

2nd Capacity Building Seminar on IFRS 17
Hotel Sea Princess, Mumbai
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Ind-AS-117 Transition – Fair Value Measurement Approach

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Agenda



A) IFRS 17 – Fair value approach for Transition

- Transition Date and Overview
- Permitted modification for FV
- Retrospective Vs Fair Value approach

B) Introduction to IFRS 13

- Definition
- Framework
- Input Hierarchy
- Measurement techniques

C) Practical issues in applying IFRS 13 for Fair value calculations

- CSM under fair value approach
- Disclosures

IFRS 17 – Fair value approach for Transition

Applying IFRS 17 for the first time



Global - 01 Jan 2021

Global -01 Jan 2022

India - 01 Apr 2019

India - 01 Apr 2020*

Transition date

Beginning of the annual reporting period immediately preceding the date of initial application

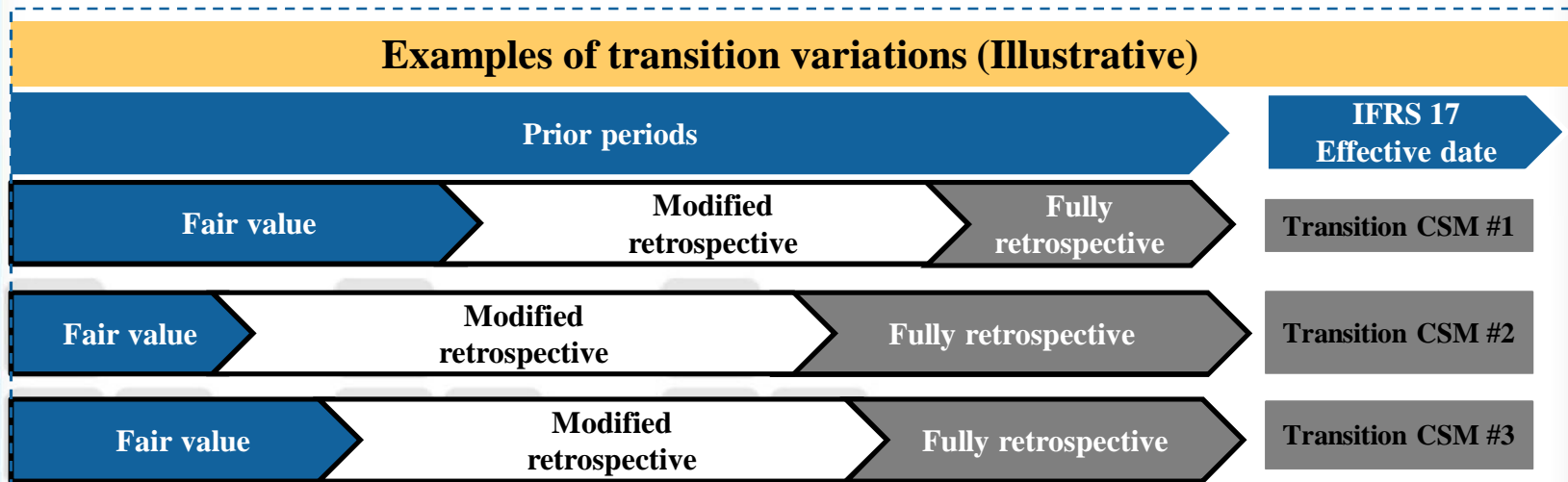
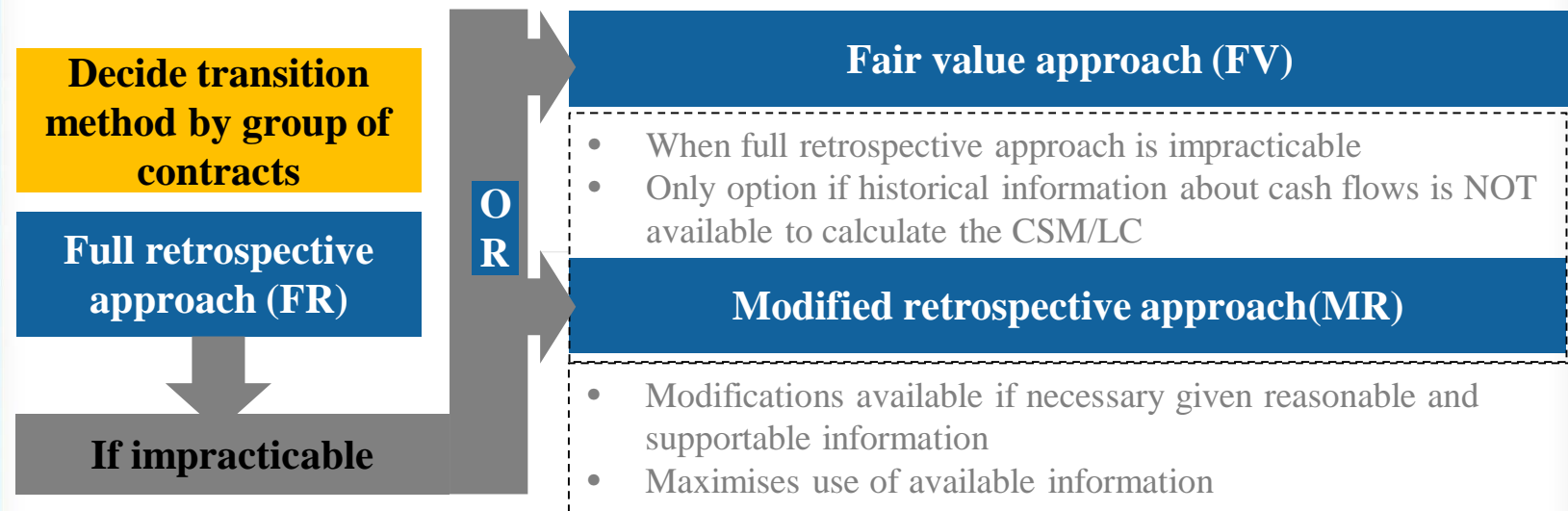
Date of initial application

