

By Hand / Fax

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12th March 2020

Mr. Gehan Shivantha Rajapakse
President
Insurance Association of Sri Lanka (IASL)
143A, Vajira Road
Colombo 05.

Dear Sir,

IMPLEMENTATION OF SRI LANKA FINANCIAL REPORTING STANDARD (SLFRS) 16 - LEASES

We refer to IASL letter dated 12th February 2020 and other correspondences exchanged regarding the above subject.

Having considered the request made by IASL, the Commission has decided to issue a clarification on application of SLFRS 16 (Leases) to Solvency Margin (Risk Based Capital) Rules, 2015 and same is attached herewith.

Kindly keep your members and External Auditors informed of same.

Yours faithfully,



Damayanthi Fernando

Director General

CE/ny

encl:

copy: Ms. Geetha Wimalaweera, CEO (Acting), NITF

CLARIFICATION ON APPLICATION OF SRI LANKA ACCOUNTING STANDARD SLFRS 16 – LEASES TO THE SOLVENCY MARGIN (RISK BASED CAPITAL) RULES 2015

The Sri Lanka Accounting Standard, 'SLFRS 16 – Leases' (referred as SLFRS 16 in this paper) was implemented with effect from 01st January 2019, where companies are required to recognize leases on the Balance Sheet for lease contracts as 'Right of Use Asset' and 'Lease Liability'.

The application of new "Right of Use (RoU) Assets" and "Lease Liabilities" have not been explicitly addressed in the Solvency Margin (Risk Based Capital) Rules 2015 (referred as RBC Rules).

The IRCSL has reviewed the impact of SLFRS 16 application to the RBC Rules after obtaining details from Insurers mainly taking into account of following:

- I. Item a) of Section 12 states that 'goodwill and other intangible assets, including capitalized expenditure' shall be deducted from the total of Tier 1 capital and Tier 2 capital.
- II. Item b) of Section 12 states that 'Inadmissible land, building, other immovable property, plant, and equipment' shall be deducted from the total of Tier 1 capital and Tier 2 capital.
- III. Items K & L of Table 1 discusses "admissible" land and buildings which should be "Freehold" in nature.
- IV. Application of Risk Charges; 100% Concentration Risk capital charges and 1% Operational Risk charges (if not applicable items I and II).

Having noted the considerable impact to the industry, and the request made by IASL, the IRCSL has decided to clarify the application of SLFRS 16 – Leases' to the Solvency Margin (Risk Based Capital) Rules 2015 as follows:

1. Netting off shall be permitted for RoU Asset and the corresponding lease liability arisen due to implementation of SLFRS 16 when determining Total Available Capital and Capital Adequacy Ratio.
2. In the event of an excess of the value of the RoU Asset over the corresponding lease liability, same should be treated in terms of;
 - i. Item a) of Section 12 or
 - ii. Item b) of Section 12 or
 - iii. Subject to 100% Concentration Risk Capital charge and 1% Operational Risk Capital charge considering the Nature of lease arrangements.

3. In the event of an excess of the value of the lease liability over the corresponding RoU Asset, same should be treated as "Other Liabilities"
4. Treatment over Other Assets and Liabilities prescribed in the Solvency Margin (Risk Based Capital) Rules 2015 remain unchanged.
5. Insurers are required to follow the relevant accounting standards for the presentation and disclosures of the financial statements without effecting the above mentioned requirements.
6. Above treatment is subject to further review and amendments to the existing Solvency Margin Rules which will come in to effect in future.
7. The above is effective from 31st December 2019.