the insurer to deny payment if it is not satisfied that the event caused an adverse effect.

Lapse or persistency risk (ie the risk that the counterparty will cancel the contract earlier or later than the issuer had expected in pricing the contract) is not insurance risk because the payment to the counterparty is not contingent on an uncertain future event that adversely affects the counterparty. Similarly, expense risk (ie the risk of unexpected increases in the administrative costs associated with the servicing of a contract, rather than in costs associated with insured events) is not insurance risk because an unexpected increase in expenses does not adversely affect the counterparty.

Therefore, a contract that exposes the issuer to lapse risk, persistency risk or expense risk is not an insurance contract unless it also exposes the issuer to insurance risk. However, if the issuer of that contract mitigates that risk by using a second contract to transfer part of that risk to another party, the second contract exposes that other party to insurance risk.

An insurer can accept significant insurance risk from the policyholder only if the insurer is an entity separate from the policyholder. In the case of a mutual insurer, the mutual accepts risk from each policyholder and pools that risk. Although policyholders bear that pooled risk collectively in their capacity as owners, the mutual has still accepted the risk that is the essence of an insurance contract.

Examples of insurance contracts

The following are examples of contracts that are insurance contracts, if the transfer of insurance risk is significant:

insurance against theft or damage to property.

insurance against product liability, professional liability, civil liability or legal expenses.

life insurance and prepaid funeral plans (although death is certain, it is uncertain when death will occur or, for some types of life insurance, whether death will occur within the period covered by the insurance).

life-contingent annuities and pensions (ie contracts that provide compensation for the uncertain future event—the survival of the annuitant or pensioner—to assist the annuitant or pensioner in maintaining a given standard of living, which would otherwise be adversely affected by his or her survival).

disability and medical cover.

surety bonds, fidelity bonds, performance bonds and bid bonds (ie contracts that provide compensation if another party fails to perform a contractual obligation, for example an obligation to construct a building).

credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. These contracts could have various legal forms, such as that of a guarantee, some types of letter of credit, a credit derivative default contract or an insurance contract. However, although these contracts meet the definition of an insurance contract, they also meet the definition of a financial guarantee contract in Ind AS 39 and are within the scope of Ind AS 107 and Ind AS 39, not this Indian Accounting Standard (see paragraph 4(d)). Nevertheless, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either Ind AS 39 and Ind AS 107 or this Standard to such financial guarantee contracts.

product warranties. Product warranties issued by another party for goods sold by a manufacturer, dealer or retailer are within the scope of this Accounting Standard. However, product warranties issued directly by a manufacturer, dealer or retailer are outside its scope, because they are within the scope of Ind AS 18 and Ind AS 37.

title insurance (ie insurance against the discovery of defects in title to land that were not apparent when the insurance contract was written). In this case, the insured event is the discovery of a defect in the title, not the defect itself.

travel assistance (ie compensation in cash or in kind to policyholders for losses suffered while they are travelling). Paragraphs B6 and B7 discuss some contracts of this kind.

catastrophe bonds that provide for reduced payments of principal, interest or both if a specified event adversely affects the issuer of the bond (unless the specified event does not create significant insurance risk, for example if the event is a change in an interest rate or foreign exchange rate).

insurance swaps and other contracts that require a payment based on changes in climatic, geological or other physical variables that are specific to a party to the contract.

reinsurance contracts.

The following are examples of items that are not insurance contracts:

investment contracts that have the legal form of an insurance contract but do not expose the insurer to significant insurance risk, for example life insurance contracts in which the insurer bears no significant mortality risk (such contracts are non-insurance financial instruments or service contracts, see paragraphs B20 and B21).

contracts that have the legal form of insurance, but pass all significant insurance risk back to the policyholder through non-cancellable and enforceable mechanisms that adjust future payments by the policyholder as a direct result of insured losses, for example some financial reinsurance contracts or some group contracts (such contracts are normally non-insurance financial instruments or service contracts, see paragraphs B20 and B21).

self-insurance, in other words retaining a risk that could have been covered by insurance (there is no insurance contract because there is no agreement with another party).

contracts (such as gambling contracts) that require a payment if a specified uncertain future event occurs, but do not require, as a contractual precondition for payment, that the event adversely affects the policyholder. However, this does not preclude the specification of a predetermined payout to quantify the loss caused by a specified event such as death or an accident (see also paragraph B13).

derivatives that expose one party to financial risk but not insurance risk, because they require that party to make payment based solely on changes in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (see Ind AS 39).

a credit-related guarantee (or letter of credit, credit derivative default contract or credit insurance contract) that requires payments even if the holder has not incurred a loss on the failure of the debtor to make payments when due (see Ind AS 39).

contracts that require a payment based on a climatic, geological or other physical variable that is not specific to a party to the contract (commonly described as weather derivatives).

catastrophe bonds that provide for reduced payments of principal, interest or both, based on a climatic, geological or other physical variable that is not specific to a party to the contract.

If the contracts described in paragraph B19 create financial assets or financial liabilities, they are within the scope of Ind AS 39. Among other things, this means that the parties to the contract use what is sometimes called deposit accounting, which involves the following:

one party recognises the consideration received as a financial liability, rather than as revenue.

the other party recognises the consideration paid as a financial asset, rather than as an expense

If the contracts described in paragraph B19 do not create financial assets or financial liabilities, Ind AS 18 applies. Under Ind AS 18, revenue associated with a transaction involving the rendering of services is recognised by reference to the stage of completion of the transaction if the outcome of the transaction can be estimated reliably.

Significant insurance risk

A contract is an insurance contract only if it transfers significant insurance risk. Paragraphs B8–B21 discuss insurance risk. The following paragraphs discuss the assessment of whether insurance risk is significant.

Insurance risk is significant if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (ie have no discernible effect on the economics of the transaction). If significant additional benefits would be payable in scenarios that have commercial substance, the condition in the previous sentence may be met even if the insured event is extremely unlikely or even if the expected (ie probability-weighted) present value of contingent cash flows is a small proportion of the expected present value of all the remaining contractual cash flows.

The additional benefits described in paragraph B23 refer to amounts that exceed those that would be payable if no insured event occurred (excluding scenarios that lack commercial substance). Those additional amounts include claims handling and claims assessment costs, but exclude:

the loss of the ability to charge the policyholder for future services. For example, in an investment-linked life insurance contract, the death of the policyholder means that the insurer can no longer perform investment management services and collect a fee for doing so. However, this economic loss for the insurer does not reflect insurance risk, just as a mutual fund manager does not take on insurance risk in relation to the possible death of the client. Therefore, the potential loss of future investment management fees is not relevant in assessing how much insurance risk is transferred by a contract.

waiver on death of charges that would be made on cancellation or surrender. Because the contract brought those charges into existence, the waiver of these charges does not compensate the policyholder for a pre-existing risk. Hence, they are not relevant in assessing how much insurance risk is transferred by a contract.

a payment conditional on an event that does not cause a significant loss to the holder of the contract. For example, consider a contract that requires the issuer to pay one million Rupees if an asset suffers physical damage causing an insignificant economic loss of one Rupee to the holder. In this contract, the holder transfers to the insurer the insignificant risk of losing one Rupee. At the same time, the contract creates non-insurance risk that the issuer will need to pay 999,999 Rupees if the specified event occurs. Because the issuer does not accept significant insurance risk from the holder, this contract is not an insurance contract.

possible reinsurance recoveries. The insurer accounts for these separately.

An insurer shall assess the significance of insurance risk contract by contract, rather than by reference to materiality to the financial statements.[4] Thus, insurance risk may be significant even if there is a minimal probability of material losses for a whole book of contracts. This contract-by-contract assessment makes it easier to classify a contract as an insurance contract. However, if a relatively homogeneous book of small contracts is known to consist of contracts that all transfer insurance risk, an insurer need not examine each contract within that book to identify a few non-derivative contracts that transfer insignificant insurance risk.

It follows from paragraphs B23–B25 that if a contract pays a death benefit exceeding the amount payable on survival, the contract is an insurance contract unless the additional death benefit is insignificant (judged by reference to the contract rather than to an entire book of contracts). As noted in paragraph B24(b), the waiver on death of cancellation or surrender charges is not included in this assessment if this waiver does not compensate the policyholder for a pre-existing risk. Similarly, an annuity contract that pays out regular sums for the rest of a policyholder's life is an insurance contract, unless the aggregate life-contingent payments are insignificant.

Paragraph B23 refers to additional benefits. These additional benefits could include a requirement to pay benefits earlier if the insured event occurs earlier and the payment is not adjusted for the time value of money. An example is whole life

[4] For this purpose, contracts entered into simultaneously with a single counterparty (or contracts that are otherwise interdependent) form a single contract.

insurance for a fixed amount (in other words, insurance that provides a fixed death benefit whenever the policyholder dies, with no expiry date for the cover). It is certain that the policyholder will die, but the date of death is uncertain. The insurer will suffer a loss on those individual contracts for which policyholders die early, even if there is no overall loss on the whole book of contracts.

If an insurance contract is unbundled into a deposit component and an insurance component, the significance of insurance risk transfer is assessed by reference to the insurance component. The significance of insurance risk transferred by an embedded derivative is assessed by reference to the embedded derivative.

Changes in the level of insurance risk

Some contracts do not transfer any insurance risk to the issuer at inception, although they do transfer insurance risk at a later time. For example, consider a contract that provides a specified investment return and includes an option for the policyholder to use the proceeds of the investment on maturity to buy a life-contingent annuity at the current annuity rates charged by the insurer to other new annuitants when the policyholder exercises the option. The contract transfers no insurance risk to the issuer until the option is exercised, because the insurer remains free to price the annuity on a basis that reflects the insurance risk transferred to the insurer at that time. However, if the contract specifies the annuity rates (or a basis for setting the annuity rates), the contract transfers insurance risk to the issuer at inception.

A contract that qualifies as an insurance contract remains an insurance contract until all rights and obligations are extinguished or expire.

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Guidance on implementing Ind AS 104 *Insurance Contracts*

This guidance accompanies, but is not part of Ind AS 104.

