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Demystifying Ind AS 117

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Introduction

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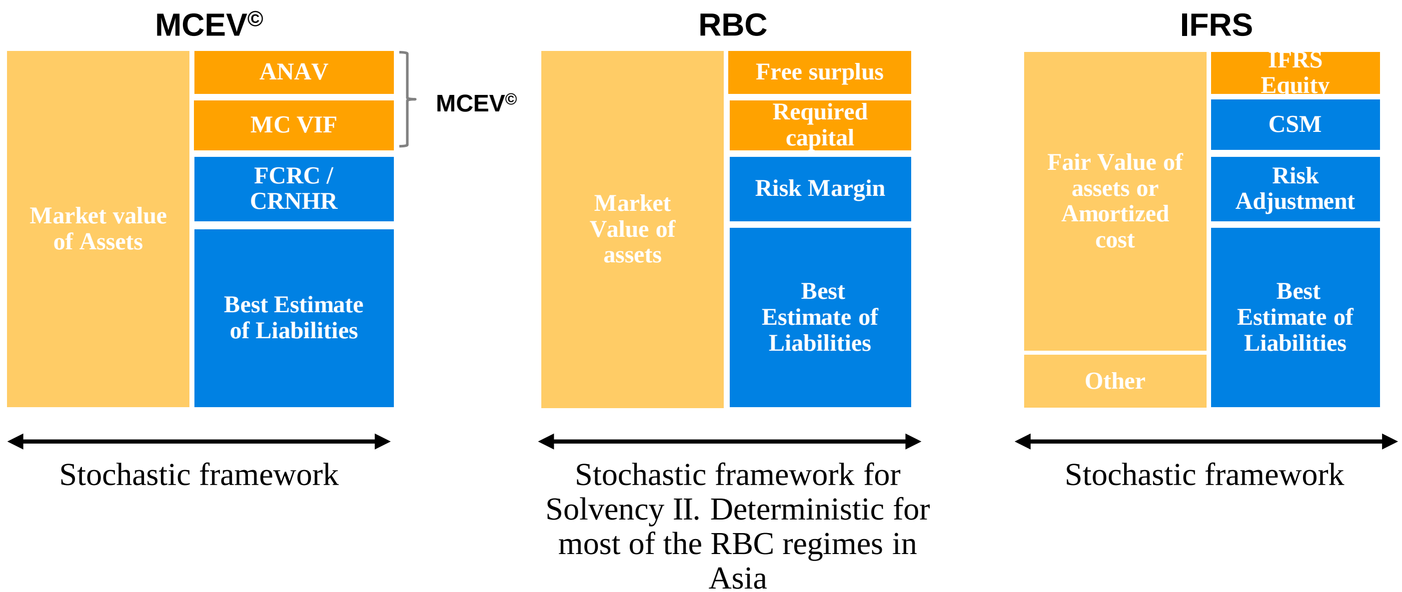
1. **Demystifying Ind AS 117 – bridges to other frameworks**
2. **Selection of measurement models**
3. **Cash flow impacts**
4. **Interesting impacts of onerous contracts**

Building block approach to valuation

- RBC regimes, IFRS 17 and MCEV assess the insurance liabilities based on an economic balance sheet framework.

