Guidelines on management of participating business

Introduction

1.1 The proposed guidelines underlying this note are applicable to long-term insurers only (thereafter referred as insurers).

1.2 At present, there are no established regulations, guidelines or a dedicated framework in Sri Lanka governing the oversight and management of participating insurance business. This document sets out the proposed principles and governance framework that insurers shall consider when formulating their Board-approved bonus policy and in overall management of participating business. The policy shall also govern the determination of bonus rates declared to policyholders as well as future bonus assumptions required in insurance liability and solvency assessments as per Solvency Margin (Risk Based Capital) Rules 2015.

Governance framework

1.3 Every insurer shall establish a well-defined governance structure for the effective management and oversight of its participating business.

1.4 The ultimate accountability for the management and governance of the participating fund shall reside with the Board of Directors. To support the Board in fulfilling this responsibility, the insurer shall establish a Participating Fund Management Committee tasked with providing oversight and recommendations on the governance, operations, and fair treatment of policyholders within the participating fund.

1.5 The Participating Fund Management Committee shall, at a minimum, comprise the Chief Executive Officer, Chief Financial Officer, the Appointed Actuary, the Head of Actuarial, Specified Officer and at least one non-executive independent member of the Board of Directors. The insurer may appoint additional members as deemed necessary to ensure effective and balanced oversight of the participating fund.

1.6 There should be a clear definition of the roles and responsibilities of all parties involved in the management of participating business:

a. The **Board of Directors** shall:

- review and approve the bonus policy for the insurer’s management of its participating life business, consistent with the guidelines outlined in this note;
- review and approve bonus rates annually;
- provide adequate oversight on the implementation of the bonus policy to ensure that the insurer’s practices are aligned with the bonus policy; and
- approve any changes to the policy, as well as the circumstances which may result in such changes.

b. The responsibilities of the **Participating Fund Management Committee (the Committee)** shall include, at a minimum, the following:

- to assess, report on, and provide clear advice and, where appropriate, formal recommendations to the Board of Directors regarding the management, performance and operation of the participating fund;
- to assess and review all policyholder communications as part of the product approval process, and to review the sales process — including distributor training — to ensure that

these are transparent, relevant and not creating undue Policyholder Reasonable Expectations (PRE).

- to assess the recommended bonus rates against calculated asset shares, including analysis of the financial impact of such rates on the liability and capital position;
- to evaluate whether the insurer's decisions adequately reflect the interests of participating policyholders, including the identification and assessment of policyholders' reasonable expectations, and the determination and allocation of discretionary benefits in a fair and equitable manner across homogeneous policyholder groups;
- to consider and advise on the insurer's approach to managing potential conflicts of interest between participating policyholders and other stakeholders;
- to ensure that participating fund is managed in accordance with the policies outlined as part of the bonus policy and deviations from this policy, if any, shall be documented and reported to the Board of Directors;
- to assess the use of the estate by the insurer and provide an opinion on the reasonability of the same;
- to ensure that future participating bonus assumptions used by the insurer of liability and solvency assessments or for any other internal assessments, are aligned to the bonus policy; and
- to review and advise on any other matters necessary to ensure that the interests of participating policyholders are appropriately protected and incorporated within the insurer's broader governance and risk management framework.

c. Insurers shall designate an appropriately qualified and responsible person to oversee the following functions:

- calculate asset shares including the derivation of underlying assumptions and data used for the calculation and projection of asset share;
- recommend bonus rates including the financial impact of such rates on the liability and capital position;
- perform additional analysis to assess the supportability of bonus rates including any sensitivity analysis;
- reasonableness checks to ensure the accuracy, consistency, and completeness of the data used and documenting any qualification / limitation relating to the data;
- ensure that the future bonus rate assumption proposed takes into consideration relevant factors as used to propose bonus rates declared for the year.
- ensure that any liability assessment due to cost of guarantees associated with participating business are included in calculation of insurance liabilities.

Grouping

1.7 Insurers shall establish appropriate groupings of participating policies for the purpose of bonus determination, including terminal bonuses. Groupings may be based on product features, guarantee levels, policy issue date, terms, risk characteristics, and premium payment mode (e.g., single vs. regular premium).