Introduction

This implementation guidance:

- illustrates which contracts and embedded derivatives are within the scope of Ind AS 104 (see paragraphs IG2–IG4).
- includes an example of an insurance contract containing a deposit component that needs to be unbundled (paragraph IG5).
- illustrates shadow accounting (paragraphs IG6–IG10).
- discusses how an insurer might satisfy the disclosure requirements in the Standard (paragraphs IG11–IG71).

Definition of insurance contract

IG Example 1 illustrates the application of the definition of an insurance contract. The example does not illustrate all possible circumstances

IG Example 1: Application of the definition of an insurance contract		
Contract type		***Treatment in phase I***
	Insurance contract (see definition in Appendix A of this Standard and guidance in Appendix B).	Within the scope of this Standard, unless covered by scope exclusions in paragraph 4 of the Standard. Some embedded derivatives and deposit components must be separated (see IG Examples 2 and 3 and paragraphs 7–12 of the Standard).
	Death benefit that could exceed amounts payable on surrender or maturity	Insurance contract (unless contingent amount is insignificant in all scenarios that have commercial substance). Insurer could suffer a significant loss on an individual contract if the policyholder dies early. See IG Examples 1.23–27 for further discussion of surrender penalties.
	A unit-linked contract that pays benefits linked to the fair value of a pool of assets. The benefit is 100 per cent of the unit value on surrender or maturity and 101 per cent of the unit	This contract contains a deposit component (100 per cent of unit value) and an insurance component (additional death benefit of 1 per cent). Paragraph 10 of the Standard permits unbundling (but requires it only if the insurance component is material and the issuer

	value on death.	would not otherwise recognise all obligations and rights arising under the deposit component). If the insurance component is not unbundled, the whole contract is an investment contract because the insurance component is insignificant in relation to the whole contract.
	Life-contingent annuity	Insurance contract (unless contingent amount is insignificant in all scenarios that have commercial substance). Insurer could suffer a significant loss on an individual contract if the annuitant survives longer than expected.
	Pure endowment. The insured person receives a payment on survival to a specified date, but beneficiaries receive nothing if the insured person dies before then.	Insurance contract (unless the transfer of insurance risk is insignificant). If a relatively homogeneous book of pure endowments is known to consist of contracts that all transfer insurance risk, the insurer may classify the entire book as insurance contracts without examining each contract to identify a few non-derivative pure endowments that transfer insignificant insurance risk (see paragraph B25).
	Deferred annuity: policyholder will receive, or can elect to receive, a life-contingent annuity at rates guaranteed at inception.	Insurance contract (unless the transfer of insurance risk is insignificant). The contract transfers mortality risk to the insurer at inception, because the insurer might have to pay significant additional benefits for an individual contract if the annuitant elects to take the life-contingent annuity and survives longer than expected (unless the contingent amount is insignificant in all scenarios that have commercial substance).
	Deferred annuity: policyholder will receive, or can elect to	Not an insurance contract at inception, if the insurer can reprice the mortality risk

	receive, a life-contingent annuity at rates prevailing when the annuity begins.	without constraints. Within the scope ofInd AS 39 *Financial Instruments: Recognition and Measurement* unless the contract contains a discretionary participation feature. Will become an insurance contract when the annuity rate is fixed (unless the contingent amount is insignificant in all scenarios that have commercial substance).
	Investment contract[(a)] that does not contain a discretionary participation feature.	Within the scope of Ind AS 39.
	Investment contract containing a discretionary participation feature.	Paragraph 35 of the Standard sets out requirements for these contracts, which are excluded from the scope of Ind AS 39.
	Investment contract in which payments are contractually linked (with no discretion) to returns on a specified pool of assets held by the issuer.	Within the scope of Ind AS 39. Payments denominated in unit values representing the fair value of the specified assets are measured at current unit value (see paragraph AG33(g) of Appendix A of Ind AS 39).
	Contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. The contract may have various legal forms (eg insurance contract, guarantee or letter of credit).	Insurance contract, but within the scope of Ind AS 39, not this Standard. However, if the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either Ind AS 39 and Ind AS 32 or this Standard to such financial guarantee contracts. The legal form of the contract does not affect its recognition and measurement. Accounting by the holder of such a contract is

		excluded from the scope of Ind AS 39 and this Standard (unless the contract is a reinsurance contract). Therefore, paragraphs 10–12 of Ind AS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* apply. Those paragraphs specify criteria to use in developing an accounting policy if no Indian Accounting Standard applies specifically to an item.
	A credit-related guarantee that does not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee is one that requires payments in response to changes in a specified credit rating or credit index.	Not an insurance contract. A derivative within the scope of Ind AS 39.
	Guarantee fund established by contract. The contract requires all participants to pay contributions to the fund so that it can meet obligations incurred by participants (and, perhaps, others). Participants would typically be from a single industry, eg insurance, banking or travel.	The contract that establishes the guarantee fund is an insurance contract (see IG Example 1.11).
	Guarantee fund established by	The commitment of participants to contribute

	law.	to the fund is not established by a contract, so there is no insurance contract. Within the scope of Ind AS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
	Residual value insurance or residual value guarantee. Guarantee by one party of the fair value at a future date of a non-financial asset held by a beneficiary of the insurance or guarantee.	Insurance contract within the scope of the Standard (unless changes in the condition of the asset have an insignificant effect). The risk of changes in the fair value of the non-financial asset is not a financial risk because the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific asset held (a non-financial variable). However, if the contract compensates the beneficiary only for changes in market prices and not for changes in the condition of the beneficiary's asset, the contract is a derivative and within the scope of Ind AS 39. Residual value guarantees given by a lessee under a finance lease are within the scope of Ind AS 17 *Leases*.
	Product warranties issued directly by a manufacturer, dealer or retailer.	Insurance contracts, but excluded from the scope of this Standard (see Ind AS 18 *Revenue* and Ind AS 37).
	Product warranties issued by a third party.	Insurance contracts, no scope exclusion. Same treatment as other insurance contracts.
	Group insurance contract that gives the insurer an enforceable and non-cancellable contractual right to recover all claims	Insurance risk is insignificant. Therefore, the contract is a financial instrument within the scope of Ind AS 39. Servicing fees are within the scope of Ind AS 18 (recognise as services are provided,

	paid out of future premiums, with appropriate compensation for the time value of money.	subject to various conditions).
	Catastrophe bond: bond in which principal, interest payments or both are reduced if a specified triggering event occurs and the triggering event does not include a condition that the issuer of the bond suffered a loss.	Financial instrument with embedded derivative. Both the holder and the issuer measure the embedded derivative at fair value.
	Catastrophe bond: bond in which principal, interest payments or both are reduced significantly if a specified triggering event occurs and the triggering event includes a condition that the issuer of the bond suffered a loss	The contract is an insurance contract, and contains an insurance component (with the issuer as policyholder and the holder as the insurer) and a deposit component. If specified conditions are met, paragraph 10 of the Standard requires the holder to unbundle the deposit component and apply Ind AS 39 to it. The issuer accounts for the insurance component as reinsurance if it uses the bond for that purpose. If the issuer does not use the insurance component as reinsurance, it is not within the scope of this Standard, which does not address accounting by policyholders for direct insurance contracts. Under paragraph 13 of the Standard, the holder could continue its existing accounting for the insurance component, unless that involves the practices prohibited by paragraph 14.

	An insurance contract issued by an insurer to a defined benefit pension plan covering the employees of the insurer, or of another entity consolidated within the same financial statements as the insurer.	The contract will generally be eliminated from the financial statements, which will include: the full amount of the pension obligation under Ind AS 19 *Employee Benefits*, with no deduction for the plan's rights under the contract. no liability to policyholders under the contract. the assets backing the contract.
	An insurance contract issued to employees as a result of a defined contribution pension plan. The contractual benefits for employee service in the current and prior periods are not contingent on future service. The insurer also issues similar contracts on the same terms to third parties.	Insurance contract within the scope of the Standard. If the employer pays part or all of the employee's premiums, the payment by the employer is an employee benefit within the scope of Ind AS 19. See also Ind AS 19, paragraphs 39–42 and 104–104D. Furthermore, a 'qualifying insurance policy' as defined in Ind AS 19 need not meet the definition of an insurance contract in this Standard.
	Loan contract containing a prepayment fee that is waived if prepayment results from the borrower's death.	Not an insurance contract. Before entering into the contract, the borrower faced no risk corresponding to the prepayment fee. Hence, although the loan contract exposes the lender to mortality risk, it does not transfer a pre-existing risk from the borrower. Thus, the risk associated with the possible waiver on death of the prepayment fee is not insurance risk (paragraphs B12 and B24(b) of Appendix B of the Standard).

	Loan contract that waives repayment of the entire loan balance if the borrower dies.	This contract contains a deposit component (the loan) and an insurance component (waiver of the loan balance on death, equivalent to a cash death benefit). If specified conditions are met, paragraph 10 of the Standard requires or permits unbundling. If the insurance component is not unbundled, the contract is an insurance contract if the insurance component is significant in relation to the whole contract.
	A contract permits the issuer to deduct a market value adjustment (MVA) from surrender values or death benefits to reflect current market prices for the underlying assets. The contract does not permit an MVA for maturity benefits.	The policyholder obtains an additional survival benefit because no MVA is applied at maturity. That benefit is a pure endowment (see IG Example 1.5). If the risk transferred by that benefit is significant, the contract is an insurance contract.
	A contract permits the issuer to deduct an MVA from surrender values or maturity payments to reflect current market prices for the underlying assets. The contract does not permit an MVA for death benefits.	The policyholder obtains an additional death benefit because no MVA is applied on death. If the risk transferred by that benefit is significant, the contract is an insurance contract.
	A contract permits the issuer to deduct an MVA from surrender payments to reflect current market prices for the underlying assets. The contract does not permit an MVA for death and maturity	The policyholder obtains an additional benefit because no MVA is applied on death or maturity. However, that benefit does not transfer insurance risk from the policyholder because it is certain that the policyholder will live or die and the amount payable on death or maturity is adjusted for the time value of money

	benefits. The amount payable on death or maturity is the amount originally invested plus interest.	(see paragraph B27 of the Standard). The contract is an investment contract. This contract combines the two features discussed in IG Examples 1.25 and 1.26. When considered separately, those two features transfer insurance risk. However, when combined, they do not transfer insurance risk. Therefore, it is not appropriate to separate this contract into two 'insurance' components. If the amount payable on death were not adjusted in full for the time value of money, or were adjusted in some other way, the contract might transfer insurance risk. If that insurance risk is significant, the contract is an insurance contract.
	A contract meets the definition of an insurance contract. It was issued by one entity in a group (for example a captive insurer) to another entity in the same group.	If the entities present individual or separate financial statements, they treat the contract as an insurance contract in those individual or separate financial statements (see Ind AS 27 *Consolidated and Separate Financial Statements*). The transaction is eliminated from the group's consolidated financial statements. If the intragroup contract is reinsured with a third party that is not part of the group, the reinsurance contract is treated as a direct insurance contract in the consolidated financial statements because the intragroup contract is eliminated on consolidation.