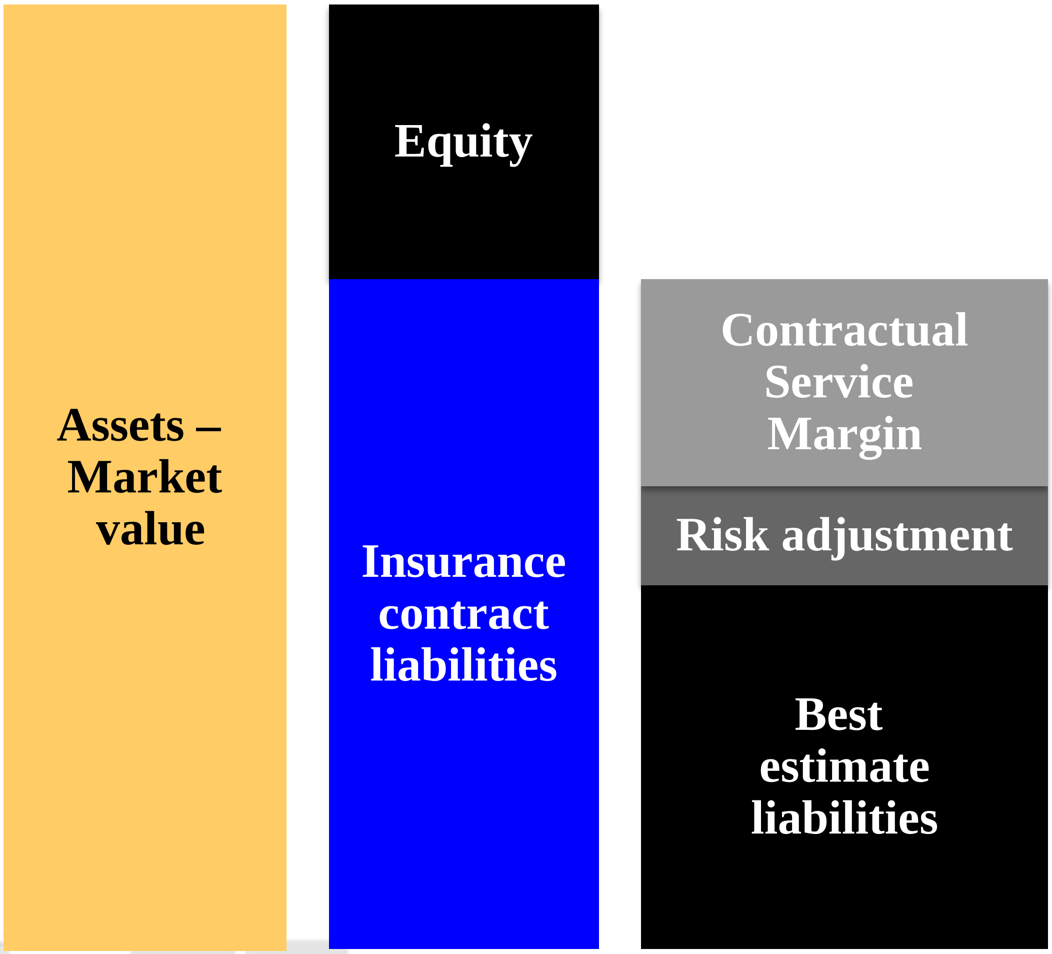


- Differences in methodology and parameters need to be identified and explained. For companies reporting under a Traditional Embedded Value (TEV) basis, it is also key to explain the differences between TEV and IFRS 17 frameworks to the management.

The balance sheet

Part II
Balance Sheet including Statement of Changes in Equity

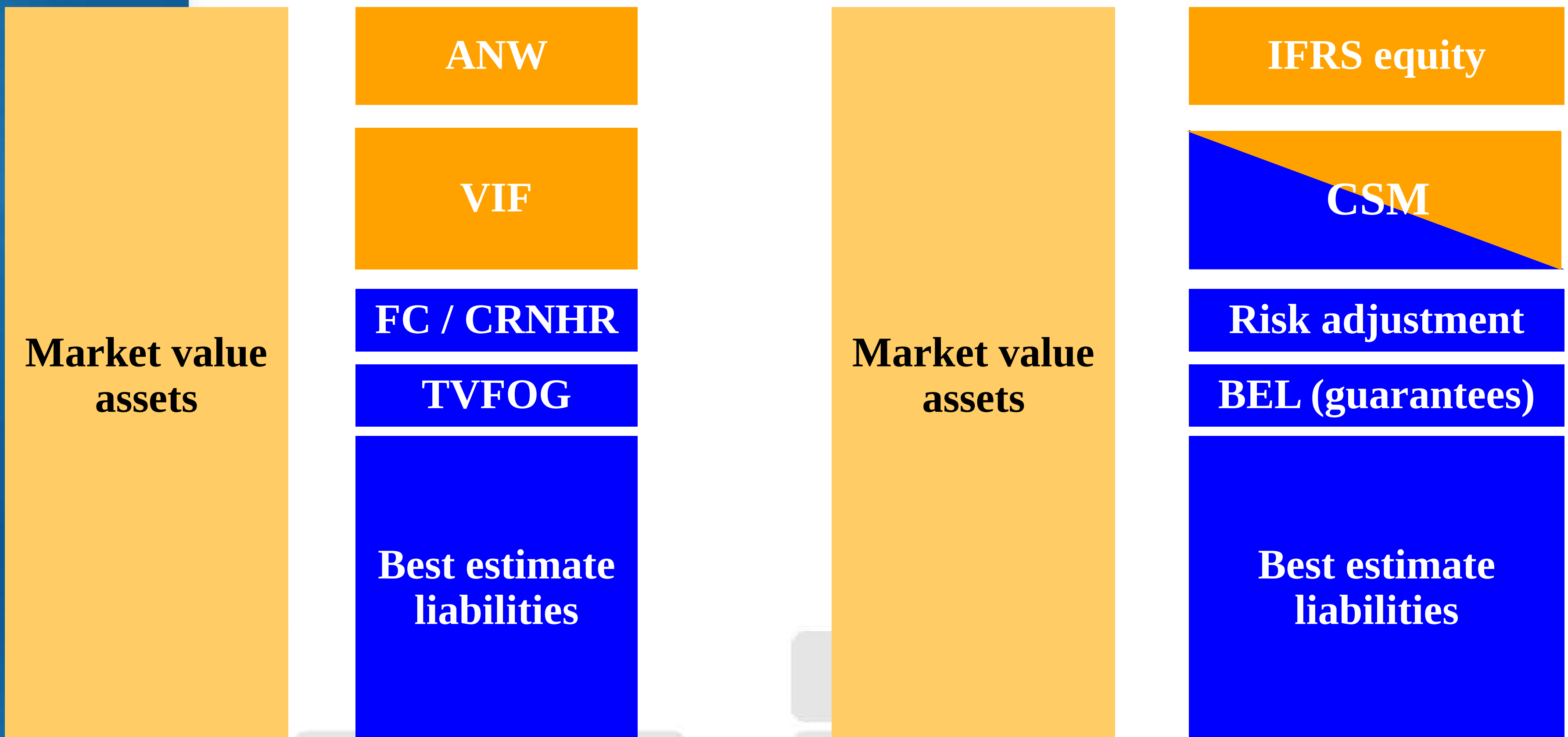
Name of insurance company			
Registration No.... Date of Registration with IRDAI			
Particulars	**Note**	**Current Year**	**Previous Year**
Assets			
Cash and cash equivalents	1		
Investments	2		
Loans	3		
Other Financial Assets	4		
Investment property	5		
Insurance contract assets	6		
Reinsurance contract assets	6		
Property, plant and equipment	7		
Goodwill	8		
Other Intangible Assets	9		
Current tax assets	-		
Deferred tax assets	-		
Other assets	10		
Assets classified as held for sale	-		
Total assets			
Liabilities			
Insurance contract liabilities	6		
Reinsurance contract liabilities	6		
Borrowings	11		
Other Financial Liabilities	12		
Current Tax Liabilities	-		
Deferred tax liabilities	-		
Other liabilities	13		
Provisions	14		
Total Liabilities (A)			
Equity			
Equity			
Share Capital			
Assigned Capital			
Financial Instruments classified as Equity			
Other Equity			
Total Equity (B)			
Total Liabilities & Equity (C)= (A) + (B)			



