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Insurance

Ind AS- The road ahead

October 2016

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IFRS Convergence in India: A quick recap

Previous plan – 1 April 2011

Finance minister's speech in July 2014

January 2015 – press release on revised roadmap issued by the MCA; phase wise implementation proposed

February 2015 – roadmap for transition to Ind AS notified and 39 converged (final) standards issued

Banks, NBFCs and Insurance companies will apply Ind AS from 2018-19 with comparatives for 2017-18

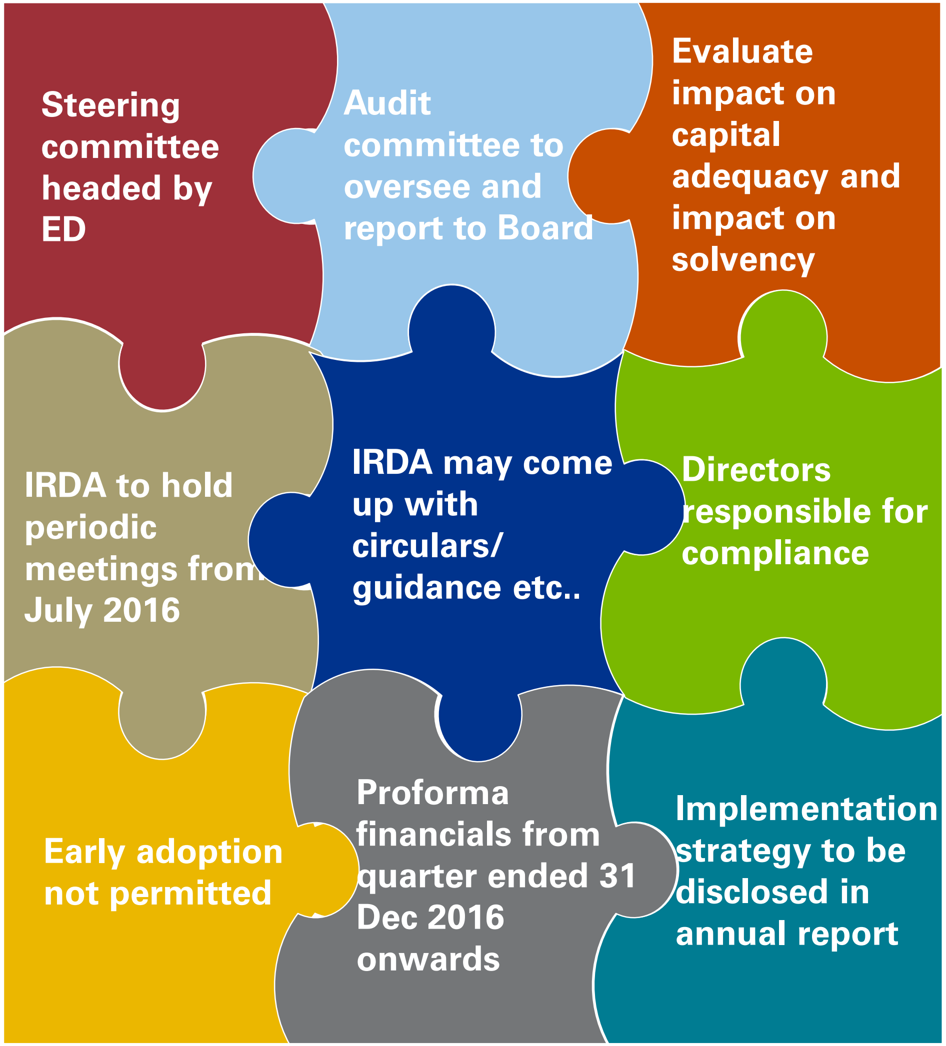
While voluntary early adoption is possible for other companies, it is not permitted for banks, NBFCs or insurance companies

