

10th Capacity Building Seminar in General Insurance

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Ind AS 109, Understanding with Examples

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Agenda

1.	Financial Assets / liabilities
2.	Financial Liabilities – classification and recognition
3.	Financial Assets - Equity instruments Classification and subsequent measurement
4.	Financials Assets - Debt instruments Classification and subsequent measurement
5.	Effective interest rate (EIR)
6.	Disclosures
7.	Example: Interaction of Ind AS 117 and 109
8.	Example: Weather Based Crop Scheme



Financial asset

A financial asset is any asset that is:

- **Cash;**
- **An equity instrument of another entity;**
- **A contractual right:**
 - To receive cash or another financial asset from another entity; or
 - To exchange financial assets or financial liabilities with another entity under conditions that are potentially **favourable** to the entity; or
- **A contract that will or may be settled in the entity's own equity instruments and is:**
 - A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
 - A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

Financial asset?

1 Trade receivables, loans given

2 Investments in Preference shares, Mutual Funds, Venture Funds

3 Investment in equity instruments, debentures, bonds, etc.

4 Investments in Commercial Papers, T bills, Security Receipts, Credit Linked Notes, Market Linked Debentures

5 Cash and bank balances, rental deposits paid

6 Prepaid expenses



Financial Liability

A contractual obligation:

- To deliver cash or another financial asset to another entity; or
- To exchange financial assets or financial liabilities with another entity under conditions that are potentially **unfavorable** to the entity; or

OR

A contract that will or may be settled in the entity's own equity instruments and is:

- A non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
- A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

Financial liability?

1

Trade payables, rental deposits received

2

Redeemable preference shares with or without cumulative dividends

3

Non convertible debentures

4

Deferred revenue

5

Intercompany loans, term loans from banks, working capital facilities, overdrafts

6

Lease liabilities under Ind AS 116

7

Financial Guarantee Contracts



Financial Liability
Classification and
recognition



Debt or equity

Financial instrument is an equity instrument only if **both** criteria are met:

- There is no obligation to deliver cash or another financial asset or to exchange financial assets or financial liability; **and**
- For a contract over own shares, the issuer will settle in a fixed number of its own equity instruments (additionally, for derivatives over own shares, the cash will also be fixed)

Does the entity have an unavoidable contractual obligation to pay cash?

Yes



Liability

No



Equity

Initial recognition and fair value

Initial recognition

- Financial assets and financial liabilities are, generally recognised on the balance sheet only when the entity becomes a party to the contractual provisions of the instrument.
- Financial instruments are generally recognised at fair value at inception.
- Transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability are added or reduced to fair value, **unless the financial asset or financial liability is measured at fair value through profit or loss.**

Scope exclusions from financial instruments standards

1 Investments in subsidiaries, associates, joint ventures unless carried at fair value

2 Rights and obligations under leases except derecognition and impairment requirements

3 Rights and obligations under employee benefit plans under Ind AS 19

4 Financial instruments covered by Ind AS 102 Share-based Payments

A group of four business professionals (three men and one woman) are gathered around a wooden conference table in a modern office. They are looking at a laptop and discussing documents. The office has large windows in the background, providing a bright and airy atmosphere. The text is overlaid on a yellow rectangular background on the left side of the image.