Balance sheet view of MCEV – and the links to Ind AS 117

MCEV ‘balance sheet’

Ind AS balance sheet



The income statement for non-participating contracts

Insurance service result

- Release of CSM and RA
- Actual vs. Expected

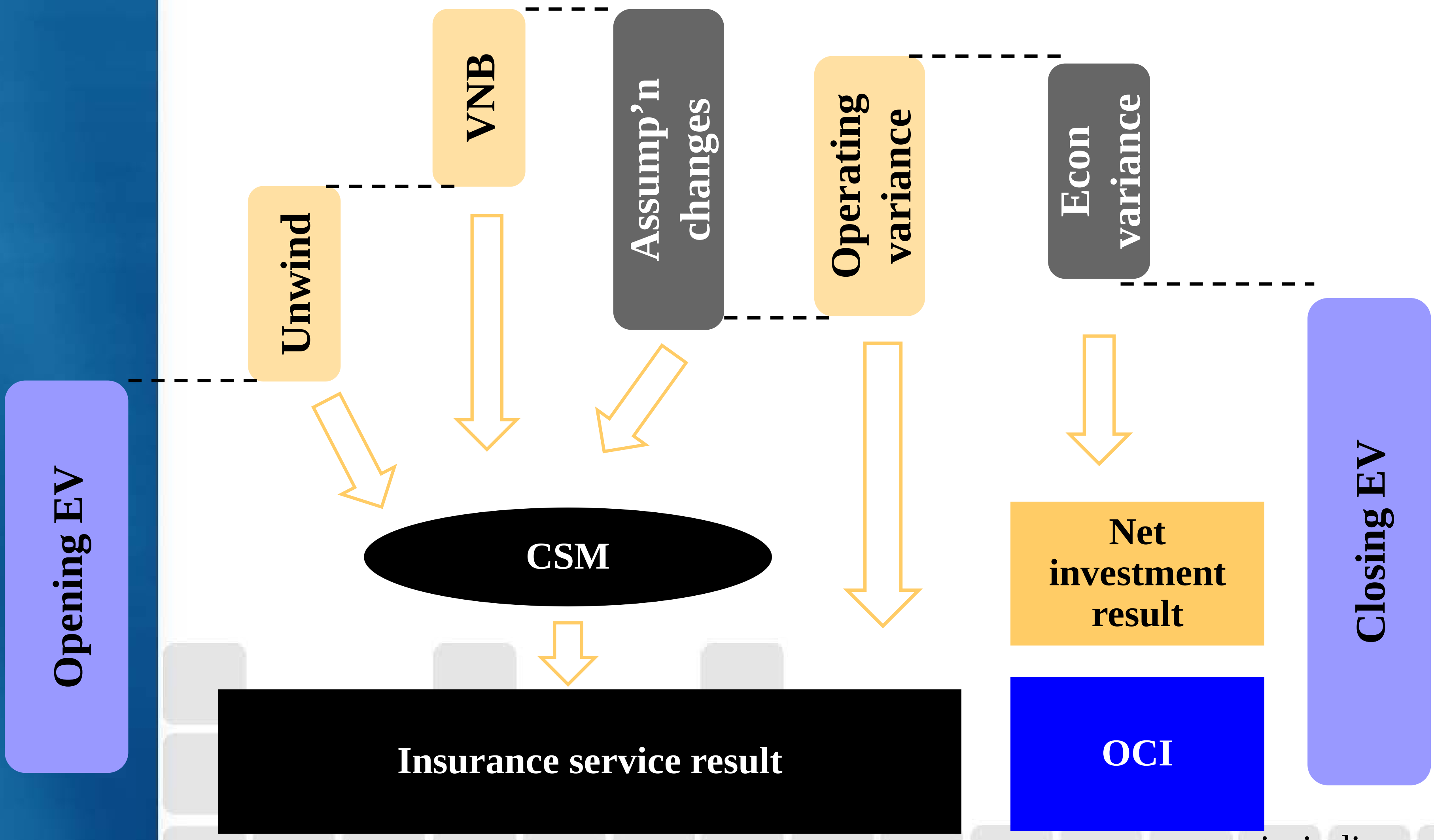
Net investment result

- Book value Investment return
- vs. locked in investment return

Other Comprehensive Income

- Asset-liability management (market value basis)

Mapping the AOM



Selection of measurement model

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Building Block Approach to valuation

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GENERAL MODEL
(aka Building Block Approach or BBA)

Default valuation approach

VARIABLE FEE APPROACH
(VFA)

Approach for contracts with direct participation features (e.g. unit-linked, with-profit contracts)

PREMIUM ALLOCATION APPROACH
(PAA)

Simplified approach for short duration contracts (coverage period up to one year)