	An agreement that entity A will compensate entity B for losses on one or more contracts issued by entity B that do not transfer significant insurance risk.	The contract is an insurance contract if it transfers significant insurance risk from entity B to entity A, even if some or all of the individual contracts do not transfer significant insurance risk to entity B. The contract is a reinsurance contract if any of the contracts issued by entity B are insurance contracts. Otherwise, the contract is a direct insurance contract.
(a) The term 'investment contract' is an informal term used for ease of discussion. It refers to a financial instrument that does not meet the definition of an insurance contract.		

Embedded derivatives

Ind AS 39 requires an entity to separate embedded derivatives that meet specified conditions from the host instrument that contains them, measure the embedded derivatives at fair value and recognise changes in their fair value in profit or loss. However, an insurer need not separate an embedded derivative that itself meets the definition of an insurance contract (paragraph 7 of the Standard). Nevertheless, separation and fair value measurement of such an embedded derivative are not prohibited if the insurer's existing accounting policies require such separation, or if an insurer changes its accounting policies and that change meets the criteria in paragraph 22 of the Standard.

IG Example 2 illustrates the treatment of embedded derivatives contained in insurance contracts and investment contracts. The term 'investment contract' is an informal term used for ease of discussion. It refers to a financial instrument that does not meet the definition of an insurance contract. The example does not illustrate all possible circumstances. Throughout the example, the phrase 'fair value measurement is required' indicates that the issuer of the contract is required:

to measure the embedded derivative at fair value and include changes in its fair value in profit or loss.

to separate the embedded derivative from the host contract, unless it measures the entire contract at fair value and includes changes in that fair value in profit or loss.

IG Example 2: Embedded derivatives			
Type of embedded derivative		***Treatment if embedded in a host insurance contract***	***Treatment if embedded in a host investment contract***
	Death benefit linked to equity prices or equity index, payable only on death or annuitisation and not on surrender or maturity.	The equity-index feature is an insurance contract (unless the life-contingent payments are insignificant), because the policyholder benefits from it only when the insured event occurs. Fair value measurement is not required (but not prohibited).	Not applicable. The entire contract is an insurance contract (unless the life-contingent payments are insignificant).
	Death benefit that is the greater of: unit value of an investment fund (equal to the amount payable on surrender or maturity); and guaranteed minimum.	Excess of guaranteed minimum over unit value is a death benefit (similar to the payout on a dual trigger contract, see IG Example 2.19). This meets the definition of an insurance contract (unless the life-contingent payments are insignificant) and	Not applicable. The entire contract is an insurance contract (unless the life-contingent payments are insignificant).

		fair value measurement is not required (but not prohibited).	
	Option to take a life-contingent annuity at guaranteed rate (combined guarantee of interest rates and mortality charges).	The embedded option is an insurance contract (unless the life-contingent payments are insignificant). Fair value measurement is not required (but not prohibited).	Not applicable. The entire contract is an insurance contract (unless the life-contingent payments are insignificant).
	Embedded guarantee of minimum interest rates in determining surrender or maturity values that is at or out of the money on issue, and not leveraged.	The embedded guarantee is not an insurance contract (unless significant payments are life-contingent[(a)]). However, it is closely related to the host contract (paragraph AG33(b) of Appendix A of Ind AS 39). Fair value measurement is not required (but not prohibited). If significant payments are life-contingent, the contract is an	Fair value measurement is not permitted (paragraph AG33(b) of Ind AS 39).

		insurance contract and contains a deposit component (the guaranteed minimum). However, an insurer is not required to unbundle the contract if it recognises all obligations arising from the deposit component (paragraph 10 of Ind AS 104). If cancelling the deposit component requires the policyholder to cancel the insurance component, the two cancellation options may be interdependent; if the option to cancel the deposit component cannot be measured separately (ie without considering the other option), both options are	

		regarded as part of the insurance component (paragraph AG33(h) of Ind AS 39).	
	Embedded guarantee of minimum interest rates in determining surrender or maturity values: in the money on issue, or leveraged.	The embedded guarantee is not an insurance contract (unless the embedded guarantee is life-contingent to a significant extent). Fair value measurement is required (paragraph AG33(b) of Ind AS 39).	Fair value measurement is required (paragraph AG33(b) of Ind AS 39).
	Embedded guarantee of minimum annuity payments if the annuity payments are contractually linked to investment returns or asset prices:		
	(a) guarantee relates only to payments that are life-contingent.	The embedded guarantee is an insurance contract (unless the life-contingent payments are insignificant). Fair value	Not applicable. The entire contract is an insurance contract (unless the life-contingent payments are insignificant).

		measurement is not required (but not prohibited).	
	(b) guarantee relates only to payments that are not life-contingent.	The embedded derivative is not an insurance contract. Fair value measurement is required (unless the guarantee is regarded as closely related to the host contract because the guarantee is an unleveraged interest floor that is at or out of the money at inception, see paragraph AG33(b) of Ind AS 39).	Fair value measurement is required (unless the guarantee is regarded as closely related to the host contract because the guarantee is an unleveraged interest floor that is at or out of the money at inception, see paragraph AG33(b) of Ind AS 39).
	(c) policyholder can elect to receive life-contingent payments or payments that are not life-contingent, and the guarantee relates to both. When the policyholder makes its election, the issuer cannot adjust the pricing of the life-contingent payments to reflect the risk that the insurer assumes at that time (see	The embedded option to benefit from a guarantee of life-contingent payments is an insurance contract (unless the life-contingent payments are insignificant). Fair value measurement is	Not applicable. The entire contract is an insurance contract (unless the life-contingent payments are insignificant).

	paragraph B29 of this Standard for discussion of contracts with separate accumulation and payout phases).	not required (but not prohibited). The embedded option to receive payments that are not life-contingent ('the second option') is not an insurance contract. However, because the second option and the life-contingent option are alternatives, their fair values are interdependent. If they are so interdependent that the issuer cannot measure the second option separately (ie without considering the life-contingent option), the second option is closely related to the insurance contract. In that case, fair value measurement is not required (but not prohibited).	
	Embedded guarantee of minimum equity returns on surrender or maturity.	The embedded guarantee is not an insurance contract	Fair value measurement is required.

		(unless the embedded guarantee is life-contingent to a significant extent) and is not closely related to the host insurance contract. Fair value measurement is required.	
	Equity-linked return available on surrender or maturity.	The embedded derivative is not an insurance contract (unless the equity-linked return is life-contingent to a significant extent) and is not closely related to the host insurance contract. Fair value measurement is required.	Fair value measurement is required.
	Embedded guarantee of minimum equity returns that is available only if the policyholder elects to take a life-contingent annuity.	The embedded guarantee is an insurance contract (unless the life-contingent payments are insignificant), because the policyholder can benefit from the guarantee only by	Not applicable. The entire contract is an insurance contract (unless the life-contingent payments are insignificant).

		taking the annuity option (whether annuity rates are set at inception or at the date of annuitisation). Fair value measurement is not required (but not prohibited).	
	Embedded guarantee of minimum equity returns available to the policyholder as either a cash payment, a period-certain annuity or a life-contingent annuity, at annuity rates prevailing at the **date of annuitisation.**	If the guaranteed payments are not contingent to a significant extent on survival, the option to take the life-contingent annuity does not transfer insurance risk until the policyholder opts to take the annuity. Therefore, the embedded guarantee is not an insurance contract and is not closely related to the host insurance contract. Fair value measurement is required. If the guaranteed payments are contingent to a significant extent	Fair value measurement is required.

		on survival, the guarantee is an insurance contract (similar to a pure endowment). Fair value measurement is not required (but not prohibited).	
a cash payment	Embedded guarantee of minimum equity returns available to the policyholder as either a period-certain annuity or a life-contingent annuity, at annuity rates set at inception.	The whole contract is an insurance contract from inception (unless the life-contingent payments are insignificant). The option to take the life-contingent annuity is an embedded insurance contract, so fair value measurement is not required (but not prohibited). The option to take the cash payment or the period-certain annuity ('the second option') is not an insurance contract (unless	Not applicable.

		the option is contingent to a significant extent on survival), so it must be separated. However, because the second option and the life-contingent option are alternatives, their fair values are interdependent. If they are so interdependent that the issuer cannot measure the second option separately (ie without considering the life-contingent option), the second option is closely related to the host insurance contract. In that case, fair value measurement is not required (but not prohibited).	
	Policyholder option to surrender a contract for a cash surrender value specified in a schedule (ie not indexed and not	Fair value measurement is not required (but not prohibited: paragraph 8 of the Standard).	The surrender option is closely related to the host contract if the surrender value is approximately

	accumulating interest).	The surrender value may be viewed as a deposit component, but this Standard does not require an insurer to unbundle a contract if it recognises all its obligations arising under the deposit component (paragraph 10).	equal to the amortised cost at each exercise date (paragraph AG30(g) of Ind AS 39). Otherwise, the surrender option is measured at fair value.
	Policyholder option to surrender a contract for account value based on a principal amount and a fixed or variable interest rate (or based on the fair value of a pool of interest-bearing securities), possibly after deducting a surrender charge.	Same as for a cash surrender value (IG Example 2.12).	Same as for a cash surrender value (IG Example 2.12).
	Policyholder option to surrender a contract for a surrender value based on an equity or commodity price or index.	The option is not closely related to the host contract (unless the option is life-contingent to a significant extent). Fair value measurement is required (paragraphs 8 of this Standard and	Fair value measurement is required (paragraph AG30(d) and (e) of Ind AS 39).

