

CIRCULAR

Sub: Creation of Reserve for Unexpired Risk (URR) by the Non-life Insurance Companies

Section 64V(1) of the Insurance Act lays down the manner of valuation of Assets and Liabilities of insurance companies. Proviso (ii) (b) of the said section provides for creation of reserves for unexpired risks in respect of –

- (i) fire and miscellaneous business, 50 per cent,
- (ii) marine cargo business, 50 per cent, and
- (iii) marine hull business, 100 per cent,

of the premium, net of re-insurances, during the preceding twelve months.

Further, Clause 2 of part I of Schedule B of the IRDA (Preparation of Financial Statements & Auditors' Report of Insurance Companies) Regulations, 2002 (the Regulations) provides that a reserve for unexpired risks shall be created as the amount representing that part of the premium written which is attributable to, and to be allocated to the succeeding accounting periods and shall not be less than as required under Section 64V(1)(ii)(b) of the Insurance Act.

The Authority has examined the request of insurers seeking relaxation from the stipulation that “such reserve shall not be less than as required under Section 64V(1)(ii) (b) of the Insurance Act”, irrespective of the premium allocated to the succeeding accounting periods in respect of the health insurance business. While the amendment to the statutory provisions as stipulated are being separately examined by the Authority to provide for appropriate regulatory framework for creation of Reserve for Unexpired Risk, taking into account the peculiar nature of the health segment, limited relaxation is being extended to the non life insurers with respect to the health segment for the financial year 2008-09.

While preparing the financial statements, the non-life insurance companies may provide for the Reserve for Unexpired Risks in the health segment on the $\frac{1}{365}$ day method basis as provided in the Regulations. The requirement for the said reserve being not less than as required under Section 64V(1)(ii)(b) of the Act, thus stands waived only with respect to the health segment for the year 2008-09.

Any insurer creating the Reserve for Unexpired Risks on the basis of $\frac{1}{365}$ method in the health segment shall ensure compliance with the stipulated conditions and disclosure

requirements as indicated below:

- 1) The relaxation is available for the accounting period 2008-09 only;
- 2) In case of the insurance company generating any accounting surplus, i.e., operating profit, net of tax, in the health segment on account of application of $\frac{1}{365}$ method, the surplus so generated shall not be available for distribution to the shareholders;
- 3) The operating profit, net of tax, generated on account of the difference between the reserve created on the basis of $\frac{1}{365}$ method and the URR as would have been created based on Section 64V(1)(ii)(b) of the Act (as reflected at pt. (2) above) shall be transferred to a "**Contingency reserve for Unexpired Risks**" and reflected in the Profit and Loss account as under:

**Extract of the Profit and Loss Account
for the year ended 31st March, 20....**

Particulars	Schedule	Current Year	Previous Year
		(Rs. '000)	(Rs. '000)
<i>Appropriations</i>			
(a) Interim dividends paid during the year (b) Proposed final dividend (c) Dividend Distribution Tax (d) Transfer to any reserve or other accounts (to be specified): <ul style="list-style-type: none"> • Contingency reserve for Unexpired Risks 			

The reserve so created is to be reflected in the Profit and Loss Account as indicated in bold letters in the above extract.

In effect, where the URR created on the basis of $\frac{1}{365}$ method is less than as provided under Section 64V(1)(ii)(b) of the Act and is resulting in an operating profit, the insurer would be required to transfer such operating profit, net of tax, to the Contingency Reserve as indicated above **and such profit shall not be available for distribution to the shareholders without the explicit approval of the Authority.**

- 4) As a matter of prudence, for the purpose of computation of Solvency Margin, the insurer shall continue to estimate its liabilities as provided for in form HG of the IRDA (Assets, Liabilities and Solvency Margin of insurers) Regulations, 2000 taking into account the stipulations as laid down at Para 3 of IRDA Circular no.045/IRDA/F&A/Mar-06, dated 31st March, 2006. No amendments are proposed in the said instructions for the purpose of computation of Solvency Margin for the year ending March 2009.

- 5) In the Notes to the Accounts, the following disclosures shall be made:

“The Company has created the Reserve for Unexpired Risks as at the end of the Accounting period based on the $\frac{1}{365}$ method in the health segment as per IRDA Circular No.IRDA/F&A/CIR/49/Mar-09 dated March 24, 2009. The said Contingency Reserve is not available for distribution to Shareholders and its utilization, at any future date would require prior approval of the Authority.

(J. Hari Narayan)
Chairman