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INSURANCE REGULATORY COMMISSION OF SRI LANKA

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BY REGISTERED POST/FAX

Ref: IRCSL/DG/LEG/18/03/130

20th March 2018

Chief Executive Officers of all Insurance Companies (Long Term Insurance Business)

Dear Madam/Sir,

Identification and Treatment of One-Off Surplus: Direction # 16 – 20.03.2018 issued under Section 96A of the Regulation of Insurance Industry Act No. 43 of 2000

The Insurance Regulatory Commission of Sri Lanka (IRCSL) issues the attached Direction, in terms of Section 96 A of the Regulation of Insurance Industry Act, No. 43 of 2000, on the methodology for the Identification and Treatment of One-Off Surplus.

Companies may forward the disclosures required to be made to the IRCSL in terms of the Direction. Please ensure that the disclosures are detailed as possible in order to avoid delays in obtaining approval. We would need all disclosures to be sent in one submission (soft and hard versions) before 23rd March 2018.

This Direction shall come in to force with immediate effect.

Please acknowledge receipt of same.

Yours faithfully,


Damayanthi Fernando

Director General

RA/TW

Cc: President, Insurance Association of Sri Lanka

Directions for Identification and Treatment of One-Off Surplus

20 March 2018

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Section 1: Introduction

Objective

- 1.1 This report sets out the Directions for the life insurance industry of Sri Lanka for the purpose of identification, transferring, maintenance and distribution of the surplus created due to change in the regulatory solvency regime from Net Premium Valuation (“NPV”) regime to a risk-based Gross Premium Valuation (“GPV”) regime, also known as the “One-off Surplus” and any disclosures required.

Background

- 1.2 The Insurance Regulatory Commission of Sri Lanka (“IRCSL” or “the Commission”) implemented the Risk Based Capital (“RBC”) regime for Insurers in Sri Lanka with effect from 1 January 2016. Accordingly, the policy liability valuation methodology transitioned from an NPV methodology to a GPV methodology. It was noted, that for most life insurance companies, this resulted in a reduction in policy liabilities leading to a significant increase in surplus. The Solvency Margin (Risk Based Capital) Rules 2015 (“RBC rules”) published by IRCSL dated 15 December 2015 describe the rules for demonstrating solvency under the RBC regime.
- 1.3 The IRCSL noted that the creation of surplus as a result of change in solvency regime was significant. It is the IRCSL’s intention to assess the relative strengths and merits of the RBC rules. Further, the IRCSL is looking to investigate further whether the RBC rules have been implemented effectively by all life insurers in respect of adapting to new methodologies and setting assumptions as there are greater number of areas of judgement when assessing best estimate assumptions, in particular, if a specific insurer has less credible experience information for certain assumptions.
- 1.4 As an interim measure, the IRCSL in its letter dated 30th December 2016 instructed life insurance companies to maintain the “**One-off Surplus**” in the life fund (or the policyholders’ fund (“PHF”)) and restricted its transfer to the shareholders’ fund (“SHF”).
- 1.5 It is now understood that the taxation rules concerning the life insurance industry will change, effective 1 April 2018. Under the new tax rules, any transfers from the PHF to SHF will be taxed at 28%. Therefore, the Insurance Association of Sri Lanka (“IASL”) has requested permission from the IRCSL to effect the transfer of One-off Surplus arising from other than participating business (within the PHF) to the SHF before 1 April 2018 as these surpluses have arisen from profits in periods prior to 2016 and hence, should not be impacted by future taxes; along with guidance on the maintenance of such money within the SHF and its eventual distribution to shareholders. The IASL further stated that this transfer will be reflected as at 31 December 2017 or on a subsequent date based on the 31 December 2017 results.
- 1.6 The IRCSL has further observed that companies have used different methods to compute the One-off Surplus; and the choice of method significantly affects the amount of such surplus. Differences in methodologies adopted have been observed in, but are not limited to, the areas below:
 - i. **Choice of valuation basis:** Solvency basis (i.e. the valuation basis as prescribed by the IRCSL for demonstrating solvency) vs Distribution basis (i.e. an internal basis that may have been adopted by a company to determine the surplus for presentation on financial statements).

A company's distribution basis is typically more prudent than the solvency basis. Further, the distribution basis is at the discretion of the company, and therefore, several approaches exist with regards to formulating a distribution basis that is specific to the particular company as opposed to the solvency basis that applies uniformly across all companies. This gives four possible methods of determining the One-off Surplus namely:

- One-off surplus = NPV Solvency basis liability – GPV Solvency basis liability;
 - One-off surplus = NPV Solvency basis liability – GPV Distribution basis liability;
 - One-off surplus = NPV Distribution basis liability – GPV Solvency basis liability; and
 - One-off surplus = NPV Distribution basis liability – GPV Distribution basis liability;
- ii. **Treatment of negative liabilities arising under the RBC regime, for the purpose of calculation of One-off Surplus:** Companies have either not zeroised the negative policy liabilities at all; or zeroised at a policy level, product level or fund level. Further, some have floored policy liabilities for certain products to certain internally defined minimum liability floors such as Unearned Premium Reserve (“UPR”) or Surrender Value.
- iii. **Universal Life:** Different methods of valuing universal life business have been observed in the industry under both - solvency basis and distribution basis, following the transition to the RBC regime; due to lack of clarity within the RBC rules for valuing such business.

1.7 Due to several different methodologies being used by life insurance companies to determine their One-off Surplus, this report recommends a consistent methodology that can be uniformly applied across the industry for the purpose of determining the One-off Surplus and related objectives.

Structure of the Report

1.8 This report includes the below:

- i. This report provides directions with respect to a consistent method that life insurance companies should adopt to determine One-off Surplus. For the avoidance of doubt, the recommended methodology is not intended to form guidance for determining regulatory or accounting surplus for the purpose of preparing financial statements and is limited to providing guidance on computation of one-off surplus only. Further, the recommendations in this report should not be construed to be an indication of any expected changes to the RBC rules in future (i.e. when the RBC rules are reviewed as part of a separate exercise) nor an indication of requirements of IFRS17.
- ii. The report recommends methodology for determining policy liabilities for universal life business under the RBC rules.
- iii. This report provides directions with regards to the transfer of One-off Surplus to the SHF and its maintenance post-transfer.
- iv. The One-off Surplus will continue to remain locked in the SHF and will not be allowed to be released to the shareholders unless certain conditions are met. These conditions have been described in this report.

- v. Disclosures required to be made to the IRCSL and also in the published financial statements with respect to the One-off Surplus are set out in this report.
- 1.9 **Section 2** of this report summarises the key recommendations.
- 1.10 **Section 3** of this report provides the basis for arriving at these recommendations.
- 1.11 **Section 4** summarises the reliances and limitations of the Independent Actuary of the IRCSL.
- 1.12 Further information regarding discussions between the IRCSL, stakeholders of the life insurance industry and CA Sri Lanka as well as other industry level analysis and reporting formats are provided in the Appendices.