Non-par savings

VIP

ULIPs

Short term – life health and P&C

Protection – life, health and P&C

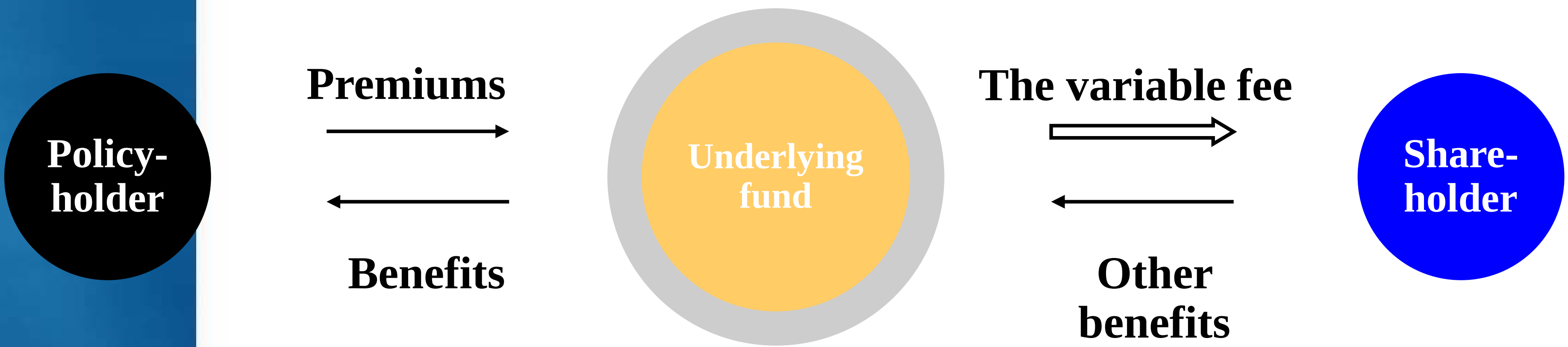
Participating

Group OYRT

Direct participation contracts

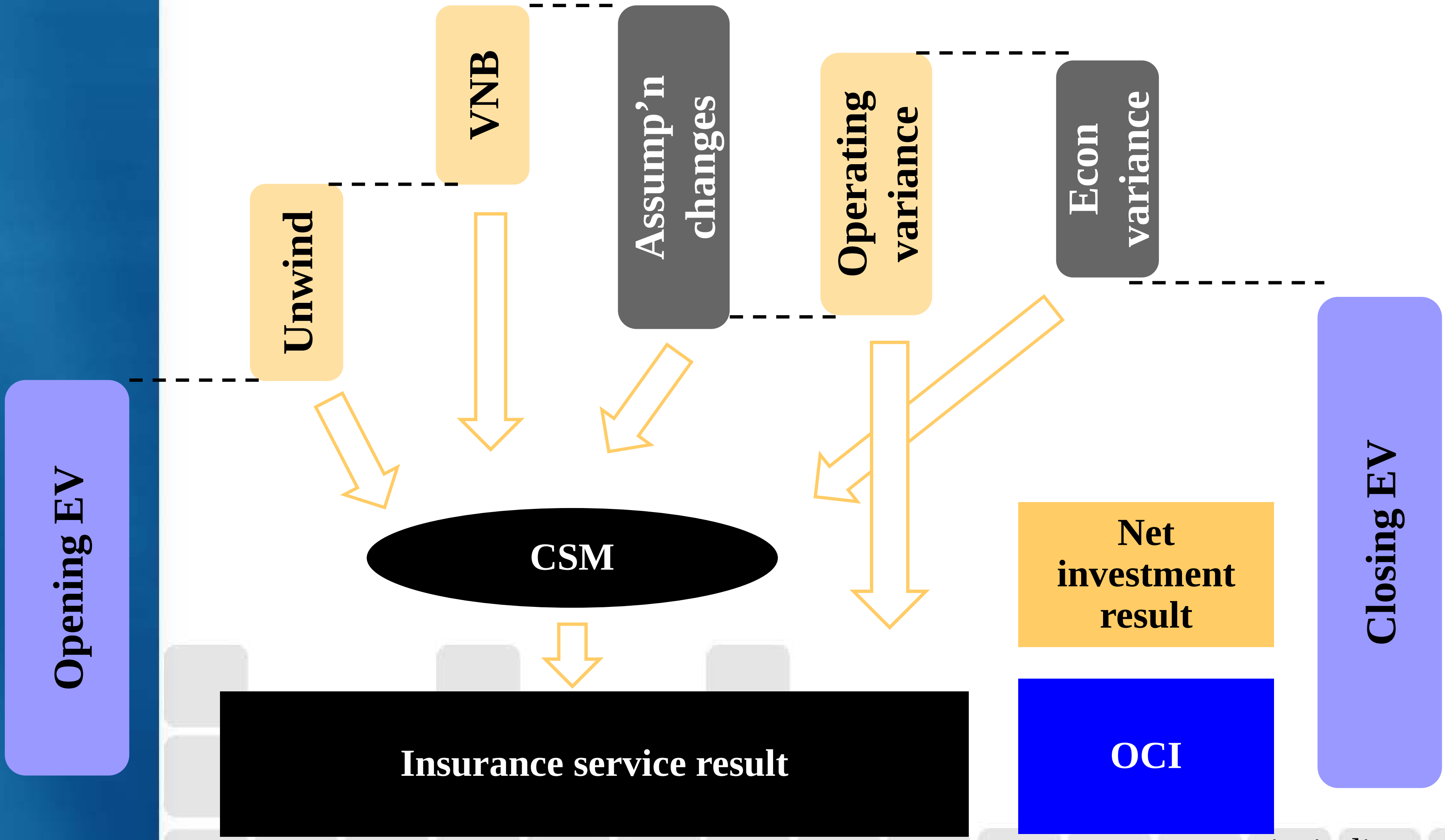
- Contract terms must specify PH to share in returns of clearly defined pool of underlying items
- Entity expects to pay PH a substantial share of FV returns on underlying items
- Entity expects a substantial portion of any change in the amounts to be paid to the PH to vary with the change in FV of the underlying items.