		AG30(d) and (e) of Ind AS 39).	
	Policyholder option to surrender a contract for account value equal to the fair value of a pool of equity investments, possibly after deducting a surrender charge.	If the insurer measures that portion of its obligation at account value, no further adjustment is needed for the option (unless the surrender value differs significantly from account value) (see paragraph AG33(g) of Ind AS 39). Otherwise, fair value measurement is required.	If the insurer regards the account value as the amortised cost or fair value of that portion of its obligation, no further adjustment is needed for the option (unless the surrender value differs significantly from account value). Otherwise, fair value measurement is required.
	Contractual feature that provides a return contractually linked (with no discretion) to the return on specified assets.	The embedded derivative is not an insurance contract and is not closely related to the contract (paragraph AG30(h) of Ind AS 39). Fair value measurement is required.	Fair value measurement is required.
	Persistency bonus paid at maturity in cash (or as a period-certain annuity).	The embedded derivative (option to receive the persistency bonus) is not an insurance contract (unless the persistency bonus is life-	An option or automatic provision to extend the remaining term to maturity of a debt instrument is not closely related to the host debt

		contingent to a significant extent). Insurance risk does not include lapse or persistency risk (paragraph B15 of this Standard). Fair value measurement is required.	instrument unless there is a concurrent adjustment to the approximate current market rate of interest at the time of the extension (paragraph AG30(c) of Ind AS 39). If the option or provision is not closely related to the host instrument, fair value measurement is required.
	Persistency bonus paid at maturity as an enhanced life-contingent annuity.	The embedded derivative is an insurance contract (unless the life-contingent payments are insignificant). Fair value measurement is not required (but not prohibited).	Not applicable. The entire contract is an insurance contract (unless the life-contingent payments are insignificant).
	Dual trigger contract, eg contract requiring a payment that is contingent on a breakdown in power supply that adversely affects the holder (first trigger) and a	The embedded derivative is an insurance contract (unless the first trigger lacks commercial substance).	Not applicable. The entire contract is an insurance contract (unless the first trigger lacks commercial substance).

	specified level of electricity prices (second trigger). The contingent payment is made only if both triggering events occur.	A contract that qualifies as an insurance contract, whether at inception or later, remains an insurance contract until all rights and obligations are extinguished or expire (paragraph B30 of this Standard). Therefore, although the remaining exposure is similar to a financial derivative after the insured event has occurred, the embedded derivative is still an insurance contract and fair value measurement is not required (but not prohibited).	
	Non-guaranteed participating dividend contained in a life insurance contract. The amount is contractually at the discretion of the insurer but is contractually	The contract contains a discretionary participation feature, rather than an embedded derivative (paragraph 34 of	Not applicable. The entire contract is an insurance contract (unless the life-contingent payments are

	based on the insurer's actual experience on the related block of insurance contracts.	this Standard).	insignificant).
(a) Payments are life-contingent if they are contingent on death or contingent on survival.			

Unbundling a deposit component

Paragraph 10 of this Standard requires an insurer to unbundle some insurance contracts that contain a deposit component. IG Example 3 illustrates this requirement. Although arrangements of this kind are more common in reinsurance, the same principle applies in direct insurance. However, unbundling is not required if the insurer recognises all obligations or rights arising from the deposit component.

IG Example 3: Unbundling a deposit component of a reinsurance contract

Background

A reinsurance contract has the following features:

every year for five years.

An experience account is established, equal to 90 per cent of cumulative premiums (including the additional premiums discussed in (c) below) less 90 per cent of cumulative claims.

If the balance in the experience account is negative (ie cumulative claims exceed cumulative premiums), the cedant pays an additional premium equal to the experience account balance divided by the number of years left to run on the contract.

At the end of the contract, if the experience account balance is positive (ie cumulative premiums exceed cumulative claims), it is refunded to the cedant; if the balance is negative, the cedant pays the balance to the reinsurer as an additional premium.

Neither party can cancel the contract before maturity.

The maximum loss that the reinsurer is required to pay in any period is Rs 200.

This contract is an insurance contract because it transfers significant insurance risk to the reinsurer. For example, in case 2 discussed below, the reinsurer is required to pay additional benefits with a present value, in year 1, of Rs 35, which is clearly significant in relation to the contract.

The following discussion addresses the accounting by the reinsurer. Similar principles apply to the accounting by the cedant.

Application of requirements: case 1—no claims

If there are no claims, the cedant will receive Rs 45 in year 5 (90 per cent of the cumulative premiums of Rs 50). In substance, the cedant has made a loan, which the reinsurer will repay in one instalment of Rs 45 in year 5.

If the reinsurer's accounting policies require it to recognise its contractual liability to repay the loan to the cedant, unbundling is permitted but not required. However, if the reinsurer's accounting policies would not require it to recognise the liability to repay the loan, the reinsurer is required to unbundle the contract (paragraph 10 of this Standard).

If the reinsurer is required, or elects, to unbundle the contract, it does so as follows. Each payment by the cedant has two components: a loan advance (deposit component) and a payment for insurance cover (insurance component). Applying Ind AS 39 to the deposit component, the reinsurer is required to measure it initially at fair value. Fair value could be determined by discounting the future cash flows from the deposit component. Assume that an appropriate discount rate is 10 per cent and that the insurance cover is equal in each year, so that the payment for insurance cover is the same in every year. Each payment of Rs 10 by the cedant is then made up of a loan advance of Rs 6.7 and an insurance premium of Rs3.3.

The reinsurer accounts for the insurance component in the same way that it accounts for a separate insurance contract with an annual premium of Rs 3.3.

The movements in the loan are shown below.

Year	Opening balance	Interest at 10 per cent	Advance (repayment)	Closing balance
	Rs	Rs	Rs	Rs
0	0.00	0.00	6.70	6.70

1	6.70	0.67	6.70	14.07
2	14.07	1.41	6.70	22.18
3	22.18	2.21	6.70	31.09
4	31.09	3.11	6.70	40.90
5	40.90	4.10	(45.00)	0.00
Total		11.50	(11.50)	

Application of requirements: case 2—claim of Rs 150 in year 1

Consider now what happens if the reinsurer pays a claim of Rs150 in year 1. The changes in the experience account, and resulting additional premiums, are as follows.

Year	Premium	Additional premium	Total premium	Cumulative premium	Claims	Cumulative claims	Cumulative premiums less claims	Experience account
	Rs	Rs	Rs	Rs	Rs	Rs	Rs	Rs
0	10	0	10	10	0	0	10	9
1	10	0	10	20	(150)	(150)	(130)	(117)
2	10	39	49	69	0	(150)	(81)	(73)
3	10	36	46	115	0	(150)	(35)	(31)
4	10	31	41	156	0	(150)	6	6
		106	156		(150)			

Incremental cash flows because of the claim in year 1

The claim in year 1 leads to the following incremental cash flows, compared with case 1:

Year	Additional premium	Claims	Refund in case 2	Refund in case 1	Net incremental cash flow	Present value at 10 per cent
	Rs	Rs	Rs	Rs	Rs	Rs
0	0	0			0	0
1	0	(150)			(150)	(150)
2	39	0			39	35
3	36	0			36	30
4	31	0			31	23
5	0	0	(6)	(45)	39	27
Total	106	(150)	(6)	(45)	(5)	(35)

The incremental cash flows have a present value, in year 1, of Rs 35 (assuming a discount razte of 10 per cent is appropriate). Applying paragraphs 10–12 of this Standard, the cedant unbundles the contract and appliesInd AS 39 to this deposit component (unless the cedant already recognises its contractual obligation to repay the deposit component to the reinsurer). If this were not done, the cedant might recognise the Rs 150 received in year 1 as income, and the incremental payments in years 2–5 as expenses. However, in substance, the reinsurer has paid a claim of Rs 35 and made a loan of Rs 115 (Rs150 less Rs 35) that will be repaid in instalments.

The following table shows the changes in the loan balance. The table assumes that the original loan shown in case 1 and the new loan in case 2 met the criteria for offsetting in Ind AS 32. Amounts shown in the table are rounded.

Loan to (from) the reinsurer

Year	Opening balance	Interest at 10 per cent	Payments per original schedule	Additional payments in case 2	Closing balance
	Rs	Rs	Rs	Rs	Rs
0	–	–	6	–	6
1	6	1	7	(115)	(101)
2	(101)	(10)	7	39	(65)
3	(65)	(7)	7	36	(29)
4	(29)	(3)	6	31	5
5	5	1	(45)	39	0
Total		(18)	(12)	30	

Shadow accounting

Paragraph 30 of this Standard permits, but does not require, a practice sometimes described as 'shadow accounting'. IG Example 4 illustrates shadow accounting.

Shadow accounting is not the same as fair value hedge accounting under Ind AS 39 and will not usually have the same effect. Under Ind AS 39, a non-derivative financial asset or non-derivative financial liability may be designated as a hedging instrument only for a hedge of foreign currency risk.

Shadow accounting is not applicable for liabilities arising from investment contracts (ie contracts within the scope of Ind AS 39) because the underlying measurement of those liabilities (including the treatment of related transaction costs) does not depend on asset values or asset returns. However, shadow accounting may be applicable for a discretionary participation feature within an investment contract if the measurement of that feature depends on asset values or asset returns.