Section 2: Key Recommendations

2.1 This section summarises the key recommendations with regards to the One-off Surplus.

Identification of One-off Surplus:

- 2.2 The recommendations below set out the approach to determine the **minimum One-off Surplus** that a company should recognise. A company may adopt a different approach to determine its One-off Surplus, if and only if, the One-off Surplus so determined is greater than or equal to the minimum One-off surplus determined based on the approach recommended below. Any deviations from the recommended approach along with supporting rationale should form part of a company's disclosures.
- 2.3 The One-off Surplus will be determined as at 1 January 2016 and shall remain unchanged until further notice from the IRCSL or until the IRCSL permits its distribution to shareholders.
- 2.4 The One-off Surplus should be defined as the **excess of the total policy liabilities** under the NPV regime as at 31 December 2015 over the total policy liabilities under the RBC regime as at 1 January 2016 (as defined below in section 2.6 and section 2.8). The valuation of liabilities under the RBC regime should be based on the policy data as at 31 December 2015 and the RBC rules effective 1 January 2016.
- 2.5 The One-off Surplus should be determined separately in respect of "participating business" and "other than participating business"; and if negative (at either of these two levels) should be zeroised.
- 2.6 For avoidance of doubt, the **total policy liabilities under the NPV regime:**
- i. Should be determined using the **minimum regulatory basis** (i.e. basis as prescribed by the IRCSL for demonstrating solvency). A company may adopt a more prudent internal basis as well, however, it is not considered necessary.
 - ii. Should comprise of the following:
 - a. Policy liabilities in respect of "non-participating business", "participating business", "non-unit account", "liabilities in respect of bonuses declared for the current year" and "unit account (where savings benefits are guaranteed by the insurer" – as mentioned in Form K – LT-2 filed with the IRCSL as at 31 December 2015.
 - b. Reserves of Unit-linked products without savings guarantees as at 31 December 2015.
- 2.7 The NPV liabilities should include any revisions made to NPV liabilities (and communicated to the IRCSL) after the regulatory submissions as at 31 December 2015. The reason for such changes in NPV liabilities should form part of a company's disclosures to the IRCSL and published financial statements in respect of the One-off Surplus.
- 2.8 For avoidance of doubt, the **total policy liabilities under the RBC regime:**
- i. Should be determined on a basis set with reference to a company's **distribution basis**. The One-off Surplus should be determined using a methodology/approach which results in total liabilities to be less than or equal to the total liabilities that would arise using the methodology/approach underlying the company's distribution basis as at 31 December

2017 (i.e. basis used to demonstrate surplus in the most recent financials prepared by the company).

- ii. Should comprise the SLFFS value of “Total Policyholder Liabilities (net of reinsurance)” as per “Table 2: Balance Sheet – Liabilities” of the RBC template
 - iii. Should be determined as at 1 January 2016.
 - iv. Should reflect changes to assumptions made after 1 January 2016 that may be considered reasonable to form the basis of policy liability valuation as at 1 January 2016 (for example, where changes made to the assumptions better reflect the experience over the period the company would have typically considered if it were to set assumptions for a policy liability valuation as at 1 January 2016)
- 2.9 **Distribution basis:** the choice of basis for the determination of One-off Surplus shall impose a restriction on the methodology/approach underlying a company’s distribution basis going forward. A company will not be allowed to use an approach/methodology for its distribution basis less prudent than the methodology adopted for its One-off Surplus basis until the time distribution of One-off Surplus is restricted by the IRCSL. In the event that a company intends to change the methodology for its distribution basis in future which may result in a lower liability compared to the methodology underlying the distribution basis used as at 31 December 2017, then, it is recommended that the One-off Surplus as at 1 January 2016 also be determined using a methodology which is less or as prudent than the intended methodology for the distribution basis in future. For avoidance of doubt, this restriction is imposed on the methodology underlying the distribution basis; and no restrictions are imposed on the assumptions underlying the distribution basis for any of the future regulatory submissions as at all times the assumptions should reflect the most up-to-date experience and expectations of future outlook. Also, One-off Surplus once determined as at 1 January 2016 shall remain unchanged and will not be re-calculated if the methodology or assumptions underlying the distribution basis are changed in future (in accordance with the recommendations prescribed above).
- 2.10 **Zeroisation of negative liabilities:** The IRCSL is not prescribing any particular level at which negative liabilities should be zeroised when setting the distribution basis. However, it should be noted that the IRCSL has intentions of further strengthening the RBC rules and also implementing the IFRS17 in the near future. Although the impact of these likely future developments is not known at this moment, these can result in an increase in capital requirements in the near future. Further, a company’s exposure to all risks may not be captured suitably within the existing RBC rules, as these rules apply uniformly across companies and a company’s own assessment of its risks may differ. Therefore, the IRCSL suggests companies to take a cautious approach with respect to determining surplus transfers to the SHF – one such approach may be to zeroise negative liabilities at a policy level on the distribution basis.
- 2.11 **Valuation of universal life business:** It is hereby clarified that, under the existing RBC rules, universal life business may be valued using either discounted cash flow method or as policy account value plus general account (non-unit) liabilities. However, the discount rate used should be the risk-free interest rate curve; and the crediting rate assumption should be set consistent with the discount rate. From 31 December 2017 onwards, this approach to valuing universal life business is recommended for demonstrating solvency under the RBC rules until these are more fully reviewed as part of a separate exercise. For the purpose of One-Surplus calculation, a company should be able to demonstrate that the distribution basis adopted by the company results in liabilities for the universal life business to be greater than or equal to the recommended approach as set out in this section of the report.
- 2.12 In the event that the classification of any set of liabilities has changed between participating and other than participating business after the regulatory submissions as at 31 December 2015, then this should be reflected in both NPV liabilities and GPV liabilities for the calculation of One-off Surplus.

Transfer of One-off Surplus:

- 2.13 For other than participating business, the One-off Surplus determined based on the recommendations above may be transferred to the SHF upon receiving approval from the IRC SL.
- 2.14 One-off surplus in respect of participating business should be held within the participating fund as part of the unallocated valuation surplus and may only be transferred to the SHF by means of bonuses to policyholders in line with Section 38 of the "Regulation of Insurance Industry, Act No.43 of 2000". It is recommended that any bonus declared to transfer the One-off Surplus be sustainable, equitable and in line with policyholders' reasonable expectations. Declaration of a special one-off large bonus, in order to distribute significant proportion of One-off Surplus is not recommended.
- 2.15 For avoidance of doubt, the One-off Surplus can continue to support a company's capital adequacy ratio ("CAR").

Maintenance of One-off Surplus:

- 2.16 The One-off Surplus amount, once transferred to the SHF, shall remain unchanged until further notice from the IRC SL or until distributed to shareholders upon explicit approval of the IRC SL.
- 2.17 Following the transfer of One-off Surplus from the PHF to the SHF, the SHF must maintain investments in "Government Debt Securities" and "Deposits" to fully support the amount of One-off Surplus at any given time on a market value basis. For avoidance of doubt, interpretation of "Government Debt Securities" and "Deposits" should be considered to be as per items (a) and (d) of "Table A" of Determination #1 made by the IRC SL (titled "Investment from the technical reserve and the from the long term insurance fund") respectively.
- 2.18 Investment income earned on the assets assumed to be supporting the One-off Surplus in the SHF may accrue to the SHF directly. The shareholders are required to ensure that the market value of allocated assets in the SHF are greater than or equal to the One-off Surplus at all times.
- 2.19 Any expenses incurred in maintaining the assets supporting the One-off Surplus in the SHF shall be borne by the SHF and may not be charged to the One-off surplus to reduce its balance.