Financial Assets

Equity instruments –
classification and
subsequent measurement

Equity instruments – classification & measurement

1 Equity instruments measured at FV-PL

2 Option to elect to measure at FV-OCI if not held for trading

3 No subsequent recycling if measured at FV-OCI but can be transferred within equity

4 Dividends continue to be recognised in P&L



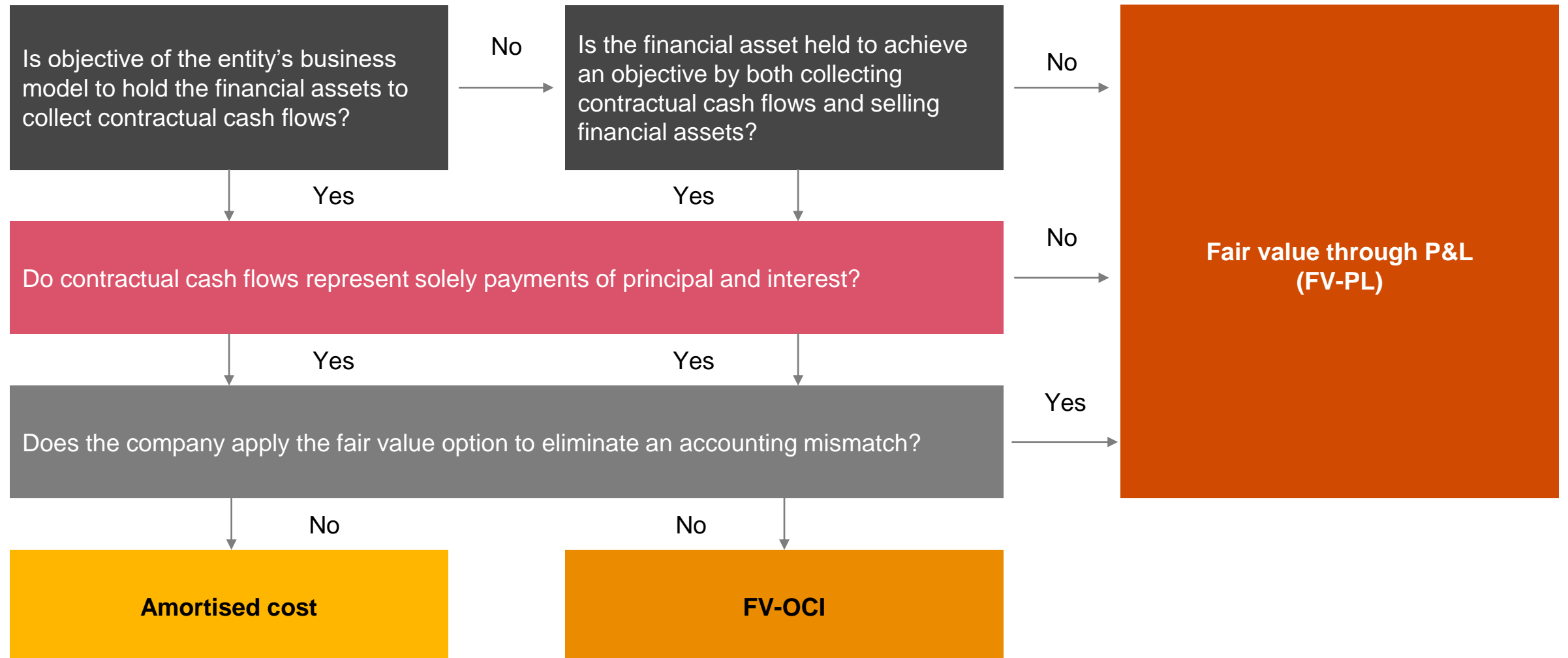
A man and a woman in an office setting are looking at documents. The man is on the left, wearing a dark suit and tie, looking down at a document. The woman is on the right, wearing a white shirt and glasses, also looking down at a document. Several colorful sticky notes (orange, green, yellow) are floating in the air around them. In the background, another person is visible, and there are shelves with blue folders. The overall scene is a professional office environment.

Financial Assets

Debt instruments –
classification and
subsequent measurement

Debt instruments – classification & measurement

Business Model Assessment



Debt instruments- classification & measurement

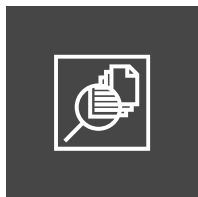
Business Model Assessment – SPPI & Accounting mismatch



SPPI

If contractual cash flows are only from interest and principal, then the debt instrument will pass the contractual cash flows solely payments of principal and interest (SPPI) test.

- For example a regular debenture with regular interest coupon.



