

Ind AS 109, Financial Instruments

IAI - 7th Seminar on Current Issues in General Insurance

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New concepts and statements

Financial instruments

Terms

- Cost – transaction price (in general)
- Amortised cost
- EIR - Effective interest method
- FVTPL – Fair value through profit or loss
- FVOCI – Fair value through OCI
- ECL – Expected credit loss

An entity shall measure a financial asset or financial liability at its fair value plus/minus the transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.



Presentation impact

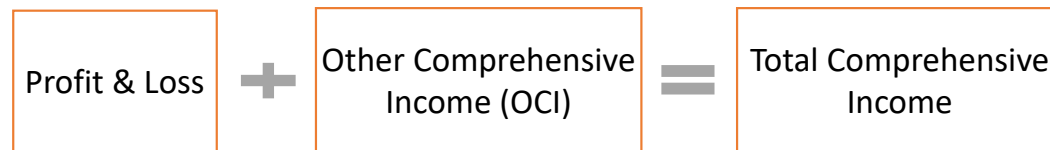
Financial instruments

Indian GAAP

Only Profit and Loss

Ind AS

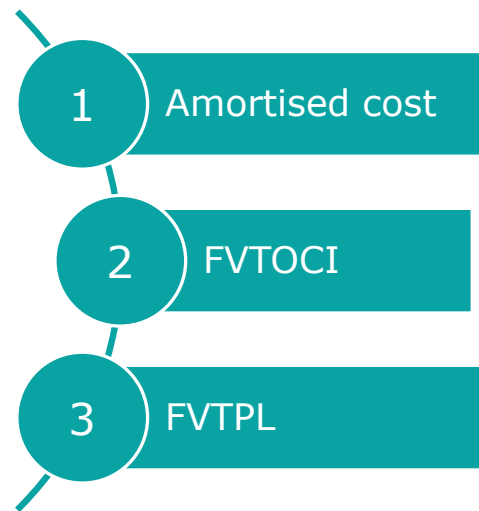
Statement consists of:



Classification

Financial instruments

Financial assets should be classified into one of the following **three categories** for measurement and income recognition:



The above classification is based on:

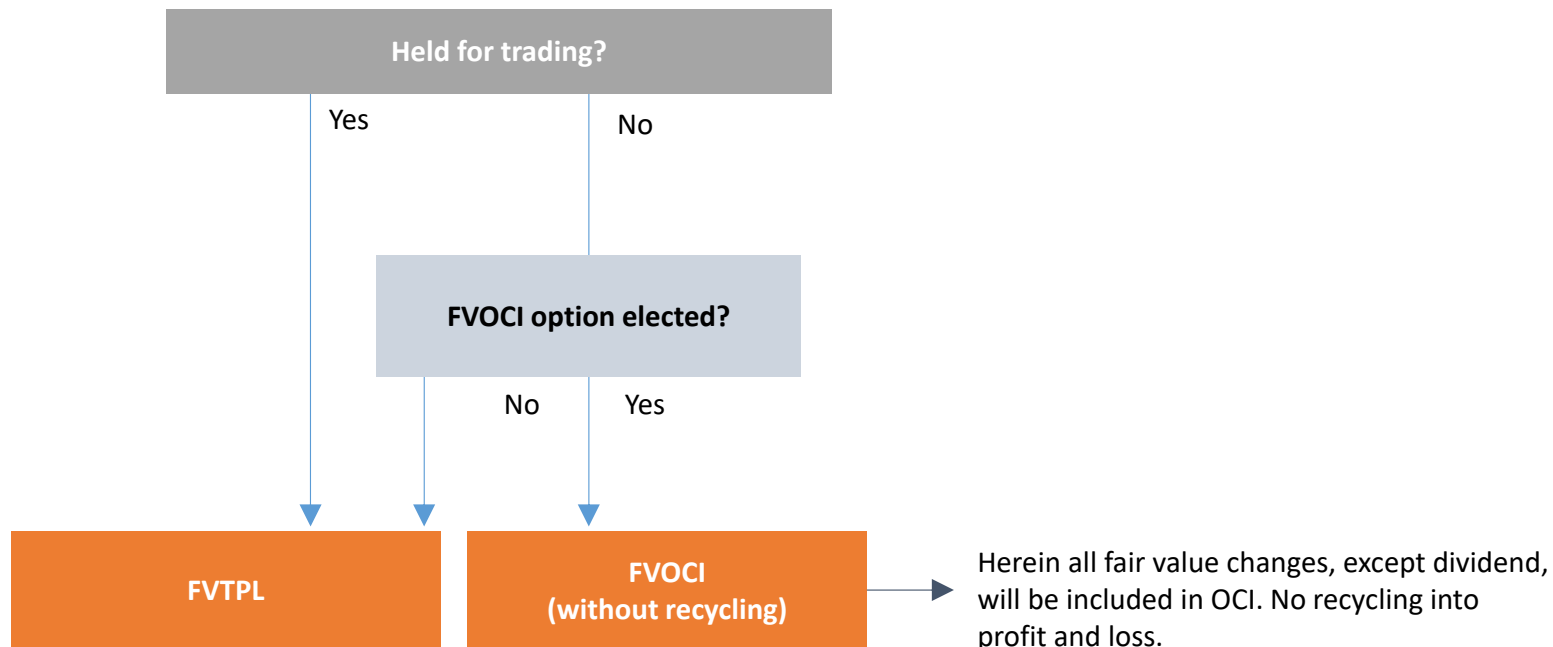
- Business model for managing financial assets; and
- Characteristics of the contractual cash flows of the financial asset.