Distribution of One-off Surplus:

- 2.20 The distribution of One-off Surplus to shareholders shall remain restricted until a company develops appropriate policies and procedures for effective management of its business, as listed below. These policies must be approved by the Board of Directors of the company and must also comply with any relevant guidance issued by the IRC SL from time to time. It should be noted that the IRC SL will reconsider the distribution of One-off Surplus when the RBC rules are revised.
- i. Expense allocation policy setting out basis of allocation of expenses between the SHF and the PHF as well as between different lines of business within the PHF, particularly participating and non-participating.
 - ii. Dividend declaration policy for universal life business
 - iii. Bonus policy for the participating business, which should include treatment of One-off Surplus for the purpose of bonus declaration.
 - iv. Asset-liability management policy

- v. Policy on internal target CAR
 - vi. Considerations for transfer of funds from PHF to SHF
- 2.21 The IRCSL will permit distribution of One-off Surplus subject to yearly distribution caps on a case-by-case basis.
- 2.22 Apart from the governance policies listed above, the IRCSL may require a company to set up additional policies to facilitate the release of One-off Surplus.
- 2.23 The distribution of any surplus (including the One-off Surplus and surplus arising as a result of any changes to insurance contract liabilities as a result of these recommendations/directions) should be in conformity with Section 48 of "Regulation of Insurance Industry, Act No.43 of 2000".
- 2.24 The One-off Surplus will be presented on the financial statements as Restricted Regulatory Reserve (as described in the disclosure requirements below) and will be available to demonstrate solvency strength only. Any increase in insurance contract liability in future will be effected through the Income Statement as per the Accounting Standards.

Disclosure requirements:

- 2.25 **Disclosures in financial statements:** the following disclosures are required to be made.
- i. Balance Sheet: Equity should include a new line item called "Restricted Regulatory Reserve" with value equal to the One-off Surplus for other than participating business. The same disclosure should be made in the Statement of Changes in Equity. Adequate disclosure should be made with regard to "Restricted Regulatory Reserve".
 - ii. The transfer of One-off Surplus from the PHF to the SHF should be treated as a release permitted by the IRCSL during the relevant period and accounted through the Income Statement, in line with the Sri Lanka Accounting Standards.
 - iii. The Income Statement should include a new line item in respect of transfer of One-off Surplus from the PHF to the SHF below the current year change in contract liability. This should be called as "Change in contract liability due to transfer of One-off Surplus".
 - iv. The disclosures in the financial statements should clearly state that the "distribution of One-off Surplus to shareholders , held as part of the Restricted Regulatory Reserve, is subject to meeting governance requirements stipulated by the IRCSL and can only be released upon receiving approval from the IRCSL. The One-off Surplus in the SHF will remain invested in assets in notesas per the directions of the IRCSL".
 - v. The basis for computation of One-off Surplus should be stated separately for the participating business and other than participating business in the financial statements. Any deviation from the directions in respect of determining the "minimum One-off Surplus" should be disclosed.
 - vi. In the notes to the accounts, the one off surplus in the insurance contract liability should be disclosed separately for participating business and other than participating business, if any.

- vii. Financial ratios should be determined in accordance with Sri Lanka Accounting Standards. Additional financial ratios, excluding the impact of transfer of One-off Surplus, may be disclosed by a company separately if required.
- viii. A disclosure should be made regarding the composition of investments supporting the Restricted Regulatory Reserve in the respective note.

2.26 **Disclosures to the IRCSL:** The following disclosures are required to be made to the IRCSL, to obtain approval for transferring One-off Surplus for other than participating business to the SHF. These disclosures are only required to be made once. For avoidance of doubt, the disclosures below are required in respect of One-off Surplus for both - participating business and other than participating business. These may be provided to the IRCSL in the form of a letter on the company's letterhead.

- i. Please state whether the basis used for determining the NPV liabilities is other than the minimum regulatory basis. If different, please provide supporting rationale.
- ii. Describe in detail the differences in methodology and assumptions used in the determination of liabilities under the SLFRS basis (or the internal distribution basis) compared with the RBC basis as at 31 December 2017.
- iii. Describe in detail the differences in methodology and assumptions used in the determination of One-off Surplus compared with the SLFRS basis as at 31 December 2017. Please provide rationale for each area of difference identified.
- iv. Please confirm whether the methodology underlying the basis adopted for the determination of liabilities for One-off Surplus calculation is more prudent or less prudent than the SLFRS basis as at 31 December 2017. Please describe how this has been tested.
- v. Please describe in detail the valuation methodology adopted for valuing universal life business under RBC basis, SLFRS basis and the One-off Surplus basis. In particular, please describe how internal consistency between the risk-free rate and the crediting rate assumption is ensured.
 - a. Please confirm that the policy liabilities under the RBC basis are greater than or equal to the recommended approach.
 - b. Please confirm that the policy liabilities under the distribution basis are greater than or equal to the recommended approach and the RBC basis.
 - c. Please confirm that the policy liabilities under the One-off Surplus basis are less than or equal to the distribution basis.

- vi. Please furnish the information below, as at 31 December 2015; and state reasons for differences between A and B.

Line item	NPV liabilities filed with IRCSL (A)	NPV liabilities for One-off Surplus calculation (B)	Reason for difference
Participating business			
Non-participating business			
Non-unit account			
Liabilities in respect of bonuses declared for the current year			
Unit account (where savings benefits are guaranteed by the insurer)			
Unit Linked reserves (without savings guarantees)			
Total Participating business			
Total other than participating business			
Total company level			

- vii. Please furnish the information below, as at 1 January 2016. Please state reasons for differences between A and B. Please provide an explanation of difference in B and C for each line items separately.

Line item	Liabilities on RBC basis from parallel run (A)	Liabilities on RBC basis (if any methodology changes incorporated after the parallel run) (B)	Liabilities for One-off calculation (C)	Reasons for differences (B) – (A)	Reasons for differences (C) – (B)
Participating business					
Non-participating business					
Universal life					
Non-unit account liabilities for unit linked business					
Unit Linked reserves					
Unmodelled products					
Aggregate provisions – participating business					

Line item	Liabilities on RBC basis from parallel run (A)	Liabilities on RBC basis (if any methodology changes incorporated after the parallel run) (B)	Liabilities for One-off calculation (C)	Reasons for differences (B) – (A)	Reasons for differences (C) – (B)
Aggregate provisions – other than par business					
Total Participating business					
Total other than participating business					
Total company level					

viii. Please furnish the information below for the calculation of One-off Surplus:

Line item	NPV liability	GPV liability	One-off Surplus
Participating business			
Other than participating business			
Total company level			

- ix. Please demonstrate that the One-off Surplus determined by the company is not less than the One-off Surplus as per the recommended approach.
- x. Please confirm whether the company has any plans of changing its internal distribution basis? If yes, please confirm how this was considered in determining the One-off Surplus.
- xi. Until the requirement to maintain the One-off Surplus exists, the One-off Surplus shall remain unchanged - Please confirm whether the company has understood this direction.
- xii. Until the requirement to maintain the One-off Surplus exists, the methodology underlying a company's distribution basis can only be such which results in liabilities to be greater than or equal to the liabilities under the One-off Surplus basis. Please confirm whether the company has understood the implications of this direction.
- xiii. Please confirm that the company undertakes to comply with the directions as set out in this report.
- xiv. In the event of a decrease in one-off surplus previously maintained by the company (i.e. before the introduction of these directions), how will the additional surplus created be presented on a company's balance sheet? Will the company transfer the additional surplus created to the SHF or distribute any part of this additional surplus with immediate effect? Please provide a list of assets, along with their market values, which will be

transferred to the SHF from the PHF in addition to the assets supporting the One-off Surplus, if any.