Accounting mismatch

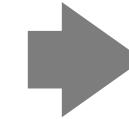
This is an option allowed where both the asset and corresponding liability which has funded the asset is fair valued.

- For example if a Company has taken a loan (liability) to buy a bond (asset) and the loan is fair valued, the Company has an option to fair value the bond as well with corresponding fair value changes routed through P&L.

Debt instruments - classification & measurement

Examples

Company has invested in a portfolio of bonds, payment of which are only from interest and principal. Intention is to hold till maturity.



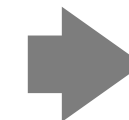
Amortised cost

Company has invested in a portfolio of redeemable preference shares, payment of which are only from interest and principal. Intention is to hold and earn coupon interest and then make profits on sale.



FV-OCI

Company has invested in a portfolio of debentures. The Company is not interested in periodic returns but intends to sell these debentures and make profits on sale.



FV-PL

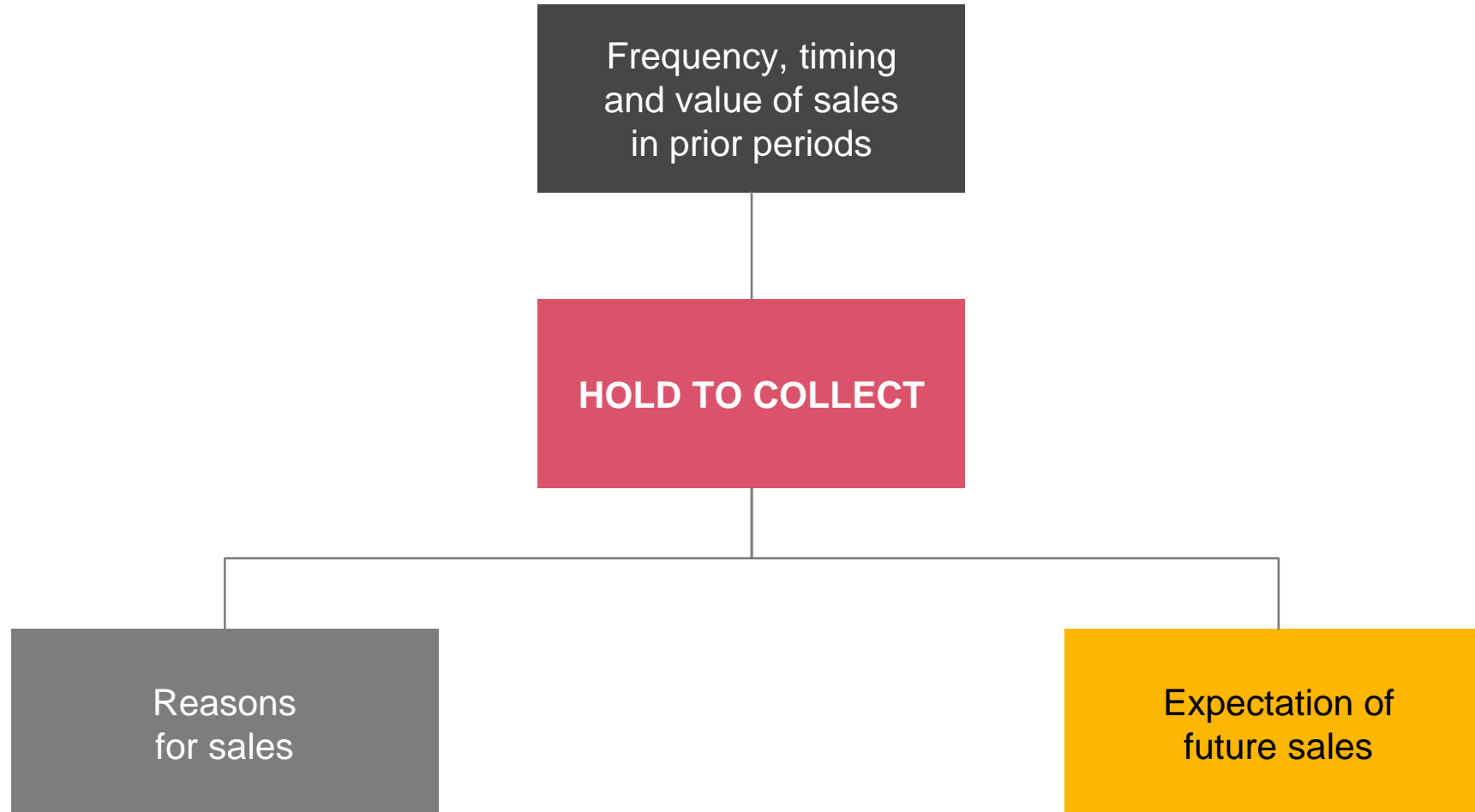
Company holds a portfolio of bonds. Returns on these bonds include share of profits of the investee company.



