

CIRCULAR

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All Life Insurers, Non Life Insurers and Re-insurer

IRDA (Assets, Liabilities and Solvency Margin of Insurers) Regulations, 2000 – Clarifications

Queries have been raised by insurers on various matters relating to the manner of computation of solvency margin as provided in the Regulations. To ensure consistency in the interpretation of the Regulations, the following clarifications are issued. Insurers are required to ensure compliance with these clarifications while computing the solvency margin as at 31st March, 2006 and thereafter.

1. Table I to Form KG: Statement of Solvency Margin: (General Insurers) –
 - (a) Gross Premium for the purpose of Solvency Margin shall be the aggregate of gross direct premium and reinsurance accepted premium; and
 - (b) Incurred claims: Explanation (ii) to Section 64VA of the Insurance Act, 1938 stipulates that net incurred claims means the average of the net incurred claims during the specified period of not exceeding three preceding financial years. It is now clarified that:
 - i. the Gross Incurred Claims and Net Incurred Claims (inclusive of IBNR and IBNER) shall be taken as the average of the previous three years (excluding the financial year with reference to which the solvency of the insurer is being computed) and shall in no case be less than the amounts of Gross and Net incurred claims for the financial year ending on the reporting date; and
 - ii. the incurred claims should also include claims pertaining to reinsurance accepted.
2. Valuation of Assets: Schedule I of the Regulations – Clause 2 (3) of the Regulations provides that all assets of an insurer, other than those specified at (1) and (2), have to be valued in accordance with the IRDA (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002. However, as a matter of prudence and also consistent with the requirement of Section 64 V (1) (i) of the Insurance Act, 1938

which states that "Assets shall be valued at values not exceeding their market or realizable values", for the purpose of computation of solvency margin, debt securities shall be valued at lower of the amortized cost and the market value.

It is, thus, clarified that while for the purpose of preparation of financial statements the debt securities would continue to be valued at the amortized cost, for the purpose of computation of solvency margin, these shall be valued at lower of the amortized cost and the market value.

3. Clause 2 (ii) of the Schedule II-B of the regulations lays down the manner of determination of Reserve for Unexpired Risk. Some insurers have misinterpreted this provision to mean that even where the actual reserves maintained in the Accounts of the insurer are higher, it is adequate to use the percentages stated in the Regulations for assessing the solvency margin.

It is clarified that it will not be prudent to consider a reserve for computation of solvency margin which is less than that created in the financial statements.

Accordingly, the Reserve for Unexpired Risks taken into account for the purpose of computation of solvency margin should be the higher of (i) the actual reserve maintained in the books of accounts of the insurer and (ii) the URR arrived at based on the percentages stated in the Regulations for each class of business stated therein.

4. Deferred Tax Assets: Section 64 V (1) of the Insurance Act, 1938 and the regulations list out the assets which shall be assigned value "zero". While "Deferred Tax Assets" have not been listed there under, as a matter of prudence, it is hereby advised that such assets shall also be assigned "zero" value for the purpose of computing solvency margin.

All insurers are advised to ensure compliance with the clarifications issued herewith effective from the statements as at the end of financial year 2005-06.

(C. S. Rao)
Chairman