Beginning of the annual reporting period in which an entity first applies IFRS 17

*** Initial Application date in India is uncertain as it stands today**

IFRS 17 – Fair value approach for Transition

Transition - Overview



IFRS 17 – Fair value approach for Transition

Modifications permitted for fair value approach



Following determinations may be **applied at transition date** rather than **inception date**, if **sufficient information** is **not available at inception date**

Grouping of Contracts

Identification and grouping of insurance contracts based on “similar risks and managed together” and “Profitability” based on information at transition date

Measurement model

Determination of whether an insurance contract is eligible to use the VFA based on information at transition date

Discount rate

Determination of Discount rates at the transition date and lock them for future use

Yearly cohorting

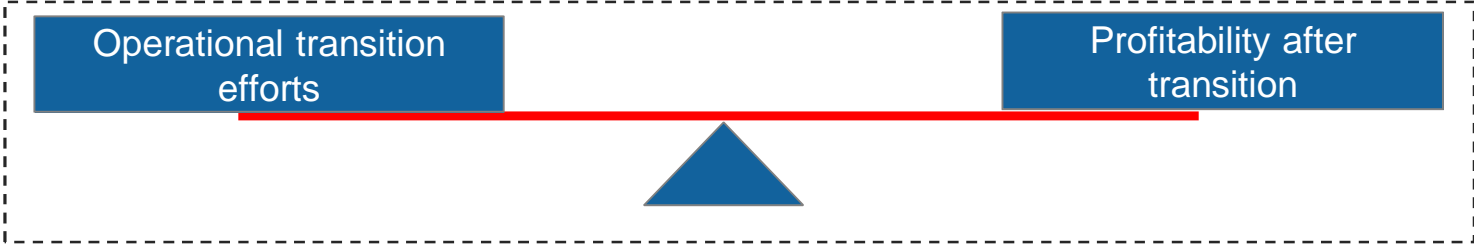
Grouping together contracts that are more than one year apart