Variable fee approach (VFA)



For products with discretionary participation features, the policyholder’s return is substantially linked to a pool of underlying items. The insurer’s role in this product is often much more like that of a ‘manager’ of a fund, with the insurer taking a fee for providing services

Mapping the AOM - VFA



Cash flow impacts

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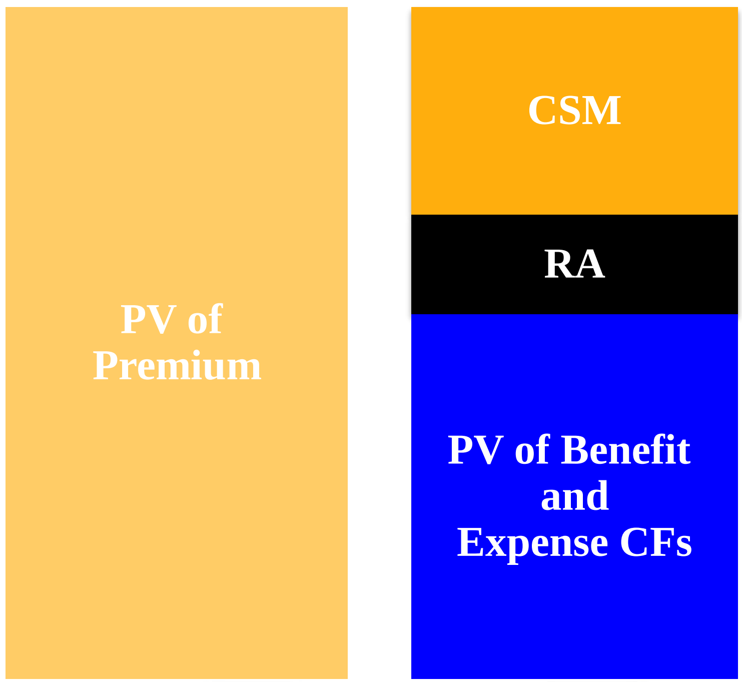
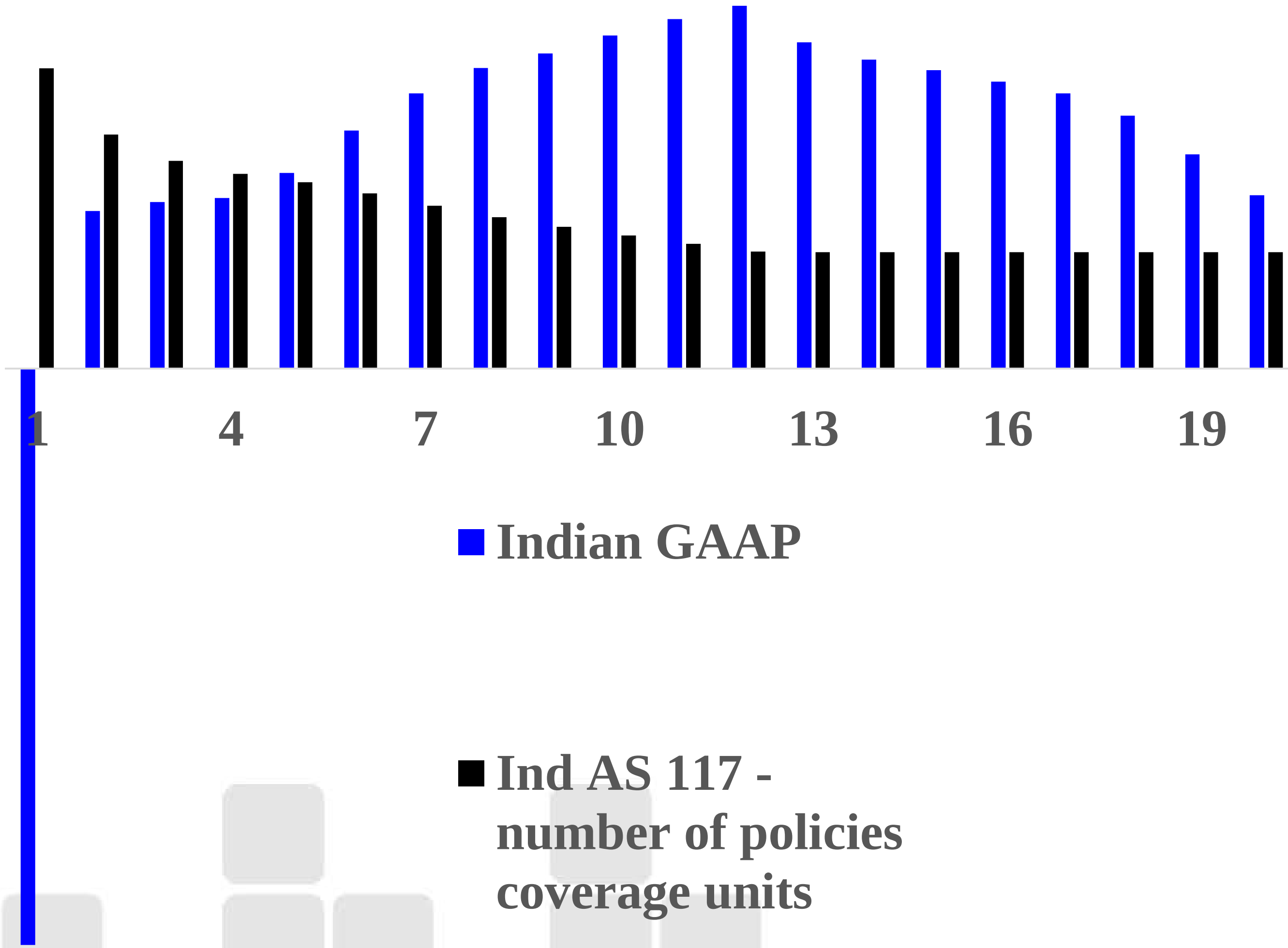
Initial calibration



- Contractual Service Margin
- Risk Adjustment
- Present Value of Best Estimate of fulfilment cash flows