FV-PL

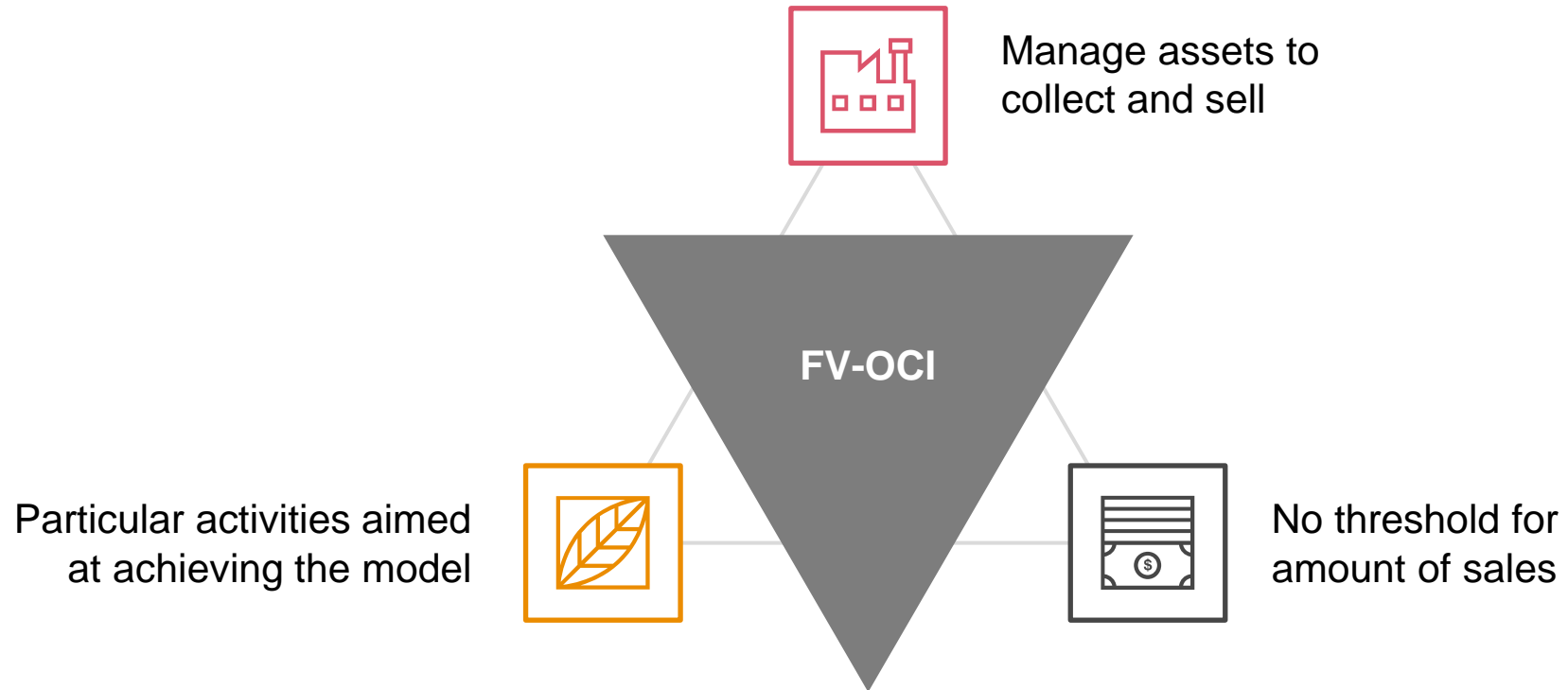
Debt instruments - classification & measurement

