

CIRCULAR

No F&A/CIR/011/MAR-04

23rd March, 2004

ALL LIFE INSURERS

Re.: Preparation of financial statements of life insurers

A. Introduction:

Attention of the insurers is drawn to the IRDA (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002. During the course of review of the financial statements furnished by the insurers ending with the financial year 2002-03, it was noticed that the insurers have adopted different practices for presentation of the accounts. In particular, provisions of section 49 of the Insurance Act, 1938 have been read in varying manners, and accordingly declaration of bonus and the presentation of the financial statements filed with the Authority are not in consonance with what has been provided for in the Act and the Regulations framed thereunder.

B. Provisions of Section 49 of the Insurance Act, 1938:

Section 49, inter alia provides that no insurer shall declare bonus to the policyholders except out of a surplus shown in the valuation Balance Sheet which may arise as a result of actuarial valuation of the assets and liabilities of the insurer; nor shall he increase such surplus by contributions out of any reserve fund or otherwise unless such contributions have been brought in as revenue through the Revenue Account on or before the date of valuation.

C. Conditions to be met for declaration of bonus to the Policyholders:

It has been observed that insurers have taken recourse to shareholders' funds in different ways to enable declaration of bonus to participating policy holders. In doing so compliance with section 49 of Insurance Act has not been fully ensured. Hence, it has become necessary to issue guidelines to be followed by the insurers. An insurer intending to declare bonus, where the Life Fund is in deficit, should strictly satisfy the conditions, as laid down by the Authority, hereunder:

1. The Insurer shall make good the accumulated deficit in the Policyholders' A/c and also transfer adequate assets to cover the cost of bonus, prior to declaration of bonus to the participating policyholders. Such transfer from the Shareholders' A/c can be out of the Profit & Loss A/c balance or reserves in the Shareholders A/c,

and/or by drawing upon the paid-up capital of the Insurer. By implication, there shall be no deficit in the Policyholders' A/c in case of the insurer opting for declaration of bonus under these circumstances.

2. Any transfer as aforesaid, shall be by a debit to the Profit & Loss (Shareholders') Account and a credit to the Revenue (Policyholders') Account.
3. The funds so transferred to the Policyholders' A/c shall be irreversible in nature, i.e., at no point of time can they be recouped to the Shareholders' Fund.
4. The transfer to the Policyholders' A/c must be fully backed by transfer of assets/investments to the Policyholder' Funds, and should be adequate to meet the policyholders' liabilities, including the cost of bonus. The valuation of these assets must be in compliance with the IRDA Circular No.IRDA/FA/02/10/2003-04 dated 29th October, 2003.
5. The proposed rates of bonus should be capable of being sustained over the future.
6. The transfer of funds to the Policyholders' A/c shall be supported by a special resolution of the shareholders at the general meeting of the insurer. Further, the Insurer shall appropriately increase the paid-up equity capital, within a period of six months from the date of transfer of funds, or such longer period as may be approved by the Authority, with a view to aligning the paid-up equity capital, such as to make up the deficiency (including the cost of bonus) in the life fund as aforesaid, and is backed up and represented by Policyholders' assets/investments.

Insurers who have adopted any practice not in conformity with the above provisions, shall ensure compliance with the above said requirements with retrospective effect, and shall give effect to the same while finalizing their accounts for the financial year 2003-04. The insurers are given the option to either revise their financial statements for the years 2001-02 and 2002-03, or give retrospective effect to the above, while drawing up the financial statements for the financial year 2003-04.

The above provisions, for the purposes of meeting the requirement of declaration of bonus are available to the insurers only during the first five financial years, commencing from the year in which the life insurance business operations were started. It is expected that after five years of operations declaration of bonus will be supported by surplus within the life fund without recourse to contribution from the shareholders.

D. Modifications in the format of financial statements:

(Applicable to all life insurers, irrespective of whether or not the position as at "C" above is adopted)

As regards presentation of the financial statements, the following modifications in the formats are to be complied with:

Form A- RA (Policyholders' A/c):

Any contributions made to the Policyholders' A/c shall be indicated as under:

Under the head: "Other Income"

Add another line item as under:
"Contribution from the Shareholders' a/c"

Form A -PL (Shareholders' A/c):

Under the head "Provisions":

Add another line item:
"Contribution to the Policyholders Fund"

Accordingly, the First line item in the Shareholders' A/c shall stand modified to read as under:

"Amount transferred from the Policyholders' A/c".

The words "/To", shall stand deleted.

E. Disclosures in the Notes to Accounts:

Further, the insurer shall make a disclosure in the Notes to the Accounts, to the effect that the contributions made by the shareholders to the Policyholders' A/c are irreversible in nature, and shall not be recouped to the shareholders at any point of time in future.

The Notes shall also refer to the general meeting of the insurer at which such previous approval of the shareholders has been obtained.

F. Insurers not opting for the route as indicated at point "C' above.

In respect of the insurers who are carrying forward the deficit in the Policyholders' A/c at the close of the financial year, the presentation in the Balance Sheet shall be as under:

(i) Under the "Application of Funds":

Insert another line item after the "Debit Balance in the Profit and Loss A/c":
"Deficit in the Revenue A/c (Policyholders' A/c)"

(ii) The “Insurance Reserves” under the “Policyholders’ Funds”, represents any reserves maintained in respect of life insurance business, such as “unallocated surplus”. As such, the Insurance Reserves cannot be a negative figure. Also, with the change in the format as indicated at “D” above, the transfer to the Policyholders’ A/c shall in no case be indicated as a negative figure under the head “Appropriations to the Shareholders’ A/c”.

All life insurers are required to ensure compliance with the above.

(C.S.RAO)
Chairman