IFRS 17 – Fair value approach for Transition

Retrospective vs Fair Value approach



Challenge is to find an optimised approach



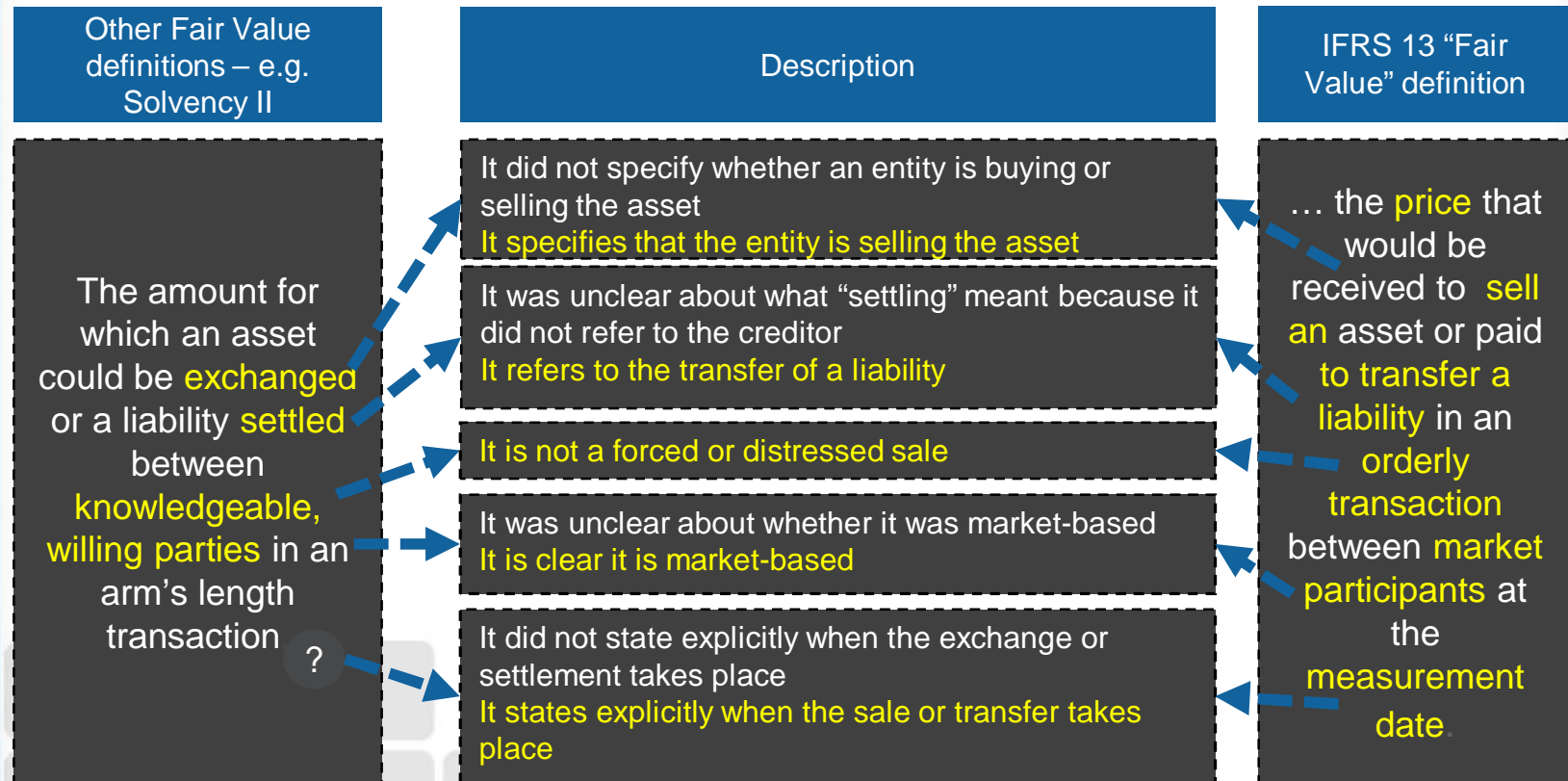
	Retrospective Approach	Modified Retrospective Approach	Fair Value Approach
Principles / Judgement	Least Complex	Less Complex	Complex
Application	Most Difficult	Less Difficult	Least Difficult
Relative value of CSM	Highest	Can't Say	Least
OCI and Loss component at balance sheet date	OCI and Loss component Built up		OCI can be accumulated or set to zero