Classification and Measurement

Financial instruments

Investment in equity instruments:

(Equity instruments are those that meet the definition of “equity” as defined in Ind AS 32)



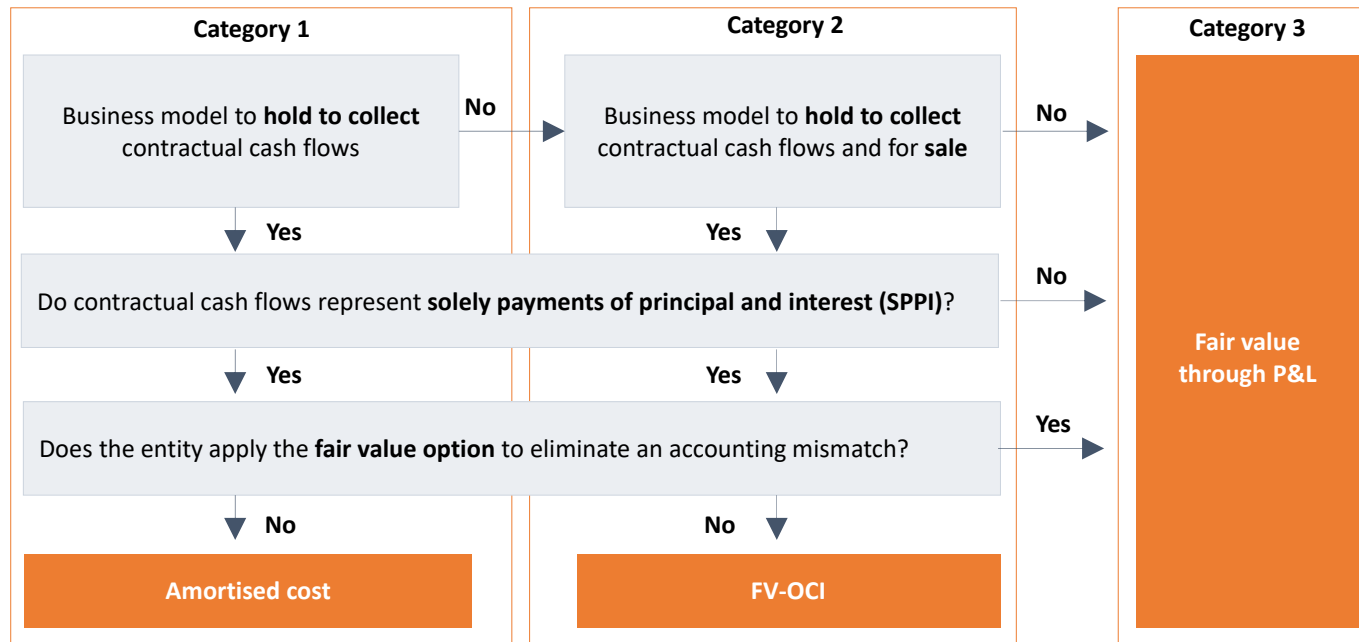
*An equity instrument is defined as any contract that **evidences a residual interest** in the assets of an entity after deducting all of its liabilities (Ind AS 32)

Classification and Measurement

Financial instruments

Investment in debt instruments:

(Debt instruments are financial assets other than equity instruments. Classification under Ind AS 109 is driven by the entity's business model for managing financial assets and their contractual cash flow characteristics (bifurcation of embedded derivatives is prohibited for assets))



Other Comprehensive Income (OCI) vs Income statement

Option under Ind AS 109 and 117

Investment in debt instruments:

IFRS 17 allows you to choose where to recognise the discounting of reserves. Either in the Income Statement or through the OCI. Similarly, IFRS 9 allows you to choose, under certain conditions, where to book the fair value movements, either in the Income statement or OCI.