- xv. Please provide a list of assets, along with their market values, which will be transferred to the SHF from the PHF on transfer of the One-off Surplus.
- xvi. Please submit a confirmation demonstrating Determination #1 for the PHF post such transfers, including the One-off Surplus. Please also submit Form BR-IN.

2.27 The following **disclosures are required to be made to the IRC SL every quarter**.

- i. Please provide details of the assets in the SHF supporting the One-off Surplus – in the format prescribed in Appendix C.
- ii. Please describe any changes to the methodology or assumptions underlying the company's distribution basis.
- iii. Please demonstrate that the company's distribution basis results in the policy liabilities to be greater than or equal to the policy liabilities under its One-off Surplus basis.

2.28 **Certification by the Appointed Actuary:** As a disclosure to the IRC SL, the One-off Surplus should be certified by the Appointed Actuary. If the One-off Surplus has been certified by the Appointed Actuary previously, then another certification is required only in the event of a change in the One-off Surplus. In either scenario, a company's Appointed Actuary must confirm whether the directions set out in this report have been complied with for the **identification of One-off Surplus** and provide supporting rationale in the event that an alternate methodology has been adopted. Further, the Appointed Actuary must certify that he/she has **no objection to transfer the One-off Surplus to the SHF**. The certification should be in the format prescribed in Appendix D.

Section 3: Basis for Conclusions

3.1 This section describes the approach adopted and the analysis undertaken to arrive at the key recommendations as set out in Section 2 above.

Approach

- 3.2 The IRCSL invited proposals from actuaries and actuarial firms to provide expert advice on the One-off Surplus, based on IASL's request to permit transfer of One-off Surplus from other than participating business to the SHF. On evaluating all proposals based on a set criteria, the IRCSL engaged Towers Watson India Private Limited (a Willis Towers Watson entity) for this assignment. In order to ensure independence and avoid conflicts of interest, Willis Towers Watson provided Abhishek Chadha (Fellow of Institute and Faculty of Actuaries, UK), a qualified actuary ("Independent Actuary") to the IRCSL to act as "loaned employee" under the supervision of IRCSL during the course of this assignment. The assignment was kicked-off on 19 February 2018.
- 3.3 The Independent Actuary and the IRCSL worked collaboratively to arrive at suitable directions for the treatment of One-off Surplus.
- 3.4 Several discussions were held with key stakeholders of the life insurance industry, which included an all industry meeting and several one-to-one meetings, the details of which are provided in Appendix A of this report.
- 3.5 All correspondence with the life insurance industry on this matter before the commencement of this assignment, which includes e-mails from individual life insurance companies, IASL and Actuarial Association of Sri Lanka ("AASL"), have also been considered for setting recommendations.
- 3.6 Discussions with the life insurance industry resulted in several suggestions pertaining to the treatment of One-off Surplus. The pros and cons of each of these suggestions have been studied and discussed with stakeholders of the life insurance industry.
- 3.7 Recommendations have been drafted such that they:
- meet the objectives of this assignment and requirements of the industry and do not leave room for multiple interpretations;
 - are understood by the life insurance industry;
 - reflect the concerns of all stakeholders and are arrived at through a consultative process with the key stakeholders of the industry;
 - are non-disruptive, pragmatic and can be implemented in time to be able to transfer any One-off Surplus to the SHF before 1 April 2018.
- 3.8 The rest of this section sets out the analysis undertaken to arrive at the key recommendations.

Identification of One-off Surplus:

3.9 Decision 1: Definition of One-off Surplus:

Option	Description	Pros	Cons	Selected?
A	One-off Surplus = $\text{Max}(0, \text{NPV Liabilities} - \text{GPV Liabilities})$	<ul style="list-style-type: none"> ▪ Definition was previously agreed with the industry, therefore, most pragmatic to implement. ▪ Least disruptive among the options considered. ▪ Reflects only liability side changes; as there are relatively less concerns around asset valuations under RBC. 	<ul style="list-style-type: none"> ▪ Does not truly reflect the change in surplus available for transfer to shareholders as it ignores the differences in value of admissible assets under the two regimes. 	Yes
B	One-off Surplus = change in regulatory surplus due to solvency regime change	<ul style="list-style-type: none"> ▪ Reflects the change in value of both assets and liabilities – therefore reflects true impact on surplus of regime change. 	<ul style="list-style-type: none"> ▪ Impact analysis suggests this may result in a significant increase in One-off Surplus for the industry; therefore considered disruptive. ▪ May not be pragmatic; as under this approach there may be a need to introduce a requirement to re-state One-off Surplus quarter on quarter to reflect market movements in assets. 	No
C	One-off Surplus = change in regulatory surplus net of minimum solvency margin requirements (i.e. all capital the distribution of which to shareholders is restricted), due to solvency regime change	<ul style="list-style-type: none"> ▪ Reflects the change in only that proportion of surplus which may be available for distribution as dividends to shareholders. 	<ul style="list-style-type: none"> ▪ Cons as under Option B above. ▪ Results in the lowest One-off Surplus, therefore, least capital with regulatory constraints and insufficient regulatory buffer ▪ One-off Surplus will remain available to support CAR and will not be distributed as dividends immediately, therefore, it is not considered necessary to adopt this method. 	No
D	Increase the minimum regulatory CAR ratio from 160%; instead of determining a One-off Surplus	<ul style="list-style-type: none"> ▪ Easy to calculate 	<ul style="list-style-type: none"> ▪ Difficult to calibrate a suitable industry level CAR in the given timeframe which will meet the objectives of a One-off Surplus and give enough comfort to the IRCSL. 	No

3.10 *Decision 2: NPV liabilities – minimum regulatory vs distribution basis*

Option	Description	Pros	Cons	Selected?
A	NPV liabilities should be as per the minimum regulatory basis	<ul style="list-style-type: none"> ▪ Ensures consistency across insurers ▪ The previous NPV regime was considered strong enough; therefore minimum regulatory basis was generally considered a suitable measure of solvency strength by the IRCSL. ▪ Most insurers did not have a separate distribution basis. 	<ul style="list-style-type: none"> ▪ Is not consistent with the liabilities as provided in the financial statements. 	Yes
B	NPV liabilities should be as per the distribution basis (if different to minimum regulatory basis)	<ul style="list-style-type: none"> ▪ Consistent with the liabilities as provided in the financial statements. ▪ Will include additional reserves, where an insurer felt that NPV regime was not sufficient. 	<ul style="list-style-type: none"> ▪ Very few companies had a distribution basis – in each instance it was more prudent and reflected best-practices or additional conservatism on part of the insurer. ▪ Using the distribution basis, will result in a higher One-off Surplus for such insurers. Therefore, greater capital will be constrained as One-off Surplus due to following more prudent practices previously, which may not be fair. 	No

3.11 Although Option B is not the recommended approach, an insurer may still use Option B to determine its One-off Surplus. This will result in a higher One-Off Surplus than under Option A. However, in case Option B is selected, this must be clearly stated in the company's disclosures.