Introduction to IFRS 13

Fair Value approach - Definition

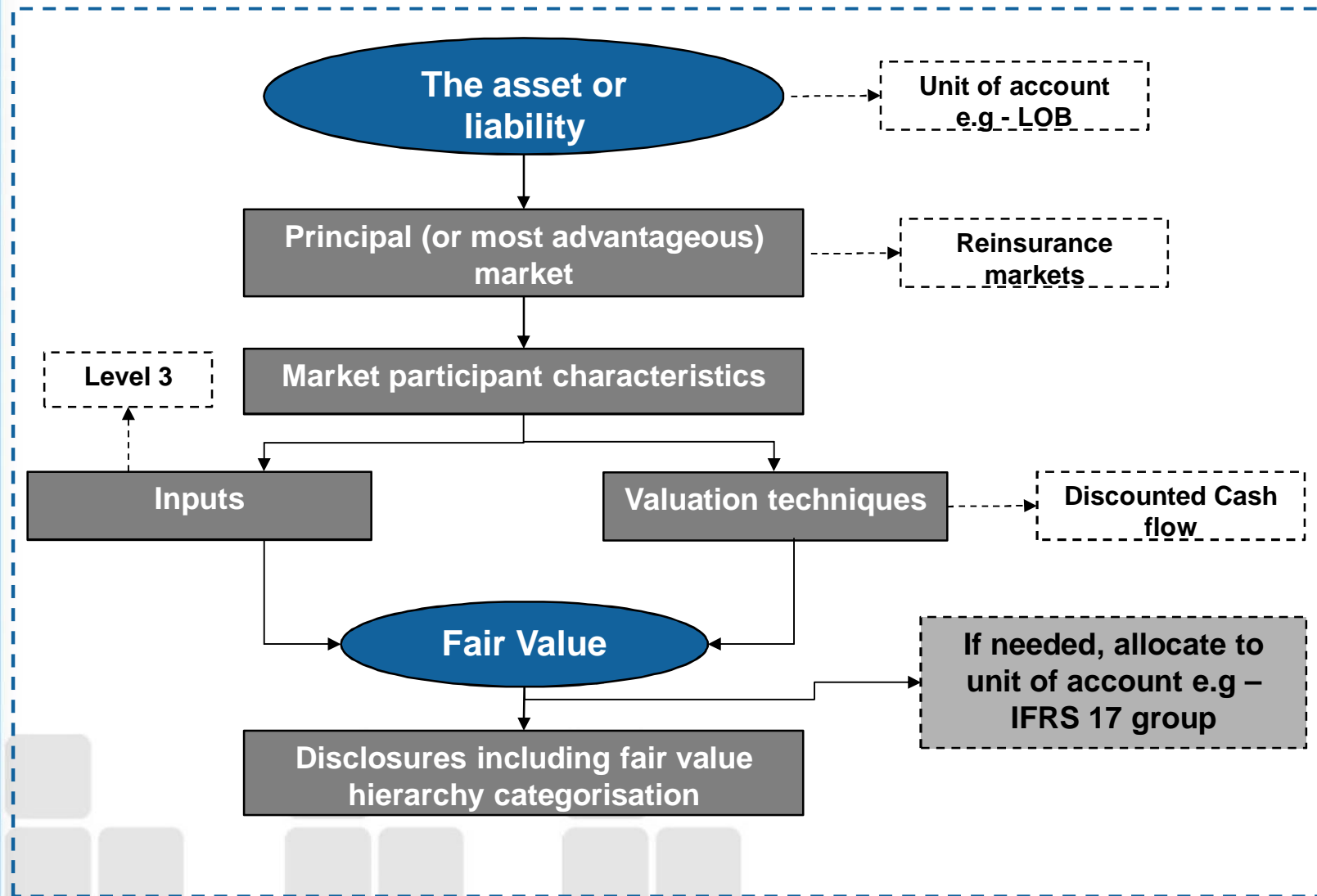


- Definition – IFRS 13 defines fair value as ‘the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date
- Fair Value = as determined by IFRS 13 (**‘exit price on going concern basis’**)



Introduction to IFRS 13

FV measurement framework (Only IFRS 17)



Introduction to IFRS 13

Input Hierarchy



	Level 1	Level 2	Level 3
Definition	Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly	Unobservable inputs to valuation techniques