Business Model Assessment – hold to collect business model



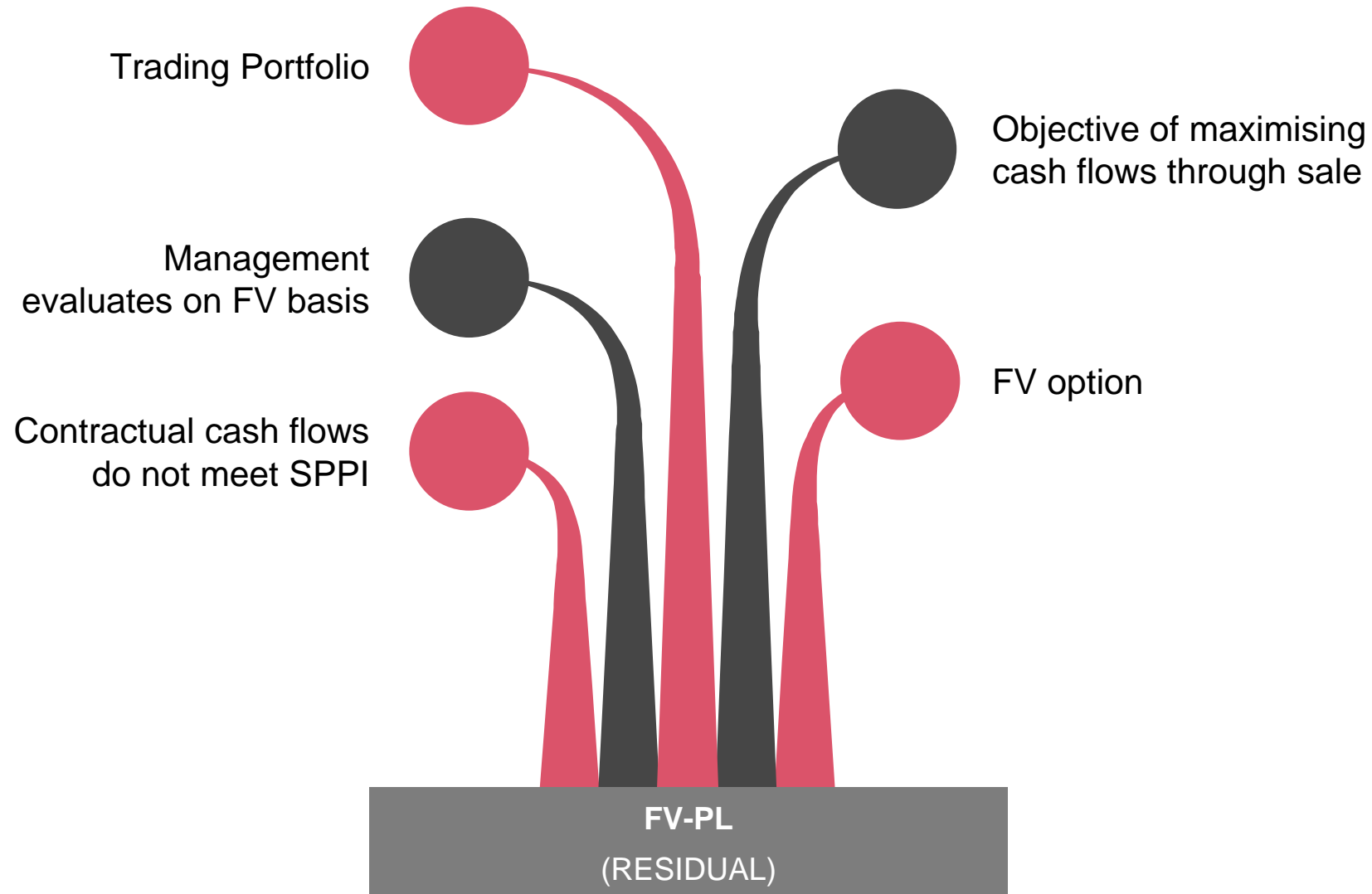
Debt instruments - classification & measurement