Profit profile



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Actual <> Expected mortality: Impact on income statement

PROJECTION YEAR	1	2	3	4	5	6	7	8	9	10
Insurance service result	1,322	1,140	1,081	957	941	925	908	892	876	858
Net Investment result	-	-	-	-	-	-	-	-	-	-
IFRS net income	**1,322**	**1,140**	**1,081**	**957**	**941**	**925**	**908**	**892**	**876**	**858**
OCI	-	-	-	-	-	-	-	-	-	-

BASE CASE SCENARIO

Actual mortality = expected mortality

PROJECTION YEAR	1	2	3	4	5	6	7	8	9	10
Insurance service result	1,322	884	1,080	957	941	925	908	892	876	858
Net Investment result	-	-	-							
IFRS net income	**1,322**	**884**	**1,080**							
OCI	-	-	-							

- Mortality profit is worse than expected in year 2 leading to a lower Insurance service result.
- Insurance service result is slightly reduced in year 3 as actual reserve as at end of year 2 is lower than in base case scenario.

Actual mortality in year 2 = 500% expected mortality
No change in mortality assumption

PROJECTION YEAR	1	2	3	4	5	6	7	8	9	10
Insurance service result	1,322	884	971	837	816	796	774	753	731	707
Net Investment result	-	-								
IFRS net income	**1,322**	**884**								
OCI	-	-								

- No impact in year 2 in comparison with sensitivity 1 as change in mortality assumption is absorbed by the CSM.
- Insurance service result is reduced from year 3 onwards as the release in CSM is lower than in Sensitivity 2 due to lower CSM at the end of year 2 (see next slide).

Actual mortality in year 2+ = 500% expected mortality

Mortality assumption is updated

Actual <> Expected mortality: Impact on balance sheet

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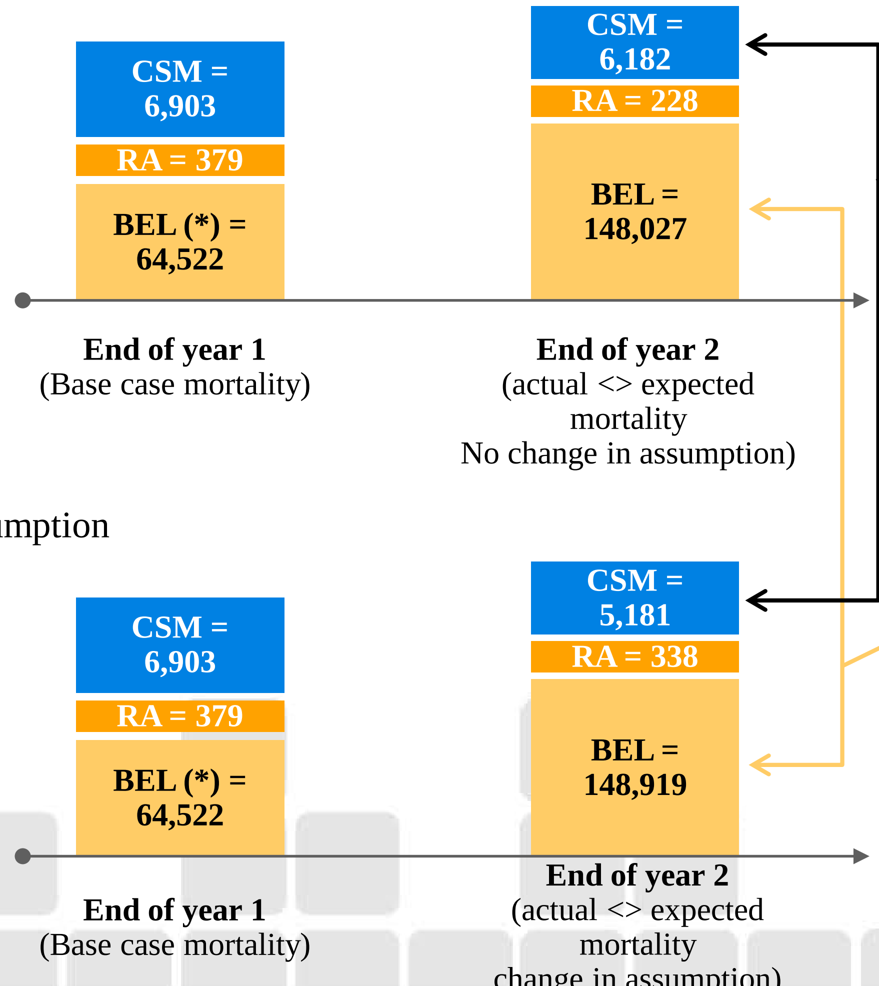
SENSITIVITY 1
No change in mortality assumption

SENSITIVITY 2
Change in mortality assumption



The CSM absorbs the increase in both BEL and RA and reduces by 1,011

As the future mortality assumption is increased from 100% to 500% of base case mortality, both BEL and RA increase (total increase is equal to 1,011)

Actual <> Expected investment income

BASE CASE SCENARIO				
YEAR	**1**	**2**	**3**	**4+**
Actual IR	4%	4%	4%	4%
Exp. IR / DR	4%	4%	4%	4%

SENSITIVITY 1				
YEAR	**1**	**2**	**3**	**4+**
Actual IR	4%	**3%**	**3%**	4%
Exp. IR / DR	4%	4%	4%	4%

SENSITIVITY 2				
YEAR	**1**	**2**	**3**	**4+**
Actual IR	4%	**3%**	**3%**	**3%**
Exp. IR / DR	4%	4%	**3%**	**3%**