Fixed Income investments

Fair value / amortisation adjustments

Expired risk / Liability for incurred claims

Discounting impact in period

- Unwind of discounting adjustment
- Impact of change in yield curve

Income statement

Other Comprehensive Income (OCI)

Option 1 - FVTPL

Volatility will exist both with duration and currency mismatches.

Option 2 - FVOCI

The storing of the 'initial discount rate' adds complexity

Investment classification

Quick Comparison

Accounting for Investment:

Classification of investments under Ind AS 109 is driven by the entity's asset liability approach to manage its risk exposure. Nature of insurance liability will be deciding factor for classification. Classification of investment can be portfolio based or for each class of securities.

IND AS 109

Classification on basis of business model		
FVTPL	FVOCI	Amortised cost
Equity Instruments and Mutual funds		
Traditional: FVTPL . Irrevocable selection of FVOCI option. ULIP: FVTPL Mutual funds: FVTPL		
Debt Instruments		
Traditional: Amortised Cost . Effective Interest Method ULIP: FVTPL .		

IGAAP – IRDAI Guidelines

Classification on basis of nature of product	
Traditional Products	ULIP Products
Equity Instruments and Mutual funds	
Unrealised gains or losses are recorded in Fair value change account in BS.	Realised and unrealised gains or losses in Revenue account .
Debt Instruments	
Measured at Amortised Cost . Straight line amortisation of premium, discount and other transaction costs.	Measured at FV

Scope of Impairment

Financial Instruments

Examples to illustrate the scope of expected credit loss model:

Financial asset	Within scope?
Trade receivables	
Loan to subsidiaries (Inter-company loans)	
Investments in bonds (for trading)	
Investments in bonds (Not for trading)	
Investments in equity instruments	
Lease receivable	
Reinsurance receivables	
Financial guarantees	