Business Model Assessment – FV-OCI business model



Debt instruments - classification & measurement

Business Model Assessment – FV-PL business model



Effective interest rate



Effective Interest Rate

Use effective interest method which is the rate that exactly discounts the expected stream of future cash payments or receipts through maturity to the net carrying amount at initial recognition.

$$\begin{array}{ccccccc} \text{Amortised} & & & & & & \\ \text{cost} & = & \text{Cash paid} & - & \text{Principal} & + & \text{Unamortised} \\ & & & & \text{repayments} & /- & \text{premiums or} \\ & & & & & & \text{discounts} \\ & & & & & + & \text{Unamortised} \\ & & & & & & \text{transaction} \\ & & & & & & \text{cost} \end{array}$$

Effective Interest Rate (EIR) – Transaction costs

Nature	Included in EIR as part of transaction costs
Fees and commissions paid to agents, advisors, brokers and dealers	✓
Levies by regulatory agencies and securities exchanges	✓
Transfer taxes and duties	✓
Internal administrative or holding costs	✗
Cost to exit or sell the asset	✗

Disclosures



Disclosures- Ind AS 107

Disclosure requirements on each type of financial risk

Credit risk

Liquidity risk

Market risk

1

Qualitative and quantitative disclosures

2

Through the eyes of management

3

Minimum disclosure requirements

Financial instruments measured at fair value

Fair value hierarchy

- Quoted prices
- Observable input
- Non-observable input

Further disclosures:

- Transfers between levels of hierarchy
- Reconciliation of beginning and ending balances for Level 3
- Gain or losses recognized in P&L for Level 3 instruments

Ind AS 109 and Ind AS 117
Making the consistent
choice



Determining Discount Rate Approach – OCI vs P&L

S.No	Impact of discount rate change (IFRS 17)	Assets Measurement (IFRS 9)	Affect
1	P&L	Fair Value through P&L	<ul style="list-style-type: none"> • Change in value of assets (as a result of changing interest rates) to P&L • Change in the value of liabilities (discount rate) to P&L
2	P&L	Amortized Cost	<ul style="list-style-type: none"> • Value of Liabilities change with change in DR • Change is reflected in OCI • Accounting value of assets not affected by change in DR
3	P&L	Fair Value through OCI	<ul style="list-style-type: none"> • Change in value of assets (as a result of changing interest rates) to OCI • Change in the value of liabilities (discount rate) to P&L
4	OCI	Fair Value through P&L	<ul style="list-style-type: none"> • Change in value of assets (as a result of changing interest rates) to P&L • Change in the value of liabilities (discount rate) to OCI
5	OCI	Amortized Cost	<ul style="list-style-type: none"> • Value of Liabilities change with change in DR • Change is reflected in OCI • Accounting value of assets not affected by change in DR
6	OCI	Fair Value through OCI	<ul style="list-style-type: none"> • Change in value of assets (as a result of changing interest rates) to OCI • Change in the value of liabilities (discount rate) to OCI

Example – Setting the Context

Detail of the Asset

Nominal Value	Purchase Price	Maturity	Coupon	Yield to Maturity
200Cr	226Cr	5 years	8%	5%

Nominal Value	Duration
100Cr	3 Years

Cashflows

	Year 1	Year 2	Year 3	Year 4	Year 5
Coupons	16cr	16cr	16cr	16cr	16cr
Redemption	0	0	0	0	200cr
Liability	0	0	100Cr	0	0