1.8 Insurers should ensure that no group of policyholders is materially disadvantaged relative to others, maintaining fairness and consistency in surplus distribution at the same time taking benefit of pooling of risks.

1.9 Insurers shall maintain and calculate separate asset shares for each defined policy grouping, reflecting each group's specific experience and supporting fair surplus distribution.

1.10 While equitable treatment is required, insurers shall consider practical constraints associated with overly granular grouping, such as administrative inefficiency or limited credibility of experience data.

Asset Share calculation

1.11 The insurer shall calculate asset shares for each policy grouping, which shall serve as a key reference in the following areas:

a. determination of appropriate levels of reversionary and terminal bonuses (if applicable);

b. assessment of the fairness and reasonableness of surrender, maturity, and death benefits payable to policyholders;

c. evaluation of policyholders' reasonable expectations (PRE) and to support the fair treatment of customers; and

d. assessment of the impact of smoothing mechanisms on benefit payouts across different policyholder cohorts and generations.

1.12 The ratio of asset shares to surrender or maturity value shall fall within a predefined, justifiable range for each policy grouping, subject to meeting at least the guaranteed benefits. This approach supports the fair treatment of policyholders and helps to maintain consistency and equity in benefit payouts across different cohorts. Any deviation from the prescribed ratio shall be documented and justified by the Committee.

1.13 An asset share represents the notional accumulation of a policyholder's contributions to the participating fund over time. It is calculated as:

(+) the total of premiums received,

(+) allocated investment returns,

(-) deductions for benefit payments,

(-) commissions, where commissions charged should be in line with the Determination 10

(-) expenses,

(-) taxes,

(-) allowance for the cost of capital

(-) allowance for cost of guarantees,

(-) any transfers to shareholders.

(+) Adjustments may also be made to reflect miscellaneous surplus allocations where appropriate, with proper documentation.

1.14 Accordingly, the insurer shall identify, quantify, and document all sources of surplus and deficit that contribute to the calculation of asset shares. The insurer shall also clearly define whether such amounts are to be distributed to policyholders—across different generations—or retained within the inherited estate, ensuring transparency and alignment with policyholder interests.

1.15 Miscellaneous surplus, including profits from surrenders, shall be evaluated to determine whether it forms part of the asset share or remains within the estate, and should be documented as part of this policy.

1.16 The methodology for calculating and using asset shares shall be fair, appropriate, and applied consistently year-on-year. The insurer shall maintain full documentation of the rationale, assumptions, and methodology used, aligned with internal and regulatory standards.

1.17 Asset Shares at year-end shall generally be determined by rolling forward the prior year's asset share, incorporating relevant cash flows, returns, and deductions during the year.

1.18 The Committee shall regularly review and, where appropriate, enhance the methodology used to determine asset shares across policy groupings. This is to ensure continued robustness, transparency, and fairness in surplus distribution and to uphold equitable treatment of all participating policyholders.

Considerations of Asset Share management

1.19 In determining bonus rates for participating policyholders, the insurer shall give due consideration to the experience of the participating fund and ensure fairness, equity, and consistency across policyholder groups.

Assumptions

1.20 The insurer shall use historical data, including actual policy-level and fund-level cash flows, to derive asset shares up to the current valuation date.

1.21 Where complete data is not readily available, the insurer shall apply reasonable approximations and sound actuarial judgement, with underlying approach and associated limitations clearly documented and justified.

1.22 In projecting asset shares beyond the valuation date, the insurer shall adopt appropriate and supportable assumptions, consistent with the participating fund's expected experience and aligned with the principles of fairness and prudence.

1.23 All assumptions underlying calculation and projection of asset share should be clearly documented.

Expenses

1.24 Expense allocations should happen by way of a Board approved expense allocation policy

1.25 The Board approved expense allocation policy shall be reviewed at least once annually.

1.26 The expense charging approach shall aim to ensure fairness between shareholders and policyholders, as well as across policyholder groupings.

1.27 The insurer shall ensure that all deductions made to asset shares, including expenses, are reasonable and have been, or will be, incurred in the ongoing management of that participating life fund.