Shadow accounting is not applicable if the measurement of an insurance liability is not driven directly by realised gains and losses on assets held. For example, assume that financial assets are measured at fair value and insurance liabilities are measured using a discount rate that reflects current market rates but does not depend directly on the actual assets held. The measurements of the assets and the liability both reflect changes in interest rates, but the measurement of the liability does not depend directly on the carrying amount of the assets held. Therefore, shadow accounting is not applicable and changes in the carrying amount of the liability are recognised in profit or loss because Ind AS 1 *Presentation of Financial Statements* requires all items of income or expense to be recognised in profit or loss unless an Indian Accounting Standard requires otherwise.

Shadow accounting may be relevant if there is a contractual link between payments to policyholders and the carrying amount of, or returns from, owner-occupied property. If an entity uses the revaluation model in Ind AS 16 *Property, Plant and Equipment*, it recognises changes in the carrying amount of the owner-occupied property in revaluation surplus. If it also elects to use shadow accounting, the changes in the measurement of the insurance liability resulting from revaluations of the property are also recognised in revaluation surplus.

IG Example 4: Shadow accounting

Background

Under some jurisdictions, for some insurance contracts, deferred acquisition costs (DAC) are amortised over the life of the contract as a constant proportion of estimated gross profits (EGP). EGP includes investment returns, including realised (but not unrealised) gains and losses. Interest is applied to both DAC and EGP, to preserve present value relationships. For simplicity, this example ignores interest and ignores re-estimation of EGP.

At the inception of a contract, insurer A has DAC of Rs 20 relating to that contract and the present value, at inception, of EGP is Rs 100. In other words, DAC is

20 per cent of EGP at inception. Thus, for each Re1 of realised gross profits, insurer A amortises DAC by Rs 0.20. For example, if insurer A sells assets and recognises a gain of Rs 10, insurer A amortises DAC by Rs 2 (20 per cent of Rs 10).

Before adopting Indian Accounting Standards for the first time in 20X1, insurer A measured financial assets on a cost basis. (Therefore, EGP under those national requirements considers only realised gains and losses.) However, under Indian Accounting Standards, it classifies its financial assets as available for sale. Thus, insurer A measures the assets at fair value and recognises changes in their fair value in other comprehensive income. In 20X1, insurer A recognises unrealised gains of Rs 10 on the assets backing the contract.

In 20X2, insurer A sells the assets for an amount equal to their fair value at the end of 20X1 and, to comply with Ind AS 39, reclassifies the now-realised gain of Rs 10 from equity to profit or loss as a reclassification adjustment.

Application of paragraph 30 of Ind AS 104

Paragraph 30 of this Standard permits, but does not require, insurer A to adopt shadow accounting. If insurer A adopts shadow accounting, it amortises DAC in 20X1 by an additional Rs 2 (20 per cent of Rs 10) as a result of the change in the fair value of the assets. Because insurer A recognised the change in their fair value in other comprehensive income, it recognises the additional amortisation of Rs 2 in other comprehensive income.

When insurer A sells the assets in 20X2, it makes no further adjustment to DAC, but reclassifies DAC amortisation of Rs 2, relating to the now-realised gain, from equity to profit or loss as a reclassification adjustment.

In summary, shadow accounting treats an unrealised gain in the same way as a realised gain, except that the unrealised gain and resulting DAC amortisation are (a) recognised in other comprehensive income rather than in profit or loss and (b) reclassified from equity to profit or loss when the gain on the asset becomes realised.

If insurer A does not adopt shadow accounting, unrealised gains on assets do not affect the amortisation of DAC.

Disclosure

Purpose of this guidance

The guidance in paragraphs IG12–IG71 suggests possible ways to apply the disclosure requirements in paragraphs 36–39A of this Standard. As explained in paragraphs 36 and 38 of this Standard, the objective of the disclosures is:

to identify and explain the amounts in an insurer's financial statements arising from insurance contracts; and

to enable users of those financial statements to evaluate the nature and extent of risks arising from insurance contracts

An insurer decides in the light of its circumstances how much detail it gives to satisfy those requirements, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information that has materially different characteristics. It is necessary to strike a balance so that important information is not obscured either by the inclusion of a large amount of insignificant detail or by the aggregation of items that have materially different characteristics. For example:

a large international insurance group that operates in a wide range of regulatory jurisdictions typically provides disclosures that differ in format, content and detail from those provided by a specialised niche insurer operating in one jurisdiction.

many insurance contracts have similar characteristics. When no single contract is individually material, a summary by classes of contracts is appropriate

information about an individual contract may be material when it is, for example, a significant contributor to an insurer's risk profile.

To satisfy the requirements, an insurer would not typically need to disclose all the information suggested in the guidance. This guidance does not create additional requirements.

Ind AS 1 *Presentation of Financial Statements* requires an entity to 'provide additional disclosures when compliance with the specific requirements in Indian

Accounting Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.'

For convenience, this Implementation Guidance discusses each disclosure requirement in this Indian Accounting Standard separately. In practice, disclosures would normally be presented as an integrated package and individual disclosures may satisfy more than one requirement. For example, information about the assumptions that have the greatest effect on the measurement of amounts arising from insurance contracts may help to convey information about insurance risk and market risk.

Materiality

Ind AS 1 notes that a specific disclosure requirement in an Indian Accounting Standard need not be satisfied if the information is not material. Ind AS 1 defines materiality as follows:

> Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

Ind AS 1 also explains the following:

> Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. The *Framework for the Preparation and Presentation of Financial Statements* issued by the Institute of Chartered Accountants of India states in paragraph 26 that 'it is assumed that users have a reasonable knowledge of business and economic activities and accounting and study the information with reasonable diligence.' Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

Explanation of recognised amounts (paragraphs 36 and 37 of Ind AS 104)

Accounting policies

Ind AS 1 requires disclosure of accounting policies and paragraph 37(a) of this Standard highlights this requirement. In developing disclosures about accounting policies for insurance contracts, an insurer might conclude that it needs to address the treatment of, for example, some or all of the following, if applicable:

premiums (including the treatment of unearned premiums, renewals and lapses, premiums collected by agents and brokers but not yet passed on and premium taxes or other levies on premiums).

fees or other charges made to policyholders.

acquisition costs (including a description of their nature).

claims incurred (both reported and not reported), claims handling costs (including a description of their nature) and liability adequacy tests (including a description of the cash flows included in the test, whether and how the cash flows are discounted and the treatment of embedded options and guarantees in those tests, see paragraphs 15–19 of this Standard). An insurer might disclose whether insurance liabilities are discounted and, if they are discounted, explain the methodology used.

the objective of methods used to adjust insurance liabilities for risk and uncertainty (for example, in terms of a level of assurance or level of sufficiency), the nature of those models, and the source of information used in the models.

embedded options and guarantees (including a description of whether (i) the measurement of insurance liabilities reflects the intrinsic value and time value of these items and (ii) their measurement is consistent with observed current market prices).

discretionary participation features (including a clear statement of how the insurer applies paragraphs 34 and 35 of this Standard in classifying that feature as a liability or as a component of equity) and other features that permit policyholders to share in investment performance.

salvage, subrogation or other recoveries from third parties.

reinsurance held.

underwriting pools, coinsurance and guarantee fund arrangements.

insurance contracts acquired in business combinations and portfolio transfers, and the treatment of related intangible assets.

as required by Ind AS 1 , the judgements, apart from those involving estimations, management has made in the process of applying the accounting policies that have the most significant effect on the amounts recognised in the financial statements. The classification of discretionary participation features is an example of an accounting policy that might have a significant effect.

If the financial statements disclose supplementary information, for example embedded value information, that is not prepared on the basis used for other measurements in the financial statements, it is appropriate to explain the basis. Disclosures about embedded value methodology might include information similar to that described in paragraph IG17, as well as disclosure of whether, and how, embedded values are affected by estimated returns from assets and by locked-in capital and how those effects are estimated.

Assets, liabilities, income and expense

Paragraph 37(b) of the Standard requires an insurer to disclose the assets, liabilities, income and expenses that arise from insurance contracts. If an insurer presents its statement of cash flows using the direct method, paragraph 37(b) requires it also to disclose the cash flows that arise from insurance contracts. This Standard does not require disclosure of specific cash flows. The following paragraphs discuss how an insurer might satisfy those general requirements.

Ind AS 1 requires minimum disclosures in the balance sheet. An insurer might conclude that, to satisfy those requirements, it needs to present separately in its balance sheet the following amounts arising from insurance contracts:

urance contracts and reinsurance contracts issued.

ance contracts and reinsurance contracts issued.

assets under reinsurance ceded. Under paragraph 14(d)(i) of this Standard, these assets are not offset against the related insurance liabilities.

Neither Ind AS 1 nor this Standard prescribes the descriptions and ordering of the line items presented in the balance sheet. An insurer could amend the descriptions and ordering to suit the nature of its transactions.

Ind AS 1 requires disclosure, either in the balance sheet or in the notes, of subclassifications of the line items presented, classified in a manner appropriate to the entity's operations. Appropriate subclassifications of insurance liabilities will depend on the circumstances, but might include items such as:

ns.

policyholders.

t not reported (IBNR).

from liability adequacy tests.

e non-participating benefits.

liabilities or components of equity relating to discretionary participation features (see paragraphs 34 and 35 of this Standard). If an insurer classifies these features as a component of equity, disclosure is needed to comply with Ind AS 1, which requires an entity to disclose 'a description of the nature and purpose of each reserve within equity.'

receivables and payables related to insurance contracts (amounts currently due to and from agents, brokers and policyholders related to insurance contracts).

non-insurance assets acquired by exercising rights to recoveries.

Similar subclassifications may also be appropriate for reinsurance assets, depending on their materiality and other relevant circumstances. For assets under insurance contracts and reinsurance contracts issued, an insurer might conclude that it needs to distinguish:

costs; and

intangible assets relating to insurance contracts acquired in business combinations or portfolio transfers.

IG23A Paragraph 14 of Ind AS 107 *Financial Instruments: Disclosures* requires an entity to disclose the carrying amount of financial assets pledged as collateral for liabilities, the carrying amount of financial assets pledged as collateral for contingent liabilities, and any terms and conditions relating to assets pledged as collateral. In complying with this requirement, an insurer might also conclude that it needs to disclose segregation requirements that are intended to protect policyholders by restricting the use of some of the insurer's assets.

