

New Compliance Requirements for Indonesian Insurers

By now, insurers and reinsurers in Indonesia are well aware that there are two new standards on the horizon that they need to be in compliance with. These are:

- Indonesian Accounting Standard No. 62 (PSAK 62 on Insurance Contract), effective 1 January 2012, and
- Ministry of Finance Regulations No. 53/PMK.010/2012 on Financial Soundness of Insurance and Reinsurance Companies, effective 1 January 2013.

It is noted that guidelines for the above new compliance requirements have yet to be issued by the relevant authorities. This brief bulletin aims to present our interpretation of the salient points in these new standards pertaining to general insurance loss reserving and financial reporting.

PSAK 62

Liability adequacy test

The minimum requirements for liability adequacy test are as follows:

- a) *"... current estimates of all contractual cash flows, and of related cash flows such as claims handling costs ..."*
- b) *"If the test shows that liabilities inappropriate, the total amount of the difference is recognized in profit or loss."*

This implies that in the calculation of liability, all costs incurred or to be incurred in the settlement of incurred and future claims arising from the reporting period need to be taken into consideration. This includes among other things, claims handling expenses, unallocated loss adjustment expenses (ULAE) and maintenance expenses. The current practice of estimating premium liability based on unearned premium reserve (UPR) with 1/24th method and claim liability based on chain-ladder method without account for the above associated costs clearly do not meet this new standard.

Impairment of reinsurance assets

"If a cedant's reinsurance asset is impaired, the cedant shall reduce its carrying amount accordingly and recognise that impairment loss in profit or loss."

This means any reinsurance reimbursements that are defaulted or known to be defaulted need to be recognised in the P&L. Though the probability of reinsurer defaulting could be estimated based on reinsurer's credit rating, such assumption may not be allowed.

Continuation of existing practices

It is noted that IFRS 4 Paragraph 25(a) on measuring of liabilities on undiscounted basis is not adopted as it contradicts PSAK 28 and PSAK 36.

This means in the calculation of claims liability, long-tail claims need to be discounted at the appropriate discount rates for corresponding durations to derive the present value of claims reserve.

Disclosure

"An insurer shall disclose:

- a) *Its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks.*
- b) *Information about risk insurance (both before and after risk mitigation by reinsurance), including information about:*
 - i. *sensitivity to risk insurance;*
 - ii. *concentrations of risk insurance;*
 - iii. *actual claims compared with previous estimates (i.e. claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments...*
- c) *Information with respect to credit risk, liquidity risk and to the market risk ...*
- d) *Information about exposure to market risk from embedded derivative ...*
- e) *A sensitivity analysis that shows how profit or loss and equity would have been affected if changes in the relevant risk variable that were reasonably possible at the end of the reporting period had occurred; the methods and assumptions used in preparing the sensitivity analysis; and any changes from the previous period in the methods and assumptions used."*

First, insurers need to clearly understand its risk profile and have a risk management framework in place and all these need to be disclosed. Next, financial results such as premium and claims liabilities need to be disclosed on both gross and net of reinsurance bases.

Various risks related to insurance contracts and arising from business operation need to be accounted for and disclosed. Claims development by line of business also needs to be disclosed.

Lastly, sensitivity analysis on the premium and claims liabilities which have an ultimate impact on the company's financial results is required and the work done to be disclosed and results need to be analyzed from year to year. Key variables that could affect premium and claims liabilities estimates are loss ratio, risk margin, expense assumptions, etc. Suffice to say, the new disclosure requirements are quite onerous.

MOF Regulations No. 53

Article 16, Paragraph 2 states that: *"Determination of premium reserves ... using central assumption estimate with risk margins."*

This implies reserve should be set at Best Estimate plus PAD (Provision for Adverse Deviation). However, standards for risk margins were not specified. It is also not clear whether diversification effect on company basis is allowed.

Article 16, Paragraph 3 states that: *"Determination of unearned premium reserves ... shall take into account unexpired risk reserve including catastrophic reserve."*

There are two folds to this statement:

1. In addition to UPR, premium reserve needs to consider URR (unexpired risk reserve) as well. Presumably, premium reserve should take on the greater value of UPR and URR.
2. In determining premium liability, Company needs to consider possible catastrophic event, if there is any. Does this mean stress testing with plausible adverse scenarios?

Again, it is clear that the current practice of estimating premium liability based on UPR alone will not meet the new standard.

Article 16, Paragraph 5 states that: *“Claim reserves ... consist of unsettled claim reserves and IBNR reserves.”*

This is quite standard. However, it doesn't state whether claim reserves need to be set at central estimate plus risk margins. To be consistent with premium reserves, it is only logical to do so.

Article 17, Paragraph 2 states that: *“Determination of Liabilities in the form of technical reserves ... for General Insurance companies can be carried out by an actuarial consulting company, which is unaffiliated with the Company, at the latest until 31 December 2014.”*

Given the shortage of qualified non-life actuary in Indonesia, most general insurers may have no other option but to continue to appoint consulting actuaries to certify their loss reserving beyond 2014.

For more information on how you could be in compliance with the above new valuation and reporting standards, please do not hesitate contact Mourits Rompah, FSAI, of Dayamandiri Dharmakonsilindo via email at mourits@dayamandiri.co.id or by calling (021) 7279 8620 or 0818 925 603.

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