Setting the context ... key takeaway's from IRDA circular

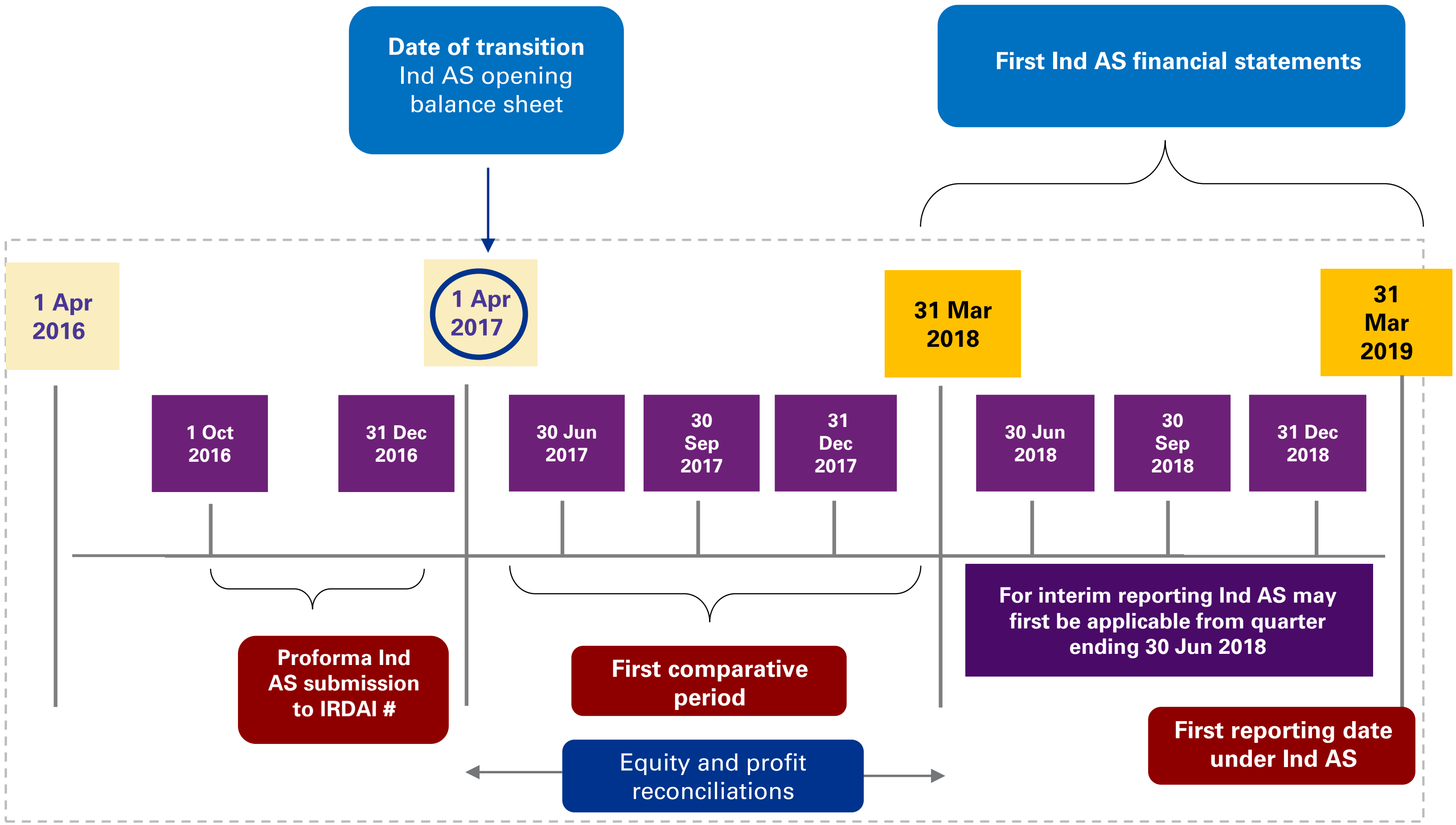
IRDA, vide notification dated 1 March 2016, has advised that Insurance companies should follow Ind AS.