1.28 Insurers shall be able to justify any costs allocated to an applicable participating fund, based on appropriate analysis with proper documentation that demonstrates the expected benefit to the relevant policy holders in incurring such costs.

1.29 The insurer shall not allocate to the participating fund any cost that comprises, directly or indirectly, any of the following:

a. fines or penalties imposed by the court, a regulatory authority or a law enforcement agency;

b. costs incurred for corporate restructuring including mergers and acquisitions, demerger, changes involving shareholding structure and management buyout, but excluding internal reorganization of the insurer's processes;

c. expense overruns arising from operational inefficiencies, management actions, or short-term volatility in actual expenses. Such overruns shall be borne by shareholders.

d. costs incurred for marketing other than participating products;

e. costs of promotional gifts issued to distribution channels must be borne by the shareholders' fund and must not be charged to the participating life fund.

f. expenses or charges incurred in relation to activities in breach of any regulatory requirements, including payments to a skilled person to produce a report required by a regulatory authority, if the report indicates that the insurer has, or may have, failed to satisfy its regulatory obligations; and

g. payments of compensation or redress due to policy holders for any act or omission for which the insurer should be responsible. Such compensation shall also include actions to meet any undue PRE that have been formed, including but not limited to, due to inappropriate management of the participating life fund.

Investment returns and Investment strategy

1.30 Insurers shall maintain comprehensive documentation of the methodology used to determine the historic investment returns credited to asset shares for different cohorts / groupings. This shall include the calculation approach, the basis for selecting the investment return rates (e.g. market returns or amortised returns), and the policy regarding the smoothing of returns credited to asset share.

1.31 Insurers shall also document the methodology, rationale and underlying investment return assumption used to project asset shares for different cohorts/groupings. The assumption shall be aligned to the investment strategy of the insurer.

1.32 Any residual return shall be credited to the estate.

1.33 The investment strategy chosen for participating funds shall ensure that both the insurer as a whole and the participating fund remain solvent under all reasonably foreseeable circumstances.

1.34 The investment strategy should also be compliant with any statutory limits and regulatory requirements specified as part of Determination 1.

Taxation

1.35 In calculation of asset share, insurers shall clearly define and document the methodology adopted for the adjustment for taxation payable on policyholder and shareholder surplus distribution.

1.36 The documentation shall include the underlying rationale for the chosen approach and reference to the relevant tax returns or filings submitted to the appropriate tax authorities that support and validate the adopted treatment.

Considerations of bonus determination

Asset share

1.37 The insurer shall determine asset shares in accordance with the methodology and considerations set out in the preceding sections. This determination shall include the calculation of asset share as at the date of the bonus investigation, as well as the projection of such asset shares through to policy maturity.

Smoothing

1.38 Insurers shall implement a clearly defined and consistently applied smoothing policy for participating business to reduce short-term volatility in benefit payouts and support policyholders' reasonable expectations. The smoothing mechanism shall ensure fairness across different policyholder cohorts, reflect the underlying performance of the participating fund, and maintain transparency and consistency over time.

1.39 The insurer shall:

a. Prevent undue advantage or disadvantage to any policyholder group;

b. Maintain proper documentation and governance oversight for all smoothing-related decisions; and

c. Periodically review and disclose the impact of smoothing through internal reporting by tracking the difference between asset shares with and without smoothing.

Allowance of business risks

1.40 The participating fund is subject to a range of business risks beyond investment-related risks, including but not limited to mortality, longevity, morbidity, persistency, operational issues, product design, competitive pressures, regulatory and fiscal changes, and broader geopolitical developments. The insurer shall ensure that bonus determination allows for such risks and any other risks that may be identified as part of the Risk Assessment Report and ensure safeguarding the long-term solvency and sustainability of the participating fund.

Policyholders' reasonable expectations (PRE)

1.41 Policyholders' reasonable expectations concern the policy owners' expectations on how the non-guaranteed benefits of their participating life policies are managed and paid.

1.42 The Committee shall articulate sources which create PRE. PRE might get built up based on past declarations of reversionary bonuses, past communication with the policyholders, marketing material, benefit illustrations presented at the time of sale of policy or at later stages in the lifetime of a policy, and prevailing industry practices.

