

Sub: Admissibility of assets

Section 32 of the Insurance Ordinance, 2000, deals with admissible and inadmissible assets of a life insurance company for solvency purpose.

As far as admissible assets are concerned, sub section 1 of section 32 defines the following assets as admissible assets:

- (a) Government Securities except to the extent that they are subject to any encumbrance.
- (b) Assets deposited with the State Bank of Pakistan under section 29, and
- (c) Assets, other than assets referred to in clause (a) or clause (b), not specified in sub-section (2) not to be admissible assets; and
- (d) Assets being assets referred to in clause (g) of sub-section (2), in respect of which the Commission has declared that those assets are to be admissible for the purpose of this part.

Section 32(2) of the Ordinance sets out a list of assets which are not admissible assets for the purpose of solvency. I will mention here the relevant sub-sections which need clarifications.

- (b) in a statutory fund of a life insurer, any asset to the extent of 5% of the value of fund (being the market value of assets less liabilities other than policy holder liabilities. This limit of 5% has been prescribed in clause 10 of the SECP Insurance Rules, 2002.

It is difficult to understand the justification of this highly restrictive limitation, if indeed it is so intended, for bank balances and deposits either on principles of prudent regulation or international best practice. Furthermore, should this limit be applied it would be difficult to understand how certain lines of business (group life, individual and group health and personal accident etc.) could be managed in practice as they require substantial liquidity in their assets.

Application of this clause would force the insurer to channel out the funds in B rated banks instead of A and A+ rated banks just in order to avoid application of this clause. Furthermore, decision making as where to invest surplus fund purely lies with the company's fund manager who takes decision keeping in view the returns, market trend and conditions and future prospects. Under the circumstances when fixed income investment opportunities are not attractive and stock market is behaving unexpectedly, it becomes more prudent for fund manager to invest on short term basis in A rated institutions rather than investing in B rated institutions.

Huge cash collections are made at the month, quarter and year end and the same are deposited with the banks in the company's bank accounts. It would be very difficult for a company to deposit its last day collections in multiple banks.

Furthermore, on a cumulative reading of the section 32(1)(c) and 32(1)(d) a position can be summarized that assets in addition to those referred to in Section 32(1)(a) and (b) and not specified in Section 32(2) are 100% admissible assets. Cash assets appear to be admissible assets for the purpose of the Ordinance as the same are not specified as inadmissible assets under Section 32(2) of the Ordinance provided cash assets are not declared by the Commission as inadmissible assets under or in terms of Section 32(2)(v) and Section 32(2)(w).

Reinsurance arrangements are normally made with well reputed companies of international fame and their terms of settlement are on payment basis. In the Financial Statements, the reinsurance premium and reinsurance recoveries are accounted for on accrual basis. The resultant is the timing difference. There could be a scenario that in the financial statements an amount is payable to the reinsurer however, upon submission and payment of accounts on payment basis, the same is converted into huge receivable which may cross the barrier of 5%.

Hence it is extremely important to define and describe “any asset” in Section 32(2)(b). Does it mean a specific asset within an entity or entity / company itself or group of related entities / companies etc.

The value placed on any asset to determine admissibility limit needs to be clarified. It is mandated in S 32(2)(b) to be “market value” for compliance with 5% limit. However, in practice accounting values are used for non linked funds at lower the cost or market principle (except if a security is categorized as HTM).

- (g) balances with, shares in, loans to or other amounts due from any body that is related to the insurer or to any director of the insurer.

Disallowing 100% is extremely restrictive and not seen in any other country. However, the law does give right to SECP (S 32 (1)© to declare some or all related party assets as admissible. It is very important that SECP uses these positive powers. Otherwise, this can potentially weaken admissible assets if related parties are reputable and strong entities.

I will therefore propose that normal business transactions as given below may be allowed 100% as admissible assets:

- Deposits with related party bank,
- Premium receivable from related party, and
- Investments in related party stocks

Limitations as mentioned in section 32(2)(h) for accounts receivables and section 32 (2)(p)(q) for investments in stocks shall continue to be applied as mentioned in the Rules.

Under Clause 10 of the SECP Insurance Rules 2002, Investment in total immovable property has been prescribed as 60% in case of non-life insurer and twenty per cent in case of life insurer. Similarly, shares in any one company or in group of related companies has been prescribed as 25% in case of non-life insurer and 5% in case of life insurer.

Keeping in view the nature of business of both the lines, it seems more appropriate to have these %ages fixed other way round.

IAS 39

Accounting Regulation 16(1)(a) states that available for sale investments shall be stated at lower the cost or market value.

IAS 39 states that after initial recognition, an entity shall measure financial assets, including derivatives that are assets, at their fair values, without any deduction for transaction costs it may incur on sale or other disposal except few assets.

It is proposed that available for sale investments may also be stated at fair value to be in line with IAS 39.