Actual <> Expected investment income

PROJECTION YEAR	1	2	3	4	5	6	7	8	9	10
Insurance service result	1,322	1,140	1,081	957	941	925	908	892	876	858
Net Investment result	-	-	-	-	-	-	-	-	-	-
IFRS net income	**1,322**	**1,140**	**1,081**	**957**	**941**	**925**	**908**	**892**	**876**	**858**
OCI	-	-	-	-	-	-				

PROJECTION YEAR	1	2	3	4	5	6				
Insurance service result	1,322	1,140	1,081	957	941	925				
Net Investment result	-	(1,504)	(2,315)	-	-	-				
IFRS net income	**1,322**	**(363)**	**(1,234)**	**957**	**941**	**925**	**908**	**892**	**876**	**858**
OCI	-	-	-	-	-	-				

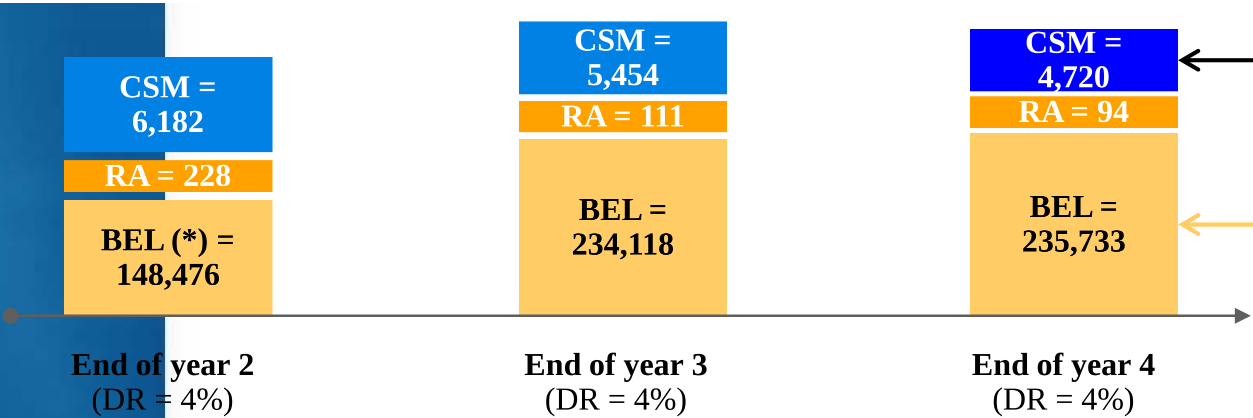
- Since the actual investment return is lower than the expected in years 2 and 3, the Net Investment result becomes negative.

PROJECTION YEAR	1	2	3	4	5	6
Insurance service result	1,322	1,140	1,081	957	941	925
Net Investment result	0	(1,504)	(2,315)	(2,442)	(2,432)	(2,423)
IFRS net income	**1,322**	**(363)**	**(1,234)**	**(1,452)**	**(1,463)**	**(1,474)**
OCI	**0**	**0**	**(14,698)**	**2,392**	**2,390**	**2,388**

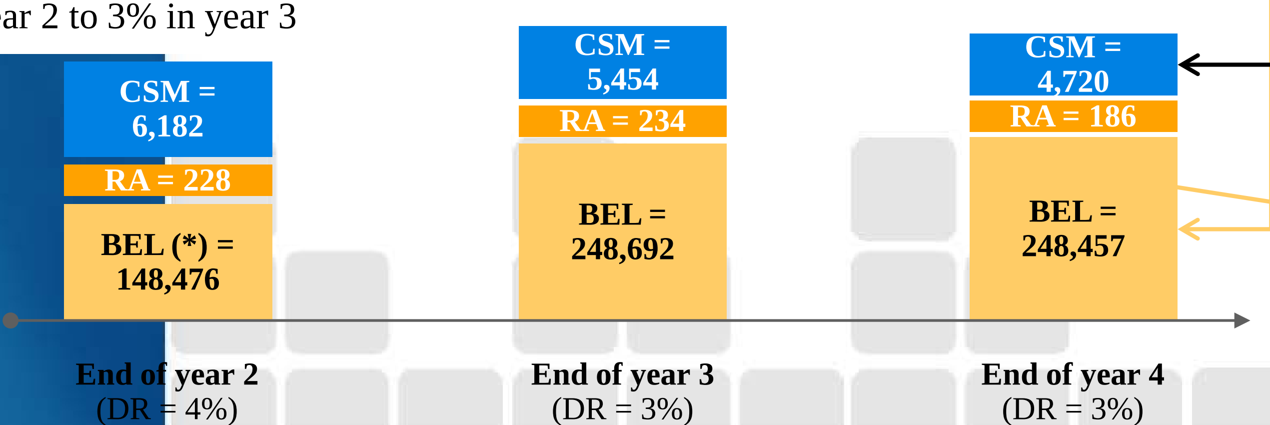
- Investment return and discount rate are updated in year 3, leading to a material negative impact on OCI in year 3.
- In practice, this negative impact would be compensated by an increase in asset value

Actual <> Expected mortality: Impact on balance sheet

BASE SCENARIO



SENSITIVITY 2
Change in discount rate from 4% in year 2 to 3% in year 3



CSM remains unchanged as based on the locked-in discount rate at inception.

In other words, the short term volatility caused by changes in discount rate is presented in the OCI.