1.43 In managing Policyholders' Reasonable Expectations (PRE), the insurer shall:

a. actively manage bonus rates in line with the level of participating life fund returns to avoid the creation of undue PRE regarding the level of bonus rates;

b. Communicate clearly to policyholders the non-guaranteed nature of discretionary bonuses and the circumstances under which such bonuses may be revised, reduced, or withdrawn; and

c. Ensure that all communications, whether through direct channels, intermediaries, marketing materials, or historical bonus practices — are accurate, not misleading, and do not give rise to the impression that bonuses are fixed or guaranteed, to protect the integrity of policyholder expectations.

1.44 When making bonus recommendations, if the Committee concludes that undue Policyholder Reasonable Expectations (PRE) have been established, the insurer shall treat the portion of benefit payouts linked to such undue PRE as guaranteed benefits and make appropriate reserves accordingly.

1.45 The insurer shall also consider the guideline on principles on fair treatment of customers as issued by IRCSL from time to time while setting up bonus rates.

Treatment of inherited estate

1.46 The insurer shall ensure that the inherited estate is managed and ultimately distributed in a fair, transparent, and equitable manner between shareholders and participating policyholders. Allocation shall also be fair across different generations of policyholders, in line with their reasonable expectations.

1.47 The run-off of the inherited estate shall be aligned with the run-off profile of the in-force participating policies, such that the estate is fully distributed by the time the last participating policy terminates.

a. Where the insurer intends to continue writing new participating business, the inherited estate may be used to support the capital strain associated with new business issuance.

b. Where no further participating business is to be written, the insurer shall develop and document a formal plan detailing the approach, governance, and timeline for distributing the estate to different generations of participating policyholders.

1.48 Notwithstanding the planned utilisation and distribution of the inherited estate, the insurer shall ensure that an adequate level of estate is retained at all times to meet internal capital objectives and solvency requirements. The insurer shall define appropriate minimum and maximum limits regarding internal solvency targets and establish clearly articulated governance procedures, including corrective actions to be taken in the event of breaches of these limits.

1.49 Consideration should also be given to the impact of writing new business on existing policyholders to ensure that they are not expected to be disadvantaged.

1.50 The Committee shall ensure that the estate is managed prudently and in a manner that does not disadvantage policyholders. If any disadvantage to policyholders does arise due to the management of the estate, the cost of such disadvantage shall be borne by the shareholders.

Surrender value

1.51 The insurer shall ensure that surrendering policyholders are treated fairly, with surrender values that are, as far as practicable, aligned with their corresponding asset shares. This approach helps to maintain equity between surrendering and continuing policyholders, ensuring that the latter neither subsidise nor are disadvantaged by early exits from the participating fund.

Calculation of insurance liabilities

1.52 The future bonus assumption used to determine insurance liabilities shall be based on the bonus policy and included as part of the bonus recommendation provided to the Committee.

1.53 The insurer shall evaluate the cost of guarantees using an appropriate and justifiable methodology. This cost shall be incorporated into the asset share analysis and included in insurance liabilities for participating business, calculated as per Solvency Margin (Risk Based Capital) Rules, 2015. The underlying assumptions, methodologies, and results shall be comprehensively documented as part of the report submitted to the Committee.

Regular policyholder statements

1.54 Insurers shall, at least annually, issue annual bonus statements to each participating policyholder which shall contain:

a. the status of the participating life policy;

b. any bonus declared for the current year;

c. the sum assured, the vested bonus including the total accumulated reversionary bonus, and other vested non-guaranteed benefits as at the date of the statement;

d. any bonus or other non-guaranteed benefit which has vested since the date of the last statement;

e. the guaranteed cash value; and

f. any other information relevant to the participating policyholders.

1.55 The proposed format for the annual policyholder statements has been provided as part of Annexure A of this guideline.

Documentation

1.56 The insurer shall ensure that all key decisions, assessments, and actions relating to the management of the participating fund, including those concerning the inherited estate, are properly documented. Such documentation shall be made available to the Board of Directors and submitted to the Insurance Regulatory Commission of Sri Lanka (IRCSL) upon request.