3.12 Decision 3: GPV liabilities – minimum regulatory or distribution basis.

Option	Description	Pros	Cons	Selected?
A	GPV liabilities should be as per the minimum regulatory basis	<ul style="list-style-type: none"> ▪ Ensures greater consistency across insurers. ▪ Easy to calculate. 	<ul style="list-style-type: none"> ▪ Allows negative liabilities to be recognized – therefore, will result in a significant increase in the One-off Surplus of the industry and will be more disruptive. ▪ Where total GPV liabilities of a company are negative, the One-off Surplus can exceed the value of admissible assets. ▪ Several insurers have previously set their One-off Surplus basis to be more prudent than the minimum regulatory basis. ▪ Is not consistent with the liabilities as provided in the financial statements. ▪ Most insurers tend to apply some limits on their regulatory surplus, for e.g. by zeroising negative liabilities at some level before transferring funds to the SHF. ▪ As of 1 January 2016, could result in One-off Surplus to be significantly higher than the surplus a company recognizes on its financial statements. Further, it may take longer for a company's accounting (distribution) surplus to exceed the One-off Surplus, thereby restricting any distribution of surplus to shareholders, should a company maintain its current (more prudent) distribution basis in future. Therefore, this method imposes additional constraints on companies adopting more prudent distribution basis than regulatory basis. 	No
B	GPV liabilities should be as per the distribution basis	<ul style="list-style-type: none"> ▪ Consistent with the liabilities as provided in the financial statements. ▪ Greater consistency with internal policy of a company to make surplus transfers 	<ul style="list-style-type: none"> ▪ There is lesser consistency between the distribution bases adopted by companies. ▪ It may be difficult to perform these calculations as at 1 January 2016. 	Yes

- 3.13 Although Option B is the recommended approach, an insurer may still use Option A to determine its One-off Surplus. This will result in a higher One-Off Surplus than under Option B. In case Option B is selected, this should be clearly stated in the company's disclosures.
- 3.14 Based on the above analysis, it is recommended that the basis for determining GPV liabilities for the purpose of One-off Surplus calculation be aligned with its distribution basis rather than the regulatory basis.
- 3.15 It is further noted that the internal policies of companies with regards to their distribution basis have evolved since 1 January 2016. The distribution basis used for the preparation of accounts as at 31 December 2017 is considered to be a better reflection of a company's views in relation to the surplus it will transfer to the SHF in future. Therefore, it is recommended that GPV liabilities for the One-off Surplus calculation be determined as at 1 January 2016, but using the methodology underlying the most recent distribution basis of the company.
- 3.16 It is also observed that some companies use a more prudent methodology in their distribution basis than others – for e.g. by zeroising negative liabilities at a policy level vs product level vs fund level vs no zeroisation (listed in order from most prudent to least prudent). Further, some companies also apply prudence by flooring the policy liabilities to certain internally defined minimum liability floors such as UPR or surrender value; or using a discount rate which is lower than the risk-free rate among other methods. Companies have adopted such policies to ensure that presentation of surplus reflects realisable profits with greater level of certainty. By not zeroising negative liabilities at all, although a company is able to show higher surplus, it is noted that this surplus also reflects profits expected to emerge in future (on a best-estimate basis), which may or may not be realised. Additional levels of prudence are also introduced by companies to better manage their exposure to other risks for e.g. risk of a mass lapse, liquidity risk, asset-liability matching risk etc. Further, distribution basis of some companies also reflects their views on likely revisions to RBC rules in future as well as expected change in valuation treatments after the introduction of IFRS17 (expected to be implemented from 2021).
- 3.17 Given the above, it is not considered reasonable to prescribe a fixed set of rules to apply to all companies with regards to the level of prudence that should be reflected in the GPV liabilities for the determination of One-off Surplus or their distribution basis. The proposed recommendation will result in a higher One-off Surplus for companies with a less prudent distribution basis and vice-versa. However, at the same time, this One-off Surplus (i.e. capital with regulatory constraints) will also be more proportional to the surplus presented in a company's financial statements.
- 3.18 The IRC SL has not prescribed any rules pertaining to the distribution basis of companies previously and it is understood that a company is free to set an internal distribution basis as long as the liabilities under the distribution basis are greater than or equal to those under the regulatory basis. However, it is recommended that the basis for One-off Surplus calculation shall impose a restriction on a company's distribution basis going forward. A company will not be allowed to use a distribution basis less prudent than the One-off Surplus basis until the One-off Surplus is to be maintained on a company's balance sheet. This is to prevent any company for setting a distribution basis as at 31 December 2017, which gives a lower One-off Surplus, only to then move to a less prudent distribution basis in future resulting in larger surplus transfers to the SHF.
- 3.19 It is recognised that the methodology underlying the distribution basis of several companies is still evolving. There may be instances where a company has plans of moving to a relatively less prudent methodology on the distribution basis than at 31 December 2017. In the event that a company intends to changes the methodology underlying its distribution basis in the future that leads to a lower liability from the distribution basis used as at 31 December 2017, then, it is recommended that the One-off Surplus as at 1 January 2016 also be determined using a methodology which is less or as prudent than

the intended methodology for the distribution basis. This may make the company's One-off Surplus basis less consistent with the distribution basis and the financials as at 31 December 2017, but will give a company more flexibility to change the distribution basis in future. However, any areas of inconsistency between a company's One-off Surplus basis and its distribution basis as at 31 December 2017 should be clearly disclosed along with supporting rationale. For avoidance of doubt, restriction is imposed on the methodology underlying the distribution basis only. No restrictions are imposed on the assumptions underlying the distribution basis for any of the future regulatory submissions; as at all times the assumptions should reflect the most up-to-date experience and expectations of future outlook.

Decision 4: GPV liabilities – zeroisation of negative liabilities

- 3.20 It was observed that majority stakeholders were in favour of zeroisation of negative liabilities at a product level for the purpose of calculation of One-Off Surplus.
- 3.21 Noting that such a rule may not be consistent with a company's distribution basis, no recommendation is being made to prescribe the level at which negative liabilities should be zeroised. Any level of zeroisation of negative liabilities is acceptable, as long as this results in GPV liabilities for One-off Surplus calculation to be less than or equal to those under the distribution basis.
- 3.22 Further, prescribing a product level zeroisation of negative liabilities for One-off Surplus calculation may result in company's currently setting their distribution basis with policy level zeroisation to also adopt less onerous product level zeroisation within the distribution basis in future; but may not drive companies adopting less prudent distribution basis now to move towards product level zeroisation unless a consistent treatment is prescribed for the distribution basis as well.
- 3.23 Although zeroising negative liabilities at a policy level will result in the most prudent GPV liabilities, it is noted that actuarial models of a number of life insurance companies do not have the capability to apply policy level zeroisation at the moment. Further, for some companies, applying product level zeroisation may also not be feasible in a short span of time, given their actuarial model constraints.
- 3.24 The IRC SL is not prescribing any particular level at which negative liabilities should be zeroised. However, the IRC SL does suggest companies to take a cautious approach with regards to determining surplus transfers to the SHF.