Scope of Impairment

Financial Instruments

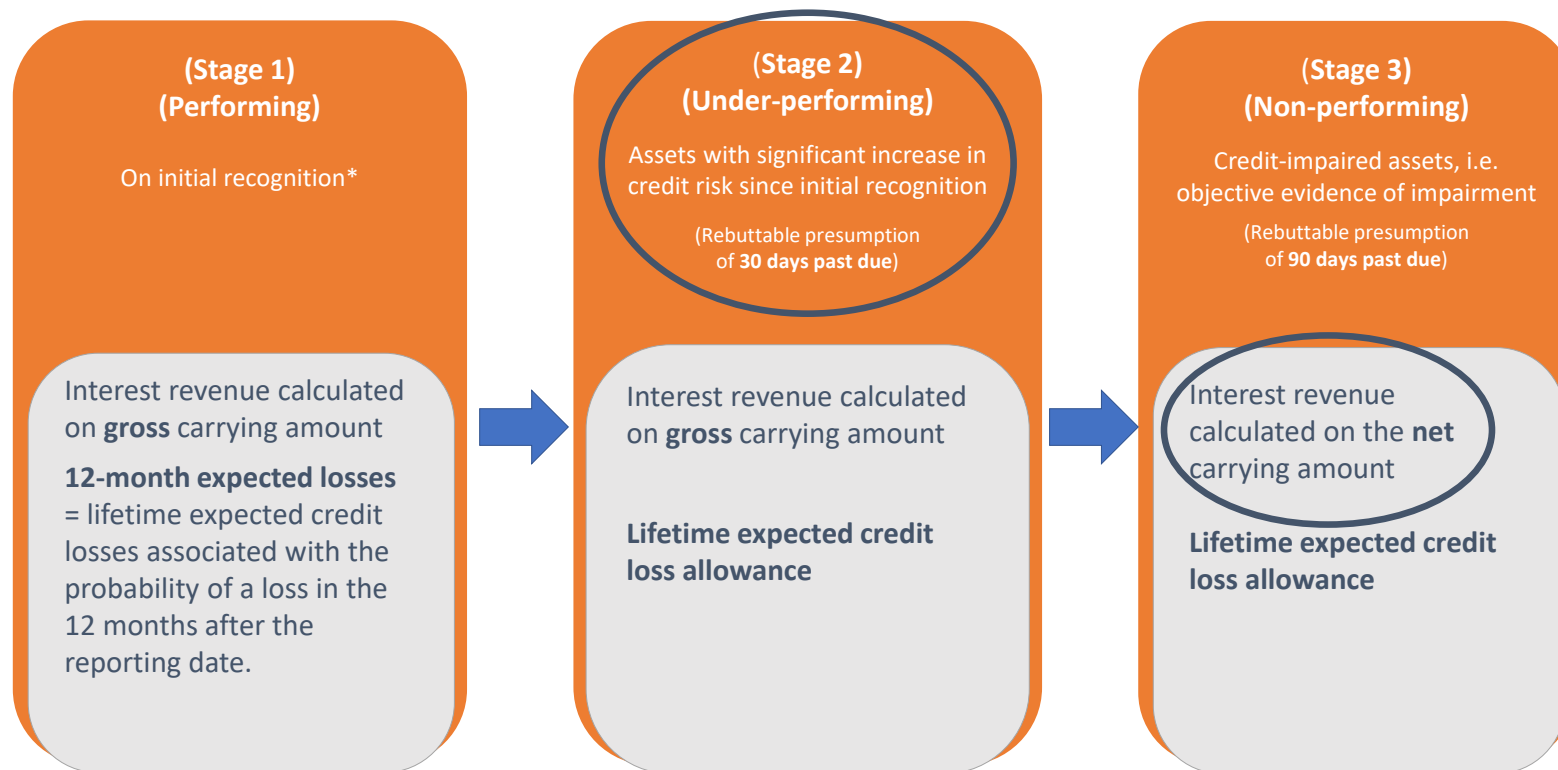
Examples to illustrate the scope of expected credit loss model:

Financial asset	Within scope?
Trade receivables	Yes
Loan to subsidiaries (Inter-company loans)	Yes
Investments in bonds (for trading)	No
Investments in bonds (Not for trading)	Yes
Investments in equity instruments	No
Lease receivable	Yes
Reinsurance receivables	Yes
Financial guarantees	Yes

Scope of Impairment

Financial Instruments

Financial assets that are not credit-impaired on initial recognition



* Except for purchased or originated credit impaired assets
More guidance to include asset with low credit risk and investment grade

Illustrate example of an insurance product not meeting IFRS 17 definition and accounted under Ind AS 109

Particulars	
Premium received on 1st Jan, 2022 with coverage period of 6 months	INR 100
Loss ratio expected as on 1st Jan, 2022	100%
Actual Loss ratio up to 31st March, 2022, expected to continue for future	80%
Actual Loss ratio up to 30th June, 2022	50%

Journal Entries under Ind AS 109		
Date	Particulars	Amount (in INR)
1-Jan-22	Cash..... Dr Derivative liability.....Cr Unamortized gain..... Cr (Recording the writing of the derivative by the insurer and receipt of premium)	100 (100) 0
31-Mar-22	Derivative Liability....Dr Profit or Loss....Cr (Recording the change in the value of derivative recorded in profit or loss)	20 (20)
30-Jun-22	Derivative Liability..... Dr Profit or Loss..... Cr (Recording the change in the value of derivative recorded in profit or loss)	30 (30)
30-Jun-22	Derivative Liability..... Dr Cash..... Cr (Net settlement of derivative of the date of expiry of the derivative)	50 (50)

Extract of P&L

As at 31.03.22

Particulars	Amount as per Ind AS
<u>Other Income</u>	
<u>Other Non Operating Income</u> Net gains (losses) on fair value changes	20
Profit	20

Particulars	Amount as per IGAAP
Premium earned (net)	50
Claim incurred (net)	(40)
Profit	10

As at 30.06.22

Particulars	Amount as per Ind AS
<u>Other Income</u>	
<u>Other Non Operating Income</u> Net gains (losses) on fair value changes	30
Profit	30

Particulars	Amount as per IGAAP
Premium earned (net)	50
Claim incurred (net)	10
Profit	40

Thank you!!

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