1.57 Any changes to the insurer's adopted approach in managing the participating fund shall be clearly documented, including the rationale for the change from previous approach. Such change should be governed via a pre-defined approval mechanism.

1.58 Any changes in expense allocation methodology for participating fund shall be clearly documented, including a reclassification of expenses, the inclusion/removal of categories of expenses.

1.59 At the end of every financial year, for the purpose of approval of the bonus rate declared for the year and setting up proposed future bonus rate assumptions, a detailed report shall be prepared by the insurer and submitted to the Committee, encompassing the following elements:

a. Calculated asset shares including the underlying assumptions and data used for the calculation and projection of asset share;

b. Evaluation of various parameters and alignment with bonus policy in setting proposed bonus rates.

c. Recommended bonus rates including the financial impact of such rates on the liability and capital position;

d. Any analysis performed to assess the supportability of bonus rates including any sensitivity or scenario analysis performed by the insurer;

e. Reasonableness checks to ensure the accuracy, consistency, and completeness of the data used;

f. Any qualifications or limitations relating to the data;

g. An explanation of how the interests and fair treatment of policyholders, including PRE, have been addressed in the bonus recommendation;

h. The report shall also include an assessment of the financial impact on the insurer arising from any actions taken to meet undue PRE; and

i. Proposed future bonus assumption as used in calculation of insurance liabilities and bonus assumption used in solvency assessments, calculated as per Solvency Margin (Risk Based Capital) Rules, 2015.

Compliance with the guidelines

1.60 Insurers will immaterial proportion of participating business may consider a degree of proportionality with respect to compliance with these guidelines. However, the fundamental principles of policyholder fairness and equitable treatment should not be diluted. Accordingly, any relaxation in requirements shall be limited in nature and should not compromise the objective of ensuring a fair and transparent distribution of surplus.

On the basis of proportionality, if the Company wishes to use a simplified approach, the Company is allowed to do so supported by appropriate documentation and justification to demonstrate compliance with this principle. Notwithstanding the above, even in such cases, insurers are required to ensure that there is an equitable distribution of the estate and surplus to the remaining participating policyholders.

1.61 Every insurer shall, at least once a financial year, submit a certification to the IRCSL confirming that the determination of bonus rates has been carried out in accordance with the bonus policy approved by the Board of Directors.

1.62 IRCSL may require insurers to obtain an independent opinion from a qualified actuary on the asset share calculations and the methodology applied, including the reasonableness of the assumptions used (such as expenses charged and investment returns calculated), the validation of data, and the supportability of the bonus rates declared, at the cost of the insurer.

Annexure A: Sample annual policyholder statement

[Company Name] –Annual Bonus Statement

Policyholder Name:
Policy Number:
Product:
Statement Date:
Policy commencement date:
Policy term:
Premium Payment term:
Policy status:
Nominee details:

Summary of Policy Benefits

Particular	**Amount (LKR)**
Annual Premium amount	
Basic Sum Assured[1]	
Accumulated Reversionary Bonuses[2]	
Total Death benefit as on date of statement	
Surrender value as on date of statement	

1. Basic sum assured refers to the original sum assured without any bonuses included
2. Accumulated reversionary bonus shall include any bonus declared on or before the date of statement

Bonus declaration for the year

Particular*	**Detail**
Reversionary Bonus rate declared (%)	
Reversionary Bonus amount added this year (LKR)	
Reversionary Bonus amount added last year (LKR)	
Cash Bonus rate declared (%)	
Cash Bonus amount paid this year (LKR)	
Cash Bonus amount paid last year (LKR)	
Terminal Bonus declared (LKR)	
Special Bonus declared (LKR)	

**Please include details on other bonuses paid by the insurers.*

Important notes for policyholders

- Bonuses once declared are guaranteed and form part of your policy benefits.
- Future bonuses are not guaranteed and will depend on the performance of the Participating Fund.

Contact us

For questions or clarification, please contact **Actuarial Unit of IRCSL**:
+94 11 2396184-9
actuarialunit@ircsl.gov.lk