Ind AS 1 lists minimum line items that an entity should present in its statement of profit and loss. It also requires the presentation of additional line items when this is necessary to present fairly the entity's financial performance. An insurer might conclude that, to satisfy these requirements, it needs to present the following amounts in its statement of profit and loss:

revenue from insurance contracts issued (without any reduction for reinsurance held).

income from contracts with reinsurers.

expense for policyholder claims and benefits (without any reduction for reinsurance held).

expenses arising from reinsurance held.

Ind AS 18 requires an entity to disclose the amount of each significant category of revenue recognised during the period, and specifically requires disclosure of revenue arising from the rendering of services. Although revenue from insurance contracts is outside the scope of Ind AS 18, similar disclosures may be appropriate for insurance contracts. This Standard does not prescribe a particular method for recognising revenue and various models exist:

Under some models, an insurer recognises premiums earned during the period as revenue and recognises claims arising during the period (including estimates of claims incurred but not reported) as an expense.

Under some other models, an insurer recognises premiums received as revenue and at the same time recognises an expense representing the resulting increase in the insurance liability.

Under yet other models, an insurer recognises premiums received as deposit receipts. Its revenue includes charges for items such as mortality, and its expenses include the policyholder claims and benefits related to those charges.

Ind AS 1 requires additional disclosure of various items of income and expense. An insurer might conclude that, to satisfy these requirements, it needs to disclose the following additional items, either in its statement of profit and loss or in the notes:

acquisition costs (distinguishing those recognised as an expense immediately from the amortisation of deferred acquisition costs).

the effect of changes in estimates and assumptions.

losses recognised as a result of applying liability adequacy tests.

for insurance liabilities measured on a discounted basis:

ct the passage of time; and

count rates.

distributions or allocations to holders of contracts that contain discretionary participation features. The portion of profit or loss that relates to any equity component of those contracts is an allocation of profit or loss, not expense or income (paragraph 34(c) of this Standard).

Some insurers present a detailed analysis of the sources of their earnings from insurance activities either in the statement of profit and loss or in the notes. Such an analysis may provide useful information about both the income and expense of the current period and the risk exposures faced during the period.

The items described in paragraph IG26 are not offset against income or expense arising from reinsurance held (paragraph 14(d)(ii) of this Standard).

Paragraph 37(b) also requires specific disclosure about gains or losses recognised on buying reinsurance. This disclosure informs users about gains or losses that may, using some measurement models, arise from imperfect measurements of the underlying direct insurance liability. Furthermore, some measurement models require a cedant to defer some of those gains and losses and amortise them over the period of the related risk exposures, or some other period. Paragraph 37(b) also requires a cedant to disclose information about such deferred gains and losses.

If an insurer does not adopt uniform accounting policies for the insurance liabilities of its subsidiaries, it might conclude that it needs to disaggregate the disclosures about amounts reported in its financial statements to give meaningful information about amounts determined using different accounting policies.

Significant assumptions and other sources of estimation uncertainty

Paragraph 37(c) of this Standard requires an insurer to describe the process used to determine the assumptions that have the greatest effect on the measurement of assets, liabilities, income and expense arising from insurance contracts and, when practicable, give quantified disclosure of those assumptions. For some disclosures, such as discount rates or assumptions about future trends or general inflation, it may be relatively easy to disclose the assumptions used (aggregated at a reasonable but not excessive level, when necessary). For other assumptions, such as mortality tables, it may not be practicable to disclose quantified assumptions because there are too many, in which case it is more important to describe the process used to generate the assumptions.

The description of the process used to determine assumptions might include a summary of the most significant of the following:

the objective of the assumptions. For example, an insurer might disclose whether the assumptions are intended to be neutral estimates of the most likely or expected outcome ('best estimates') or to provide a given level of assurance or level of sufficiency. If they are intended to provide a quantitative or qualitative level of assurance, an insurer might disclose that level.

the source of data used as inputs for the assumptions that have the greatest effect. For example, an insurer might disclose whether the inputs are internal, external or a mixture of the two. For data derived from detailed studies that are not carried out annually, an insurer might disclose the criteria used to determine when the studies are updated and the date of the latest update.

the extent to which the assumptions are consistent with observable market prices or other published information.

a description of how past experience, current conditions and other relevant benchmarks are taken into account in developing estimates and assumptions. If a relationship would normally be expected between experience and future results, an insurer might explain the reasons for using assumptions that differ from past experience and indicate the extent of the difference.

a description of how the insurer developed assumptions about future trends, such as changes in mortality, healthcare costs or litigation awards.

an explanation of how the insurer identifies correlations between different assumptions.

the insurer's policy in making allocations or distributions for contracts with discretionary participation features, the related assumptions that are reflected in the financial statements, the nature and extent of any significant uncertainty about the relative interests of policyholders and shareholders in the unallocated surplus associated with those contracts, and the effect on the financial statements of any changes during the period in that policy or those assumptions.

the nature and extent of uncertainties affecting specific assumptions. In addition, to comply with paragraphs 125–131 of Ind AS 1, an insurer may need to disclose that it is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of insurance liabilities and insurance assets. Paragraph 129 of Ind AS 1 gives further guidance on this disclosure.

This Standard does not prescribe specific assumptions that would be disclosed, because different assumptions will be more significant for different types of contract.

Changes in assumptions

Paragraph 37(d) of this Standard requires an insurer to disclose the effect of changes in assumptions used to measure insurance assets and insurance liabilities. This is consistent with Ind AS 8, which requires disclosure of the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods.

Assumptions are often interdependent. When this is the case, analysis of changes by assumption may depend on the order in which the analysis is performed and may be arbitrary to some extent. Therefore, this Standard does not specify a rigid format or content for this analysis. This allows insurers to analyse the changes in a way that meets the objective of the disclosure and is appropriate for their particular circumstances. If practicable, an insurer might disclose separately the impact of changes in different assumptions, particularly if changes in some assumptions have an adverse effect and others have a beneficial effect. An insurer might also describe the impact of interdependencies between assumptions and the resulting limitations of any analysis of the effect of changes in assumption.

An insurer might disclose the effects of changes in assumptions both before and after reinsurance held, especially if the insurer expects a significant change in the nature or extent of its reinsurance programme or if an analysis before reinsurance is relevant for an analysis of the credit risk arising from reinsurance held.

Changes in insurance liabilities and related items

Paragraph 37(e) of this Standard requires an insurer to disclose reconciliations of changes in insurance liabilities. It also requires disclosure of changes in reinsurance assets. An insurer need not disaggregate those changes into broad classes, but might do that if different forms of analysis are more relevant for different types of liability. The changes might include:

at the beginning and end of the period.

liabilities arising during the period.

e included in profit or loss.

om, or transferred to, other insurers.

net exchange differences arising on the translation of the financial statements into a different presentation currency, and on the translation of a foreign operation into the presentation currency of the reporting entity.

An insurer discloses the changes in insurance liabilities and reinsurance assets in all prior periods for which it reports full comparative information.

Paragraph 37(e) of this Standard also requires an insurer to disclose changes in deferred acquisition costs, if applicable. The reconciliation might disclose:

the carrying amount at the beginning and end of the period.

the amounts incurred during the period.

the amortisation for the period.

impairment losses recognised during the period.

other changes categorised by cause and type.

An insurer may have recognised intangible assets related to insurance contracts acquired in a business combination or portfolio transfer. Ind AS 38 *Intangible Assets* contains disclosure requirements for intangible assets, including a requirement to give a reconciliation of changes in intangible assets. Ind AS 104 does not require additional disclosures about these assets.

Nature and extent of risks arising from insurance contracts (paragraphs 38–39A of Ind AS 104)

The disclosures about the nature and extent of risks arising from insurance contracts are based on two foundations:

There should be a balance between quantitative and qualitative disclosures, enabling users to understand the nature of risk exposures and their potential impact.

Disclosures should be consistent with how management perceives its activities and risks, and the objectives, policies and processes that management uses to manage those risks. This approach is likely:

to generate information that has more predictive value than information based on assumptions and methods that management does not use, for instance, in considering the insurer's ability to react to adverse situations.

to be more effective in adapting to the continuing change in risk measurement and management techniques and developments in the external environment over time.

In developing disclosures to satisfy paragraphs 38–39A of this Standard, an insurer decides in the light of its circumstances how it would aggregate information to display the overall picture without combining information that has materially different characteristics, so that the information is useful. An insurer might group insurance contracts into broad classes appropriate for the nature of the information to be disclosed, taking into account matters such as the risks covered, the characteristics of the contracts and the measurement basis applied. The broad classes may correspond to classes established for legal or regulatory purposes, but the Standard does not require this.

Under Ind AS 108 *Operating Segments*, the identification of reportable segments reflects the way in which management allocates resources and assesses performance. An insurer might adopt a similar approach to identify broad classes of insurance contracts for disclosure purposes, although it might be appropriate to disaggregate disclosures down to the next level. For example, if an insurer identifies life insurance as a reportable segment for Ind AS 108, it might be appropriate to report separate information about, say, life insurance, annuities in the accumulation phase and annuities in the payout phase.

[Refer to Appendix 1]

In identifying broad classes for separate disclosure, an insurer might consider how best to indicate the level of uncertainty associated with the risks underwritten, to inform users whether outcomes are likely to be within a wider or a narrower range. For example, an insurer might disclose information about exposures where there are significant amounts of provisions for claims incurred but not reported (IBNR) or where outcomes and risks are unusually difficult to assess (eg asbestos).

It may be useful to disclose sufficient information about the broad classes identified to permit a reconciliation to relevant line items in the balance sheet.

Information about the nature and extent of risks arising from insurance contracts is more useful if it highlights any relationship between classes of insurance contracts (and between insurance contracts and other items, such as financial instruments) that can affect those risks. If the effect of any relationship would not be apparent from disclosures required by this Standard, further disclosure might be useful.

