

CIRCULAR

ALL INSURERS

Re.: Valuation of Debt Securities as at 31st March

The regulations for preparation of financial statements have laid down guidelines for valuation of debt and equity in broad terms. In respect of debt securities, it is further provided that these securities including government securities and redeemable preference shares shall be considered to be held to maturity and shall be measured at historical cost subject to amortization.

The philosophy behind such a treatment is that since the insurance sector had long term liabilities, particularly in the life sector, these companies are not impacted by the movement in the market price of the securities. Further, the Management Report also requires certification to the effect that the assets set forth in the Balance Sheet have been shown in the aggregate at amounts not exceeding their realizable or market value.

However, with the debt markets witnessing movement both ways over the last few years, some insurers have pursued active investment management and have churned their investment portfolios. During the Investment Inspection undertaken by the Authority it was also observed that part of the portfolio of the insurers is being earmarked for trading. Valuation of fixed income investments has to be consistent with the manner of maintaining this portfolio, namely active or passive in part or whole. It is in this context the provisions pertaining to valuation of these investments need to be revisited.

The Authority is now contemplating incorporation of the following certifications in the Management Report to be filed as part of the financial returns, as a prerequisite to consider the entire portfolio of debt securities as held to maturity:

1. Certification by the Auditors to the effect that the insurer has not opted for churning of the portfolio during the year under reporting;

2. Certification to the same effect by the Board of Directors of the insurer; and
3. The insurer shall state its policy on investments held as reflected in the Investment Policy. The insurer must spell out that the investments made are with the clear intent of being held to maturity. This certification must be in congruence with the Investment Policy of the insurer.

Only if these stipulations are met shall the insurer continue to hold the securities at the amortized cost. In case the insurer fails to meet these requirements the debt securities would need to be marked to market, and adequate provision would need to be made for the decline in the market value as against the holding value of the investments held. When there is mark-up in the value of these investments the same would be reflected in the Fair Value Change A/c.

In case a specified component of the insurer's portfolio is held for the purpose of trading the said per cent shall be marked to market. While specifying that component of the total portfolio which is held for trading, the insurer shall:

1. Specify the composition of the portfolio in the Investment Policy;
2. The composition of the said portfolio shall not undergo a change during the financial year;
3. The specified per cent of the portfolio held for trading cannot be reduced during the course of the year; and
4. Specify component of the policyholders' and shareholders; investments so earmarked.

All insurers are requested to forward their comments on the above proposed framework to the Authority within a fortnight of receipt of this communication. Your response can also be sent through e-mail at mamta@irdaonline.org.

Based on the comments received from the insurers, the Authority shall frame the final guidelines for valuation of debt securities for the purpose of presentation in the financial statements.

Yours faithfully

(C.S.RAO)