Decision 5: Valuation of universal life business

- 3.25 Differences have been observed between the approaches adopted by life insurance companies to value universal life business. The RBC rules do not clearly state the valuation methodology prescribed for universal life business. The one-month time frame of this particular assignment is not considered sufficient to revise the RBC rules for the valuation of universal life which may require more consultation with the industry. Also, any changes to regulatory

valuation methodologies at this stage may not be practical to implement in time for One-off Surplus transfer to be made before 1 April 2018. Therefore, no changes to the RBC rules are proposed at this stage. However, a recommendation is made to add more clarity to the interpretation of the RBC rules.

3.26 It is noted that the RBC rules are being interpreted in the following ways:

- A discounted cash flow method, as commonly used to value the traditional non-participating business
- Policy Account plus General Account reserves, as commonly used to value the unit-linked business.

3.27 Based on an analysis undertaken, it is observed that both approaches above should result in identical policy liabilities for universal life business. Therefore, both approaches are considered appropriate for the determination of One-off Surplus. However, it should be noted that the choice of approach may result in different interest rate risk charge capital (as it depends on how a company presents this information in the form of cash flows in the RBC template).

3.28 It is recommended that the crediting rate assumption used in the valuation of universal life business should be internally consistent with the risk-free rate assumption (i.e. the discount rate). When setting the crediting rate assumption, it should be assumed that the underlying assets will earn the risk-free rate of interest. It may not be appropriate to assume that assets earn a book yield (even if they were to be held to maturity) as the market consistent balance sheet reflects the market value of these assets and not the book value.

3.29 In the event that a company adopts a different approach to valuing universal life business, it should be able to demonstrate that the approach adopted results in liabilities for the universal life business to be greater than or equal to those under the recommended approach on the RBC basis. Further, the policy liabilities on the One-off Surplus basis should be less than or equal to the liabilities on the distribution basis.

Transfer of One-off Surplus:

3.30 There was a general consensus in the industry that only the One-off Surplus for other than participating business be transferred to the SHF before 1 April 2018.

3.31 There was also a consensus that the One-off surplus in respect of participating business be held within the participating fund as part of the unallocated valuation surplus and may only be transferred to the SHF by means of bonuses to policyholders in line with Section 38 of the "Regulation of Insurance Industry, Act No.43 of 2000".

Maintenance of One-off Surplus:

3.32 *Decision 6: Restrictions to be imposed on the investments assumed to support the One-off Surplus, post transfer to SHF*

3.33 There was a general consensus in the industry to maintain One-off Surplus as a constant value rather than revising it at regular intervals.

Option	Description	Pros	Cons	Selected?
A	Assets supporting the One-off Surplus should be ring-fenced	<ul style="list-style-type: none"> ▪ Assets will be of credible quality. ▪ Reduces admissibility concerns in case assets need to be transferred back to the PHF. 	<ul style="list-style-type: none"> ▪ Will require insurers to set up a fund within the SHF. Adds complexity as companies at the moment are trying to segregate participating and non-participating funds. ▪ Additional costs for the insurers. ▪ Under this approach, any market movements in such assets will affect One-off Surplus. Market movements can erode the value of the One-off Surplus. ▪ In case of ring-fencing it is also debatable whether investment expenses and tax on investment income should be netted off from the One-off Surplus balance or charged to SHF. ▪ More detailed disclosures will be needed. 	No
B	Company should have complete freedom in investing assets supporting One-off Surplus.	<ul style="list-style-type: none"> ▪ A company can choose to invest in assets more freely to maximize returns, subject to the risk that value of SHF at all times should be at least as high as the One-off Surplus. 	<ul style="list-style-type: none"> ▪ Several insurers and the IRC SL felt that there should be some constraints with respect to investment of assets. While it is understood that in the event that assets need to be moved back to the PHF, sale and purchase of assets will need to be carried out to ensure admissibility criteria of PHF is adhered to, some of the asset classes in Sri Lanka are not considered to be liquid enough. 	No
C	Assets supporting One-off Surplus should not be ring-fenced, but be subject to some constraints.	<ul style="list-style-type: none"> ▪ Gives freedom to insurers to invest in assets and maximize returns subject to certain rules. ▪ The SHF will contain assets considered to be sufficiently liquid at least up to the value of the One-off Surplus. ▪ An approach preferred by majority. 	<ul style="list-style-type: none"> ▪ Additional disclosures will be needed. ▪ Lower returns compared to Option B. 	Yes
3.34	As the proposed recommendation (Option C), allows shareholders freedom to invest assets (subject to some rules) and benefit from the returns, it is recommended that any expenses borne in the maintenance of such assets also be charged to the SHF.			

Distribution of One-off Surplus:

3.35 *Decision 7: When is it reasonable to distribute the One-off Surplus to shareholders?*

Option	Description	Pros	Cons	Selected?
A	Allow distribution after a set time period, say 3 years, until which any issues with RBC implementation can be resolved as and when identified.	<ul style="list-style-type: none"> ▪ Companies have already restricted distribution of a One-off Surplus for 2 years. ▪ Gives a definite time period for release. 	<ul style="list-style-type: none"> ▪ Key concern is that merits of the RBC regime are still being understood; and methodologies and assumptions adopted by companies are still being investigated. ▪ To allow release within, say 3 years, actions that should be taken in this time span need to be identified and completed. ▪ Risk that issues will remain open even at the end of 3 years. 	No
B	Allow distribution following the implementation of a revised RBC regime	<ul style="list-style-type: none"> ▪ The IRCSL intends to introduce a revised RBC regime in the near future, which is expected to be stronger than the extant RBC. A satisfactory adoption of revised RBC may be considered appropriate for the release of One-off Surplus. 	<ul style="list-style-type: none"> ▪ It is difficult to estimate how long a new RBC will take to be implemented, considering that a review of RBC rules has not yet begun. ▪ The next version of RBC may or may not address all issues; and may only be an intermediate arrangement. 	No
C	Adopt a risk-rated approach	<ul style="list-style-type: none"> ▪ Will promote better governance standards within the industry. ▪ Companies which meet governance standards issued by the IRCSL will benefit by being allowed to distribute the One-off Surplus. ▪ In most jurisdictions, RBC rules are complemented by certain governance standards (generally referred to as a "Pillar 2") ▪ Treats every insurer on its own merit. 	<ul style="list-style-type: none"> ▪ The IRCSL and the industry will need to engage with each other to arrive at best-practices that the life insurance industry must adopt – therefore, it may not be a very quick process. 	Yes

3.36 To be cautious, the IRCSL will permit distribution of One-off Surplus subject to yearly distribution caps which will be decided by the IRCSL on a case-by-case basis. This is to provide IRCSL more time should it wish to review again any of the governance standards submitted by a company.

