OPINION

IndAS 117: A paradigm shift for insurance sector

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Since the opening of the insurance sector in 2000, the industry has witnessed changes at various intervals. Be it products, distribution, servicing – every aspect has undergone changes over the last several years. Among the more recent ones, from the financial point of view is the implementation of the IndAS 117.

The need

For a long time, the insurance sector has perhaps been one of the few industries in India with a need to conform to two reporting frameworks. While the accounting framework that governs financial statements provides a statutory and prudent view, it may not provide an accurate picture of the business profits and financial performance of an insurer. The actual economic or actuarial 'Embedded Value' framework captures an insurance business' economic value more appropriately. It is a known fact that India's insurers have struggled to cater to two diverse sets of accounting frameworks leading to inconsistencies in assessing a company's financial health accurately.

Now, with the impending implementation of IndAS 117, the Indian insurance industry stands at the cusp of a transformation in financial reporting. Consistent with the International Financial Reporting Standard (IFRS) 17, the IndAS 117 will fundamentally alter the way in which insurers report profits, liabilities and consequently, record and measure financial performance.

One framework, many benefits

While the 'Embedded Value' reporting framework appropriately encapsulates the value of the business on the books, it has a few limitations. Despite its robustness, it is undeniably complex. Consequently, its understanding is limited to industry experts and the industry's long-term observers. Laypersons find it challenging to draw insights from the framework. Secondly, the 'Embedded Value' disclosures exist outside the primary audited financial statements. Accordingly, despite internal and external reviews, it may not receive the same level of audit scrutiny and regulatory oversight as the statutory accounts. And finally, while these disclosures are required to be published by listed insurers, there is no such mandate for unlisted insurers, often leading to an uneven playing field when analysing accounting information. Simply put, it may not facilitate an apple-to-apple comparison between two entities.

The IndAS 117 framework offers an opportunity to insurers to ascertain profits accurately while inspiring the layperson's confidence in the company's financial health. Insurers will now be able to represent economic profits in their statutory financial statements in a manner consistent with business intricacies. There are multiple benefits here. It will lend transparency and uniformity to the books of accounts while allowing independent observers to better understand the business. Also, since the accounting standard mandates higher level of disclosures, insurers can better present their economic position. Lastly, aligning with an internationally accepted standard will allow comparison of an Indian insurer's business strength with a global player, leading to consistent evaluations. It is pertinent considering that the Central Government has now allowed 100 per cent foreign direct investment in India's insurance sector.

A gamechanger for life insurance business

IndAS 117 will have a more transformative impact on the life insurance business. With life insurance dealing in long-term contracts, the point at which profits for a policy are booked has remained a bone of contention for long. The new standards recognise the concept of Contractual Service Margin (CSM) that is the expected profit locked in a policy and will be released into the books gradually over the policy's tenure. The CSM may become a key metric for business observers to gauge a life insurer's long-term business efficiency.

Teething issues

Insurers will need to invest substantially in overhauling current reporting systems as well as enhancing data pipelines to support the new standard's granularity. Equally important will be training of the concerned personnel. The members of the finance, actuarial, risk, data and technology functions will have to be oriented towards working in close alignment with the on-ground teams.

While operational complexities may pose a challenge, the long-term strategic benefits outweigh the efforts and costs involved. Initially, the new standards may co-exist with the Embedded Value framework as the analyst and investor community relies on the latter for decision-making. Going forward, internationally consistent and enhanced IndAS 117 disclosures should lead to greater comparability, both within the industry as well as with global peers. It will help in attracting larger pools of long-term domestic and international capital giving a fillip to growth and insurance penetration.

Regardless of the initial hiccups, the adoption of the IndAS 117 standard is a pivotal opportunity to align India's insurers with contemporary accounting conventions.

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