Risk management objectives and policies for mitigating risks arising from insurance contracts

Paragraph 39(a) of this Standard requires an insurer to disclose its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks. Such discussion provides an additional perspective that complements information about contracts outstanding at a particular time. Such disclosure might include information about:

the structure and organisation of the insurer's risk management function(s), including a discussion of independence and accountability.

the scope and nature of the insurer's risk reporting or measurement systems, such as internal risk measurement models, sensitivity analyses, scenario analysis, and stress testing, and how the insurer integrates them into its operating activities. Useful disclosure might include a summary description of the approach used, associated assumptions and parameters (including confidence intervals, computation frequencies and historical observation periods) and strengths and limitations of the approach.

the insurer's processes for accepting, measuring, monitoring and controlling insurance risks and the underwriting strategy to ensure that there are appropriate risk classification and premium levels.

the extent to which insurance risks are assessed and managed on an entity-wide basis.

the methods the insurer employs to limit or transfer insurance risk exposures and avoid undue concentrations of risk, such as retention limits, inclusion of options in contracts, and reinsurance.

asset and liability management (ALM) techniques.

the insurer's processes for managing, monitoring and controlling commitments received (or given) to accept (or contribute) additional debt or equity capital when specified events occur.

These disclosures might be provided both for individual types of risks insured and overall, and might include a combination of narrative descriptions and specific quantified data, as appropriate to the nature of the insurance contracts and their relative significance to the insurer.

[Refer to Appendix 1]

[Refer to Appendix 1]

Insurance risk

Paragraph 39(c) of this Standard requires disclosures about insurance risk. Disclosures to satisfy this requirement might build on the following foundations:

Information about insurance risk might be consistent with (though less detailed than) the information provided internally to the entity's key management personnel (as defined in Ind AS 24 *Related Party Disclosures*), so that users can assess the insurer's financial position, performance and cash flows 'through the eyes of management'.

Information about risk exposures might report exposures both gross and net of reinsurance (or other risk mitigating elements, such as catastrophe bonds issued or policyholder participation features), especially if the insurer expects a significant change in the nature or extent of its reinsurance programme or if an analysis before reinsurance is relevant for an analysis of the credit risk arising from reinsurance held.

In reporting quantitative information about insurance risk, an insurer might disclose the methods used, the strengths and limitations of those methods, the assumptions made, and the effect of reinsurance, policyholder participation and other mitigating elements.

Insurers might classify risk along more than one dimension. For example, life insurers might classify contracts by both the level of mortality risk and the level of investment risk. It may sometimes be convenient to display this information in a matrix format.

If an insurer's risk exposures at the end of the reporting period are unrepresentative of its exposures during the period, it might be useful to disclose that fact.

The following disclosures required by paragraph 39 of this Standard might also be relevant:

the sensitivity of profit or loss and equity to changes in variables that have a material effect on them.

concentrations of insurance risk.

the development of prior year insurance liabilities.

IG51A Disclosures about insurance risk might include:

information about the nature of the risk covered, with a brief summary description of the class (such as annuities, pensions, other life insurance, motor, property and liability).

information about the general nature of participation features whereby policyholders share in the performance (and related risks) of individual contracts or pools of contracts or entities, including the general nature of any formula for the participation and the extent of any discretion held by the insurer.

information about the terms of any obligation or contingent obligation for the insurer to contribute to government or other guarantee funds (see also Ind AS 37 *Provisions, Contingent Liabilities and Contingent Assets*).

Sensitivity to insurance risk

Paragraph 39(c)(i) of this Standard requires disclosure about sensitivity to insurance risk. To permit meaningful aggregation, the sensitivity disclosures focus on summary indicators, namely profit or loss and equity. Although sensitivity tests can provide useful information, such tests have limitations. An insurer might disclose the strengths and limitations of sensitivity analyses performed.

IG52A Paragraph 39A permits two alternative approaches for this disclosure: quantitative disclosure of effects on profit or loss and equity (paragraph 39A(a)) or qualitative disclosure and disclosure about terms and conditions (paragraph 39A(b)). An insurer may provide quantitative disclosures for some insurance risks (in accordance with paragraph 39A(a)), and provide qualitative information about sensitivity and information about terms and conditions (in accordance with paragraph 39A(b)) for other insurance risks.

Informative disclosure avoids giving a misleading sensitivity analysis if there are significant non-linearities in sensitivities to variables that have a material effect. For example, if a change of 1 per cent in a variable has a negligible effect, but a change of 1.1 per cent has a material effect, it might be misleading to disclose the effect of a 1 per cent change without further explanation.

IG53A If an insurer chooses to disclose a quantitative sensitivity analysis in accordance with paragraph 39A(a), and that sensitivity analysis does not reflect significant correlations between key variables, the insurer might explain the effect of those correlations.

[Refer to Appendix 1]

IG54A If an insurer chooses to disclose qualitative information about sensitivity in accordance with paragraph 39A(b), it is required to disclose information about those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of cash flows. To achieve this, an insurer might disclose the qualitative information suggested by paragraphs IG51–IG58 on insurance risk and paragraphs IG62–IG65G on credit risk, liquidity risk and market risk. As stated in paragraph IG12, an insurer decides in the light of its circumstances how it aggregates information to display the overall picture without combining information with different characteristics. An insurer might conclude that qualitative information needs to be more disaggregated if it is not supplemented with quantitative information.

Concentrations of insurance risk

Paragraph 39(c)(ii) of this Standard refers to the need to disclose concentrations of insurance risk. Such concentration could arise from, for example:

a single insurance contract, or a small number of related contracts, for instance, when an insurance contract covers low-frequency, high-severity risks such as earthquakes.

single incidents that expose an insurer to risk under several different types of insurance contract. For example, a major terrorist incident could create exposure under life insurance contracts, property insurance contracts, business interruption and civil liability.

exposure to unexpected changes in trends, for example, unexpected changes in human mortality or in policyholder behaviour.

exposure to possible major changes in financial market conditions that could cause options held by policyholders to come into the money. For example, when interest rates decline significantly, interest rate and annuity guarantees may result in significant losses.

significant litigation or legislative risks that could cause a large single loss, or have a pervasive effect on many contracts.

correlations and interdependencies between different risks.

significant non-linearities, such as stop-loss or excess of loss features, especially if a key variable is close to a level that triggers a material change in future cash flows.

geographical and sectoral concentrations.

Disclosure of concentrations of insurance risk might include a description of the shared characteristic that identifies each concentration and an indication of the possible exposure, both before and after reinsurance held, associated with all insurance liabilities sharing that characteristic.

Disclosure about an insurer's historical performance on low-frequency, high-severity risks might be one way to help users to assess cash flow uncertainty associated with those risks. Consider an insurance contract that covers an earthquake that is expected to happen every 50 years, on average. If the insured event occurs during the current contract period, the insurer will report a large loss. If the insured event does not occur during the current period, the insurer will report a profit. Without adequate disclosure of the source of historical profits, it could be misleading for the insurer to report 49 years of reasonable profits, followed by one large loss; users may misinterpret the insurer's long-term ability to generate cash flows over the complete cycle of 50 years. Therefore, it might be useful to describe the extent of the exposure to risks of this kind and the estimated frequency of losses. If circumstances have not changed significantly, disclosure of the insurer's experience with this exposure may be one way to convey information about estimated frequencies.

For regulatory or other reasons, some entities produce special purpose financial reports that show catastrophe or equalisation reserves as liabilities. However, in financial statements prepared using Indian Accounting Standards, those reserves are not liabilities but are a component of equity. Therefore they are subject to the disclosure requirements in Ind AS 1 for equity. Ind AS 1 requires an entity to disclose:

a description of the nature and purpose of each reserve within equity;

information that enables users to understand the entity's objectives, policies and processes for managing capital; and

the nature of any externally imposed capital requirements, how those requirements are incorporated into the management of capital and whether during the period it complied with any externally imposed capital requirements to which it is subject.

Claims development

Paragraph 39(c)(iii) of this Standard requires disclosure of claims development information (subject to transitional relief in paragraph 44). Informative disclosure might reconcile this information to amounts reported in the balance sheet. An insurer might disclose unusual claims expenses or developments separately, allowing users to identify the underlying trends in performance.

As explained in paragraph 39(c)(iii) of this Standard, disclosures about claims development are not required for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year. Therefore, these disclosures are not normally required for most life insurance contracts. Furthermore, claims development disclosure is not normally needed for annuity contracts because each periodic payment arises, in effect, from a separate claim about which there is no uncertainty.

IG Example 5 shows one possible format for presenting claims development information. Other possible formats might, for example, present information by accident year rather than underwriting year. Although the example illustrates a format that might be useful if insurance liabilities are discounted, this Standard does not require discounting (paragraph 25(a) of this Standard).

IG Example 5: Disclosure of claims development

This example illustrates a possible format for a claims development table for a general insurer. The top half of the table shows how the insurer’s estimates of total claims for each underwriting year develop over time. For example, at the end of 20X1, the insurer estimated that it would pay claims of Rs 680 for insured events relating to insurance contracts underwritten in 20X1. By the end of 20X2, the insurer had revised the estimate of cumulative claims (both those paid and those still to be paid) to Rs 673.

The lower half of the table reconciles the cumulative claims to the amount appearing in the balance sheet. First, the cumulative payments are deducted to give the cumulative unpaid claims for each year on an undiscounted basis. Second, if the claims liabilities are discounted, the effect of discounting is deducted to give the carrying amount in the balance sheet.

Underwriting year	*20X1*	*20X2*	*20X3*	*20X4*	*20X5*	*Total*
	Rs	Rs	Rs	Rs	Rs	Rs
Estimate of cumulative claims:						
At end of underwriting year	680	790	823	920	968	
One year later	673	785	840	903		
Two years later	692	776	845			
Three years later	697	771				
Four years later	702					
Estimate of cumulative claims	702	771	845	903	968	
Cumulative payments	(702)	(689)	(570)	(350)	(217)	
	–	82	275	553	751	1,661
Effect of discounting	–	(14)	(68)	(175)	(285)	(542)
Present value recognised in the balance sheet	–	68	207	378	466	1,119

Credit risk, liquidity risk and market risk

Paragraph 39(d) of this Standard requires an insurer to disclose information about credit risk, liquidity risk and market risk that paragraphs 31–42 of Ind AS 107 would require if insurance contracts were within its scope. Such disclosure includes:

summary quantitative data about the insurer's exposure to those risks based on information provided internally to its key management personnel (as defined in Ind AS 24); and

to the extent not already covered by the disclosures discussed above, the information described in paragraphs 36–42 of Ind AS 107.