Year	Discount Rate
1	5%
2	4%
3	7%
4	5%
5	5%

Example – Movement in Assets and Liability Values

		1	2	3
Liability	0	0	0	100Cr
Beginning of Year PV T=1	86.4	90.7	95.2	
Beginning of Year PV T=2	-	92.5	96.2	
Beginning of Year PV T=3	-	-	93.5	

Period	Interest Received	Effective Interest Rate	Amortization	Carrying Value	Market Value
01/01/2022				226	
01/01/2023	16	11	5	221	229
01/01/2024	16	11	5	216	205
01/01/2025	16	11	5	211	211
01/01/2026	16	11	5	206	206
01/01/2027	16	10	6	200	200

Example – P&L Comparison

Liabilities measurement in P&L

Amortized/ P&L	Year 1	Year 2
Liability- Accretion of Interest	(4.3)	(3.7)
Liability- Change in Interest Rate	(1.7)	2.7
Assets - Investment Income	16.0	16.0
Assets - Amortized Premium	(4.7)	(4.9)
P&L	5.2	10.1

P&L / P&L	Year 1	Year 2
Liability- Accretion of Interest	(4.3)	(3.7)
Liability- Change in Interest Rate	(1.7)	2.70
Assets - change in Market value	3.0	(23.8)
Assets - Interest Income	16.0	16.0
P&L	13.0	(8.8)

OCI / P&L	Year 1	Year 2
Liability- Accretion of Interest	(4.3)	(3.7)
Liability- Change in Interest Rate	(1.7)	2.70
Assets - Interest Income	16.0	16.0
P&L	9.9	15

Liabilities measurement in OCI

Amortized/ OCI	Year 1	Year 2
Liability- Accretion of Interest	(4.3)	(4.5)
Assets - Investment Income	16.0	16.0
Assets - Amortized Premium	(4.7)	(4.9)
P&L	7.0	6.5

P&L / OCI	Year 1	Year 2
Liability- Accretion of Interest	(4.3)	(4.5)
Assets - change in Market value	3.0	(23.8)
Assets - Interest Income	16.0	16.00
P&L	14.7	(12.3)

OCI / OCI	Year 1	Year 2
Liability- Accretion of Interest	(4.3)	(4.5)
Assets - Interest Income	16.0	16.0
P&L	11.7	11.5

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Measuring liability of
insurance products

Contracts not falling within Insurance definition?

1

Contracts that require a payment that depends on a climatic, geological or any other physical variable not specific to a party to the contract (commonly described as weather derivatives).

2

Some contracts require a payment if a specified uncertain future event occurs, but do not require an adverse effect on the policyholder as a precondition for the payment.

Contracts not falling within Insurance definition?

1

Contracts that require a payment that depends on a climatic, geological or any other physical variable not specific to a party to the contract (commonly described as weather derivatives).

2

Some contracts require a payment if a specified uncertain future event occurs, but do not require an adverse effect on the policyholder as a precondition for the payment.

Classification under Ind AS 109?

Amortized Cost

Typically reserved for the financial assets that are held within a business model whose objective is to hold assets to collect contractual cash flows.



Classification

FVOCI

Not held for trading, but to meet the contractual cashflow obligations – Capital and Interest Payments



FVP&L

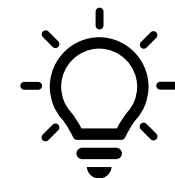


Underlying Contract - Income and Liability Recognition

Premium Written	Expected Combined Ratio at Inception	Contract Start	Contract End
100Cr	80cr	1 st Jan	30 th June

	1 st Jan	31 st Mar
Assets		
Cash	100	100
Liabilities		
Derivative Liability	80	90
Reserves	20	10
Profit (Loss)	20	-10

- Not recorded under Insurance service income and expenses for reporting
- Income and expenses from the derivative contract will be disclosed under investment income and expenses
- Upfront recognition of profit/loss based on fair value assessment of the company.
- Reinsurance can still be measure through Ind AS 117 or through 109 by using hedge Accounting



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Thank You