Disclosures of One-off Surplus:

Decision 8: Disclosures to be made in the financial statements

3.37 The IRCSL met with representatives of the CA Sri Lanka to discuss the financial disclosure requirements, in particular, the disclosure formats proposed by members of the insurance industry:

- The IASL had proposed that the One-off Surplus be presented as “Restricted Regulatory Reserve” as part of Equity on the balance sheet. This suggestion was considered reasonable.
- The IASL had proposed that transfer of One-off Surplus from the PHF to SHF be effected through “Other Comprehensive Income” so that accounting profits are not affected. CA Sri Lanka has informed us that such an arrangement is not consistent with the Accounting Standards.
- The transfer from the PHF to the SHF in respect of the One-off Surplus should be effected through the Income Statement. The IRCSL had imposed the requirement to hold the One-off Surplus as a liability in its letter dated 30 December 2016.
- The IASL had proposed that financial ratios be presented excluding the impact of transfer of One-off Surplus. CA Sri Lanka has suggested that financial ratios should be presented as per the Accounting Standards. A company is allowed to publish financial ratios in addition to those prescribed by the Accounting Standards along with appropriate disclosures.

3.38 The proposed recommendations on the financial disclosures are based on discussions between IRCSL and representatives of CA Sri Lanka.

Decision 9: Disclosures to be made to the IRCSL

3.39 Additional disclosures are required to be made in submissions to the IRCSL. This is to assist the IRCSL in reviewing the suitability of the One-off Surplus computed.

3.40 Quarterly disclosures to the IRCSL will be required to ensure that assets in the SHF supporting the One-off Surplus are compliant with the recommendations set out in this report.

Section 4: Reliances and Limitations

The Reliances and Limitations of the Independent Actuary of the IRCSL are set out below:

Reliances

- 4.1 In carrying out this review and producing this report we have relied without independent verification upon the accuracy and completeness of the data and information provided to us, both in written and oral form, by life insurance companies of Sri Lanka.
- 4.2 Reliance was placed on, but not limited to, the accuracy of the information provided to us by the life insurance companies, including responses provided to us in both oral and written form. These included:
- Regulatory NPV submissions made to the IRCSL as at 31 December 2015.
 - Results of the parallel RBC run as at 1 January 2016, submitted to the IRCSL.
 - Regulatory RBC submissions made to the IRCSL as at 31 December 2016.
 - E-mail correspondence between the life insurance companies and the IRCSL on the one-off surplus; including feedback received on the draft versions of this report.
 - E-mail correspondence between IASL, AASL and IRCSL on the one-off surplus.
 - Discussions at the all industry meeting on 22 February 2018
 - One-to-one meetings with key stakeholders as mentioned in this report.
- 4.3 Due to recent developments with respect to new tax rules becoming effective 1 April 2018, this study has been conducted within a short period of time. You appreciate that this advice has been given at short notice and as a result may not be as comprehensive as it might have been had we had an appropriate length of time to consider the matters raised.

Limitations

- 4.4 The report has been prepared to meet the specific purpose of treatment of One-off Surplus only, and must not be relied upon for any other purpose, other than explicitly provided therein.
- 4.5 For the avoidance of doubt, the proposed methodology is not intended to form guidance for determining regulatory or accounting surplus for the purpose of preparing financial statements and is limited to providing guidance on computation of one-off surplus only. Further, the recommendations in this report should not be construed to be an indication of any expected changes to the RBC rules in future (i.e. when the RBC rules are reviewed as part of a separate exercise) nor an indication of requirements of IFRS17.
- 4.6 This report has been prepared for use by persons technically competent in the areas covered.
- 4.7 This report must be considered in its entirety as individual sections, if considered in isolation, may be misleading. Draft versions of the report must not be relied upon by any person for any purpose. No reliance should be placed on any advice not given in writing. If reliance is placed contrary to the recommendations set out herein, we disclaim any and all liability which may arise. Furthermore, members of the IRCSL staff are available to explain and/or amplify any matter presented herein, and it is assumed that the user of this report will seek such explanation and/or amplification as to any matter in question.

- 4.8 This report was based on data available to the Independent Actuary and the IRC SL at, or prior to, 19 March 2018, and takes no account of developments after that date.
- 4.9 This report is governed by the terms and conditions set out in the agreement between the IRC SL and Willis Towers Watson dated 15 February 2018.

Appendix A: Documentation of Meetings

In order to arrive at the recommendations set out in this report, feedback was obtained from several stakeholders within the life insurance industry in Sri Lanka. This was done to ensure that this study is a consultative one and takes into account the views and concerns of key stakeholders of the life insurance industry in Sri Lanka.

All Industry Meeting

An All Industry Meeting was conducted on the premises of IRCSL on 22 February 2018. This meeting was attended by representatives of all life insurance companies of Sri Lanka and also other key stakeholders. The table below provides a list of attendees at the All Industry Meeting:

Name of attendee	Name of company
Damayanthi Fernando	Insurance Regulatory Commission of Sri Lanka
Chamarie Ekanayake	Insurance Regulatory Commission of Sri Lanka
Ranil Angunawela	Insurance Regulatory Commission of Sri Lanka
Sarika Wattuhewa	Insurance Regulatory Commission of Sri Lanka
Abhishek Chadha	Willis Towers Watson (but acting on behalf of Insurance Regulatory Commission of Sri Lanka)
Thanuja Krishnaratna	Actuarial Association of Sri Lanka
Priyanga Lanka Arachchi	Actuarial Association of Sri Lanka
Pushpakumar Gunasekera	Actuarial Association of Sri Lanka
Gavin D' Rosairo	AIA Insurance Lanka PLC
Stanley Perera	AIA Insurance Lanka PLC
Sampath Thushara	AIA Insurance Lanka PLC
Lalani Jayaratne	Life Insurance Corporation (Lanka) Limited
Ruwan Sanjeeva	Life Insurance Corporation (Lanka) Limited
Hashra Weerawardene	Janashakthi Insurance PLC
Sujeeva Fernando	Janashakthi Insurance PLC
Dirk Pereira	Union Assurance PLC
Sherin Cader	Union Assurance PLC
Imanthika Ranaweera	Union Assurance PLC
Suresh Paranavithana	Sri Lanka Insurance Corporation Limited
Nalin Subasinghe	Sri Lanka Insurance Corporation Limited
Malanie Tennakoon	Sri Lanka Insurance Corporation Limited
Chaminda Gunasinghe	Sri Lanka Insurance Corporation Limited
Malaka Bandara	Sri Lanka Insurance Corporation Limited
Sriyani Kulasinghe	Sri Lanka Insurance Corporation Limited
Samitha Perera	Sri Lanka Insurance Corporation Limited
Nilanga Wickramasinghe	LOLC Life Assurance Company Ltd
Sunjeevani Kotakadeniya	LOLC Life Assurance Company Limited

Name of attendee	Name of company
Thushara Amarasinghe	LOLC Life Assurance Company Limited
Devindi Samaranyake	LOLC Life Assurance Company Limited
Melanga A Doolwala	Arpico Insurance PLC
L A C Priyanthi	Arpico Insurance PLC
Sujeewa Kumarapperuma	Ceylinco Life Insurance Limited
Palitha Jayawardena	Ceylinco Life Insurance Limited
Malaka Mihindukulasuriya	Allianz Insurance Lanka Limited
Diluka Rajapaksha	Co-operative Insurance Company Limited
Muditha Geethanjali	Sanasa Insurance Company Limited
Indika Perera	HNB Assurance PLC
Pushpika Seneviratne	HNB Assurance PLC
Nuwan Pushpakumara	Softlogic Life Insurance PLC
Suranga Waduge	Softlogic Life Insurance PLC
A. A. D. C. Perera	MBSL Insurance Private Limited
Deepthi Lokuarachchi	Insurance Association of Sri Lanka

The All Industry Meeting was an interactive session where-in attendees were asked to share their views on the questions below. Further, the attendees were also informed that they may share their views via email, phone or face-to-face meetings until within a week after the All Industry Meeting.