The disclosures about credit risk, liquidity risk and market risk may be either provided in the financial statements or incorporated by cross-reference to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time.

[Refer to Appendix 1]

Informative disclosure about credit risk, liquidity risk and market risk might include:

information about the extent to which features such as policyholder participation features mitigate or compound those risks.

a summary of significant guarantees, and of the levels at which guarantees of market prices or interest rates are likely to alter the insurer's cash flows.

the basis for determining investment returns credited to policyholders, such as whether the returns are fixed, based contractually on the return of specified assets or partly or wholly subject to the insurer's discretion.

Credit risk

IG64A Paragraphs 36–38 of Ind AS 107 require disclosure about credit risk. Credit risk is defined as 'the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss'. Thus, for an insurance contract, credit risk includes the risk that an insurer incurs a financial loss because a reinsurer defaults on its obligations under the reinsurance contract. Furthermore, disputes with the reinsurer could lead to an impairment of the cedant's reinsurance asset. The risk of such disputes may have an effect similar to credit risk. Thus, similar disclosure might be relevant. Balances due from agents or brokers may also be subject to credit risk.

A financial guarantee contract reimburses a loss incurred by the holder because a specified debtor fails to make payment when due. The holder is exposed to credit risk, and Ind AS 107 requires the holder to provide disclosures about that credit risk. However, from the perspective of the issuer, the risk assumed by the issuer is insurance risk rather than credit risk.

IG65A The issuer of a financial guarantee contract provides disclosures complying with Ind AS 107 if it applies Ind AS 39 in recognising and measuring the contract. If the issuer elects, when permitted by paragraph 4(d) of this Standard, to apply this Standard in recognising and measuring the contract, it provides disclosures complying with this Standard. The main implications are as follows:

Ind AS 104 *Insurance Contracts* requires disclosure about actual claims compared with previous estimates (claims development), but does not require disclosure of the fair value of the contract.

Ind AS 107 requires disclosure of the fair value of the contract, but does not require disclosure of claims development.

Liquidity risk

IG65B Paragraph 39(a) of Ind AS 107 requires disclosure of a maturity analysis for financial liabilities that shows the remaining contractual maturities. For insurance contracts, the contractual maturity refers to the estimated date when contractually required cash flows will occur. This depends on factors such as when the insured event occurs and the possibility of lapse. However, Ind AS 104, *Insurance Contracts* permits various existing accounting practices for insurance contracts to continue. As a result, an insurer may not need to make detailed estimates of cash flows to determine the amounts it recognises in the balance sheet. To avoid requiring detailed cash flow estimates that are not required for measurement purposes, paragraph 39(d)(i) of Ind AS 104 states that an insurer need not provide the maturity analysis required by paragraph 39(a) of Ind AS 107 (ie that shows the remaining contractual maturities of insurance contracts) if it discloses an analysis, by estimated timing, of the amounts recognised in the balance sheet.

IG65C An insurer might also disclose a summary narrative description of how the maturity analysis (or analysis by estimated timing) flows could change if policyholders exercised lapse or surrender options in different ways. If an insurer considers that lapse behaviour is likely to be sensitive to interest rates, the insurer might disclose that fact and state whether the disclosures about market risk reflect that interdependence.

Market risk

IG65D Paragraph 40(a) of Ind AS 107 requires a sensitivity analysis for each type of market risk at the end of the reporting period, showing the effect of reasonably possible changes in the relevant risk variable on profit or loss or equity. If no reasonably possible change in the relevant risk variable would affect profit or loss or equity, an entity discloses that fact to comply with paragraph 40(a) of Ind AS 107. A reasonably possible change in the relevant risk variable might not affect profit or loss in the following examples:

if a non-life insurance liability is not discounted, changes in market interest rates would not affect profit or loss.

some insurers may use valuation factors that blend together the effect of various market and non-market assumptions that do not change unless the insurer assesses that its recognised insurance liability is not adequate. In some cases a reasonably possible change in the relevant risk variable would not affect the adequacy of the recognised insurance liability.

IG65E In some accounting models, a regulator specifies discount rates or other assumptions about market risk variables that the insurer uses in measuring its insurance liabilities and the regulator does not amend those assumptions to reflect current market conditions at all times. In such cases, the insurer might comply with paragraph 40(a) of Ind AS 107 by disclosing:

the effect on profit or loss or equity of a reasonably possible change in the assumption set by the regulator.

the fact that the assumption set by the regulator would not necessarily change at the same time, by the same amount, or in the same direction, as changes in market prices, or market rates, would imply.

IG65F An insurer might be able to take action to reduce the effect of changes in market conditions. For example, an insurer may have discretion to change surrender values or maturity benefits, or to vary the amount or timing of policyholder benefits arising from discretionary participation features. Paragraph 40(a) of Ind AS 107 does not require entities to consider the potential effect of future management actions that may offset the effect of the disclosed changes in the relevant risk variable. However, paragraph 40(b) of Ind AS 107 requires an entity to disclose the methods and assumptions used to prepare the sensitivity analysis. To comply with this requirement, an insurer might conclude that it needs to disclose the extent of available management actions and their effect on the sensitivity analysis.

IG65G Some insurers manage sensitivity to market conditions using a method that differs from the method described by paragraph 40(a) of Ind AS 107. For example, some insurers use an analysis of the sensitivity of embedded value to changes in market risk. Paragraph 39(d)(ii) of Ind AS 104, permits an insurer to use that sensitivity analysis to meet the requirement in paragraph 40(a) of Ind AS 107. Ind AS 104 and Ind AS 107 require an insurer to provide sensitivity analyses for all classes of financial instruments and insurance contracts, but an insurer might use different approaches for different classes. Ind AS 104 and Ind AS 107 specify the following approaches:

the sensitivity analysis described in paragraph 40(a) of Ind AS 107 for financial instruments or insurance contracts;

the method described in paragraph 41 of Ind AS 107 for financial instruments or insurance contracts; or

the method permitted by paragraph 39(d)(ii) of Ind AS 104, *Insurance Contracts* for insurance contracts.

Exposures to market risk under embedded derivatives

Paragraph 39(e) of this Standard requires an insurer to disclose information about exposures to market risk under embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivative at fair value (for example, guaranteed annuity options and guaranteed minimum death benefits).

An example of a contract containing a guaranteed annuity option is one in which the policyholder pays a fixed monthly premium for thirty years. At maturity, the policyholder can elect to take either (a) a lump sum equal to the accumulated investment value or (b) a lifetime annuity at a rate guaranteed at inception (ie when the contract started). For policyholders electing to receive the annuity, the insurer could suffer a significant loss if interest rates decline substantially or if the policyholder lives much longer than the average. The insurer is exposed to both market risk and significant insurance risk (mortality risk) and a transfer of insurance risk occurs at inception, because the insurer fixed the price for mortality risk at that date. Therefore, the contract is an insurance contract from inception. Moreover, the embedded guaranteed annuity option itself meets the definition of an insurance contract, and so separation is not required.

An example of a contract containing minimum guaranteed death benefits is one in which the policyholder pays a monthly premium for 30 years. Most of the premiums are invested in a mutual fund. The rest is used to buy life cover and to cover expenses. On maturity or surrender, the insurer pays the value of the mutual fund units at that date. On death before final maturity, the insurer pays the greater of (a) the current unit value and (b) a fixed amount. This contract could be viewed as a hybrid contract comprising (a) a mutual fund investment and (b) an embedded life insurance contract that pays a death benefit equal to the fixed amount less the current unit value (but zero if the current unit value is more than the fixed amount).

Both these embedded derivatives meet the definition of an insurance contract if the insurance risk is significant. However, in both cases market risk may be much more significant than the mortality risk. If interest rates or equity markets fall substantially, these guarantees would be well in the money. Given the long-term nature of the guarantees and the size of the exposures, an insurer might face extremely large losses. Therefore, an insurer might place particular emphasis on disclosures about such exposures.

Useful disclosures about such exposures might include:

the sensitivity analysis discussed above.

information about the levels where these exposures start to have a material effect on the insurer's cash flows (paragraph IG64(b)).

the fair value of the embedded derivative, although neither this Standard nor Ind AS 107 requires disclosure of that fair value.

Key performance indicators

Some insurers present disclosures about what they regard as key performance indicators, such as lapse and renewal rates, total sum insured, average cost per claim, average number of claims per contract, new business volumes, claims ratio, expense ratio and combined ratio. This Standard does not require such disclosures. However, such disclosures might be a useful way for an insurer to explain its financial performance during the period and to give an insight into the risks arising from insurance contracts.

Appendix 1

Note: This appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the differences between Indian Accounting Standard (Ind AS) 104 and the corresponding International Financial Reporting Standard (IFRS) 4, Insurance Contracts issued by the International Accounting Standards Board:

Comparison with IFRS 4, *Insurance Contracts*

1. Different terminology is used, to make it consistent with existing laws e.g., term 'balance sheet' is used instead of 'Statement of financial position' and 'Statement of profit and loss' is used instead of 'Statement of comprehensive income'.

2. The transitional provisions given in IFRS 4 have not been given in Ind AS 104, since all transitional provisions related to Ind ASs, wherever considered appropriate have been included in Ind AS 101, *First-time Adoption of Indian Accounting Standards* corresponding to IFRS1, *First-time Adoption of International Financial Reporting Standards*.

3. Paragraphs 39(b), IG 44, IG 49, IG 50, IG 54, IG 63 and IG 65 have been deleted in IFRS 4 by IASB. However, paragraph numbers have been retained in Ind AS 104 to maintain consistency with IFRS 4.