BEL and RA increase due to decrease in discount rate

Interesting impacts of onerous contracts

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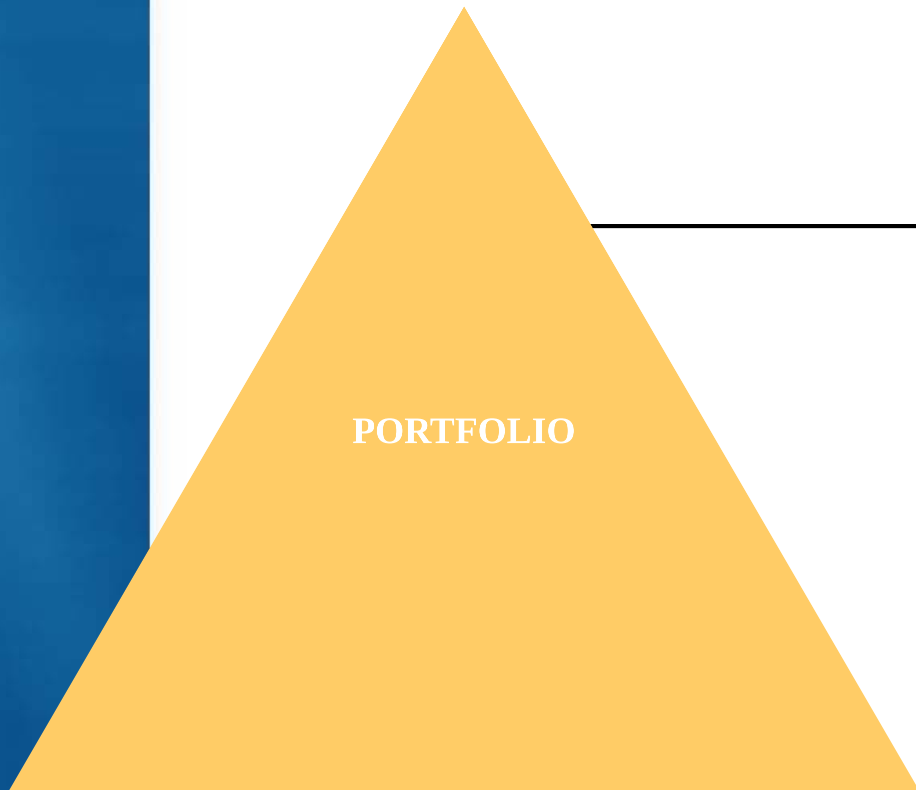
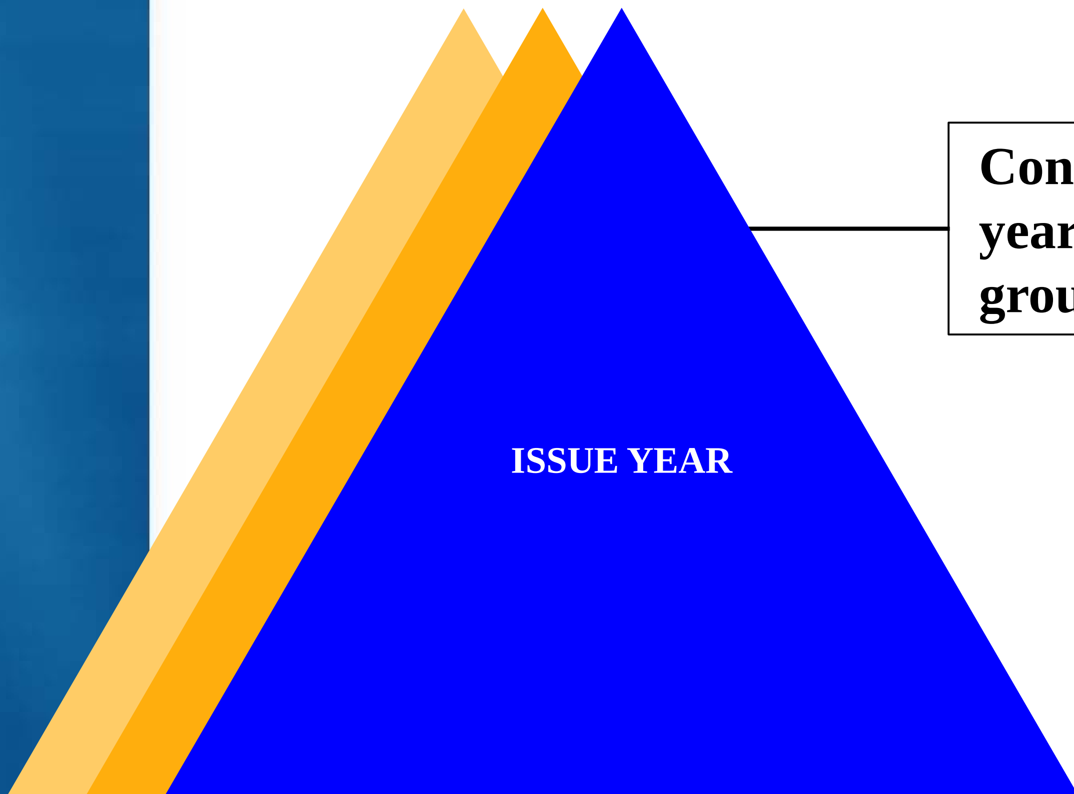
Level of aggregation



Contracts that are subject to similar risks and managed together

Level of aggregation – yearly cohorts



Contracts issued more than 1 year apart cannot be in same group

Level of aggregation – minimum grouping

1. Onerous

2. Profitable

3. Might become onerous

Exception
If there is a legal or regulatory restriction on entity's ability to reprice the product, then you can include in same group – for example PMJJBY?

Groups of contracts are the unit of measurement used in Ind AS 117

Impact of onerous contracts – simple example

	NB Premium	VNB margin	VNB	CSM	First year CSM recognition	First year P&L
Total	**1000**	**9.0%**	**90**	**90**	**10%**	**9**
ULIP	500	-5%	-25	0	N/A	-25
Par	300	5%	15	15	10%	1.5
Non-par	200	50%	100	100	10%	10
Revised total	**1000**	**9.0%**	**90**	**115**		**-13.5**