- What is the purpose of One-off Surplus?
- How should One-off Surplus be defined? Should be calculated as the change in liabilities, change in surplus or change in distributable surplus?
- What basis should be used for the liabilities under NPV – minimum regulatory or distribution?
- What basis should be used for the liabilities under GPV – minimum regulatory or distribution?
- For determining value of liabilities under GPV for the purpose of One-off Surplus calculation, at what level should zeroisation of negative liabilities apply (policy, product or fund level; or no zeroisation at all)
- How should the universal life business be valued, considering that the RBC rules do not explicitly prescribe a method?
- What should be the restrictions, if any, on the assets which support the One-off Surplus?
- How should the income on the One-off Surplus be treated? Should the income be adjusted retrospectively?
- How should the investment expenses on the One-off Surplus be treated?
- What is the reason for not allowing immediate distribution of One-off Surplus?
- When should it be considered appropriate to distribute One-off Surplus as dividends?
- How should the One-off Surplus in the participating fund be transferred to shareholders?

- What additional disclosures will need to be made in respect of One-off Surplus?
- Which areas in the current RBC regime require more attention / are ambiguous / not clearly spelt out?
- Should any guidance notes be issued with respect to valuation of liabilities and solvency capital?
- Does the industry require guidance in any other area / areas which require more attention due to the shift from NPV to GPV regime?

One-to-one meetings

Following the All Industry Meeting, one-to-one meetings were set up with representatives of several life insurance companies and other key stakeholders. Attendees at the All Industry Meeting were informed that they may request for one-to-one meetings at any point to discuss any areas of concern to them. The table below lists the one-to-one meetings:

Date	Company	List of attendees
21 February 2018	Ceylinco Life Insurance Limited	Mark Birch
22 February 2018	Ceylinco Life Insurance Limited	Sujeewa Kumarapperuma, Palitha Jayawardena, Roshan Menaka, S. Weerakkody
22 February 2018	Sri Lanka Insurance Corporation Limited	Nalin Subasinghe, Chaminda Gunasinghe, Sriyani Kulasinghe
23 February 2018	HNB Assurance PLC	Pushpika Seneviratne, Indika Perera
23 February 2018	Union Assurance PLC	Dirk Pereira, Sherin Cader, Imanthika Ranaweera
23 February 2018	Janashakthi Insurance PLC	Hashra Weerawardene, Sujeewa Fernando
23 February 2018	Softlogic Life Insurance PLC	Nuwan Pushpakumara, Suranga Waduge
23 February 2018	AIA Insurance Lanka PLC	Gavin D' Rosairo, Stanley Perera Sampath Thushara
26 February 2018	Softlogic Life Insurance PLC	Kunj Behari Maheshwari
28 February 2018	Union Assurance PLC	Nimesha Liyanage
28 February 2018	HNB Assurance PLC	Deepthi Lokuarachchi, Pushpika Seneviratne, Roshan Hemantha, Prasantha Fernando, Indika Perera
28 February 2018	Actuarial Association of Sri Lanka	Thanuja Krishnaratna
15 March 2018	CA Sri Lanka	Malinda Boyagoda, Anoji De Silva, Manil Jayasinghe, Suren Rajakarier, Ranjani Joseph, Nishan Fernando, Saumya Madhubashini, Nilangi Dilrukshi

Appendix B: Impact Analysis

The IRCSL had issued a letter to the life insurance industry on 7 March 2018. In the letter, the IRCSL had requested all life insurance companies to inform the IRCSL by 14 March 2018 about the below:

1. The impact that the proposed (draft) recommendations may have on the One-off Surplus.
2. Whether there were any concerns arising from the proposed (draft) recommendations which may impact the business.

The IRCSL received response from the IASL and certain life insurance companies. The key areas of feedback were:

- i. The industry suggested that “other liabilities” can be excluded from the One-off Surplus calculation as these are not affected by change in solvency regime; this suggestion has been reflected in the directions. Other feedback on the identification of One-off Surplus resulted in some presentational changes only.
- ii. Industry had concerns on the proposed valuation methodology for universal life business. The IRCSL has responded to the industry, however, no revision is being made to these directions in this respect.
- iii. Industry raised concerns whether the financial disclosures proposed were compliant with the Accounting Standards. The financial disclosure requirements have been amended following a meeting and further communications with representatives of the CA Sri Lanka.
- iv. Industry requested more clarity on certain sections of the directions. We have clarified or amended the directions accordingly.

The IRCSL has issued responses in respect to the above.

Based on industry responses received, the IRCSL expects the One-off Surplus of the industry to reduce significantly as a result of these directions.

Further, the IRCSL understands that these recommendations/directions do not have an adverse impact on any company.

Appendix C: Investments supporting One-off Surplus

Assets		Market Value (Rs. 000)
A	Government Debt Securities (ISIN No.)	0
	Treasury Bonds	
	Treasury Bills	
	Repo	
B	Deposits	0
i	Deposits with a licensed commercial bank or a licensed specialized bank carrying an investment grade rating;	0
	a)	
	b)	
ii	Deposits with a licensed finance company carrying an investment grade rating;	0
	a)	
	b)	
iii	Deposits with a licensed commercial bank or a licensed specialized bank which are guaranteed by the Government of Sri Lanka in terms of an Act of Parliament	0
	a)	
	b)	
	Total (A+B)	0
	Restricted Regulatory Reserve as per Form CO-BS	

Certified Correct to the best of our knowledge.

Name and Signature of the:

CFO

Date.....

Principal Officer

Date.....

.....

Specified Officer

Date.....

Appendix D: Certification by Appointed Actuary

The certification from the Appointed Actuary must include the text below:

I confirm that the recommendations titled "Directions on the Identification and Treatment of One-off Surplus" dated 20th March 2018 have been complied with in determining the One-off Surplus of(Name of company). The only exceptions to this are listed below along with supporting rationale.....

.....

I also confirm that the aforesaid one-off surplus is more than or equal to the minimum one off surplus prescribed in the recommendations above. I have no objection with the transfer of the One-off Surplus to the shareholders' fund. I confirm that additional surplus to be distributed, if any, has been recommended after considering the effect of same on the solvency position of the company under the RBC rules.

The table below sets out the One-off Surplus of the company:

Line item	NPV liability	GPV liability	One-off Surplus
Participating business			
Other than participating business			
Total company level			

Certified Correct to the best of my knowledge.

Name and Signature of the Appointed Actuary:

Name

Date.....

Signature.....