- ▶ IFRS 13 does **not specify the measurement model** to use but requires to:
 - ▶ **Maximize the use of level 1 inputs (i.e. Directly observable inputs)**
 - ▶ **Minimize the use of Level 3 inputs**
- ▶ For disclosure purposes, the fair value measurement must be categorized in its entirety based on the **lowest level input** that is **significant** to the entire measurement
- ▶ Fair value measurement of insurance contracts would usually require level 3 inputs; specially with respect to non markets variables.
- ▶ Likely to be characterized as **level 3**

Introduction to IFRS 13

Measurement Techniques



Market Approach (Price and other relevant information)

- Transaction price paid for an identical or a similar instrument
- Comparable company valuation multiples
- Prices for insurance contracts are rarely observable
- Secondary markets for insurance products exist in UK
- But do not exist in developing markets
- Fair value of insurance contracts needs to be estimated

Income Approach (Discounted future cash flows)

- **Discounted cash flow method (DCF) – Consistent with IFRS 17 FCF measurement**
- Dividend discount model
- Option Pricing models
- The fair value of a group of insurance contracts can be seen as the fulfilment cashflows adjusted to take into account the perspective of market participants (i.e. move to an exit price)
- **Fair value = $BEL_{MP} + RA_{MP} + \text{adjustments}$**
- **CSM/LC = Fair Value – $BEL_{IFRS17} - RA_{IFRS17}$**

Cost Approach

- Replacement Cost of asset
- Amount that would be required currently to replace the service capacity of an asset
- This method is not applicable to insurance liability valuation

Introduction to IFRS 13

Measurement Techniques – when there is no replicating asset



Two possible ways to approach it:

1. Use the future cash flows that a **market participant** would expect to **incur in fulfilling the obligation**, including the **compensation** that a market participant would require for taking on the obligation.

Such compensation includes:

- the cost to **fulfil** the **obligation** plus a return for undertaking the activity; and
- a **risk premium** to compensate for the risk that **actual** cash flows might **differ** from **expected** cash flows.

2. Use the amount that a market participant would receive to **enter into** or **issue** an **identical liability** or **equity instrument**

Practical issues in applying IFRS 13 for Fair value calculations of Insurance Liabilities- 1/3



Requirements - IFRS 13

The price is based on a hypothetical transaction in the principal market /most advantageous market

An estimate of future cash flows for the asset or liability

Market participant's expectations about possible variations in the amount and timing of the cash flows- representing the uncertainty and including diversification benefit

Notes / allowance as per IFRS 17

Market participants are limited to other **insurers/reinsurers** that would be able to complete a transaction

GPV + adjustment to **expense assumptions** and **cashflows outside IFRS 17 contract boundaries** to reflect the view of market participants

Market participant will have a different view of uncertainty-
Different Risk Adjustments

Practical issues in applying IFRS 13 for Fair value calculations of Insurance Liabilities- 2/3



Requirements - IFRS 13

Discount rates consistent with nature and timing of contract's cash flows

Include compensation that a market participant would require for taking on the obligation

Apply demand deposit floor on the fair value of financial liabilities

Notes/ allowance as per IFRS 17

IFRS 17 discount rates adjusted for

- entity's **own credit risk**
- market participant view in **illiquidity premium**.

Allowance for **shareholder required returns on backing capital**

IFRS 17 does **not require demand deposit floor** to apply when calculating fair value

Practical issues in applying IFRS 13 for Fair value calculations of Insurance Liabilities- 3/3



Requirements - IFRS 13

When price is not observable, measure fair value using other valuation techniques

Notes/ allowance as per IFRS 17

Embedded value gives the combined fair value of assets and liabilities

Suitable for - Business combinations

Not Suitable for transition - we need only fair value of liability

CSM under Fair Value Approach

Fulfilment Cashflow (FCF) = Best Estimate Liability (BEL) + Risk Adjustment (RA)

Fair Value (FV) = BEL* + RA* + Cost of Capital (CoC)

CSM = FV – FCF ~ CoC

* Adjusted

Additional Disclosures required by IFRS 13



Contracts under scope of IFRS 13

Separate disclosures are required for insurance contracts to which the fair value approach was applied at transition

Modifications adopted

What transition modifications were used for fair value measurement at transition date

Measurements models

Explain how insurance contracts were measured at the transition date

Initial and subsequent measurement

Fair value measurement takes place **at transition date only** and therefore the disclosure requirements may have limited applicability.

Thank you