Date of transition

1 April 2017

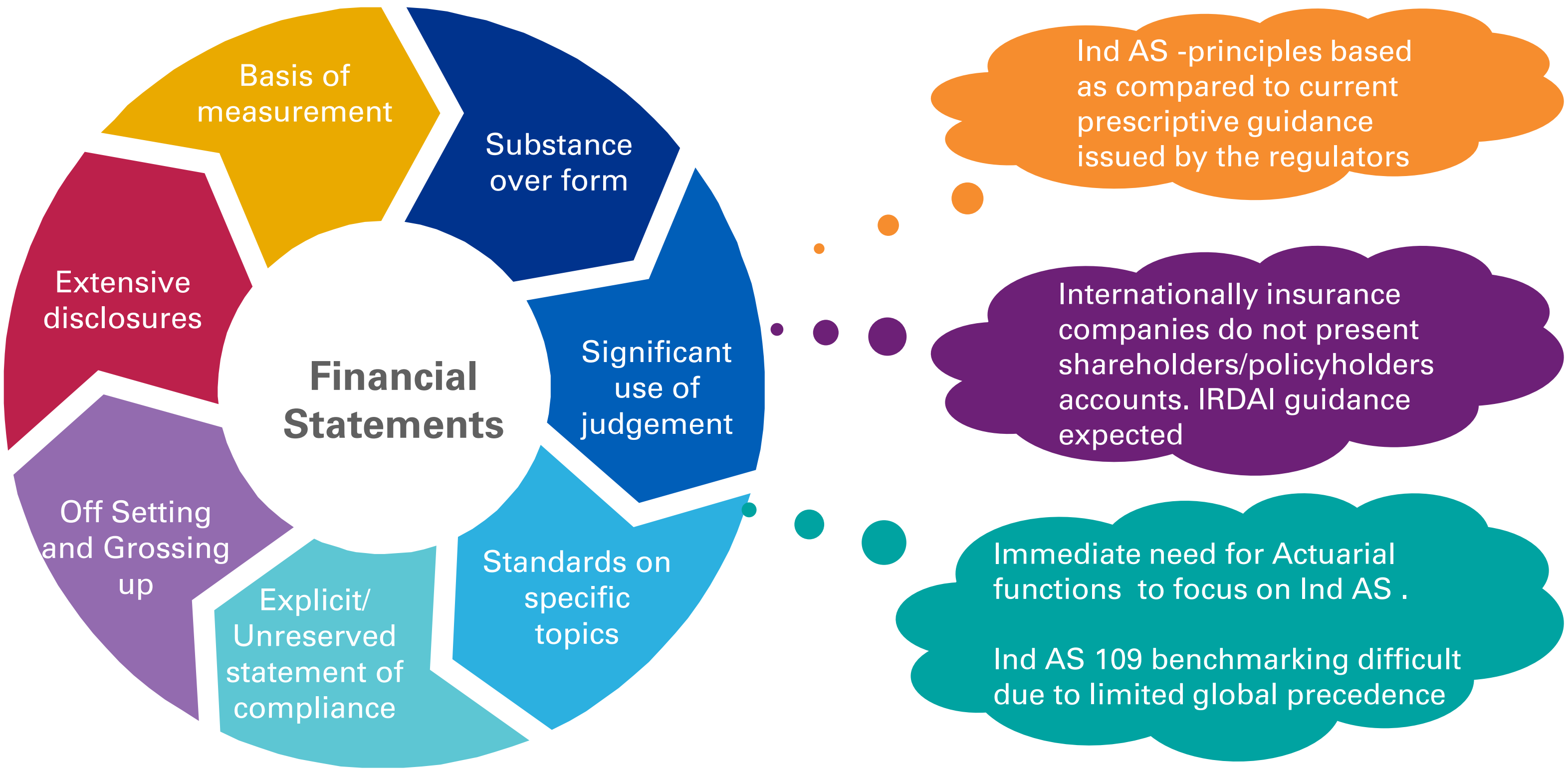


First time implementation: Timeline



 # Based on IRDA circular dated 1 Mar 2016

Ind AS is conceptually different



Key Ind AS differences

Insurance Contracts (Ind AS 104)

- Classification of Insurance/Investment Contract
- Unbundling of Cash-flows
- Grossing up of Reinsurance Assets
- Recognition of global reserves
- Deferred Acquisition Cost
- Embedded Derivative, Liability Adequacy Test

Financial Instruments (Ind AS 109 and Ind AS 113)

- Business Model Assessment
- Classification of Investments
- Impairment of Financial assets
- Fair valuation of investments

Other areas

- Segment reporting (Ind AS 108)
- ESOP (Ind AS 102)
- Leases (Ind AS 17)
- Presentation of financial statements (Ind AS 1)
- First time adoption choices (Ind AS 101)
- Disclosures

Classification and measurement of financial assets (1/3)

Indian GAAP
- Short term investments
- Long term investments

→

Ind AS
- Amortised Cost
- Fair Value through OCI (FVOCI)
- Fair Valued through P&L (FVTPL)

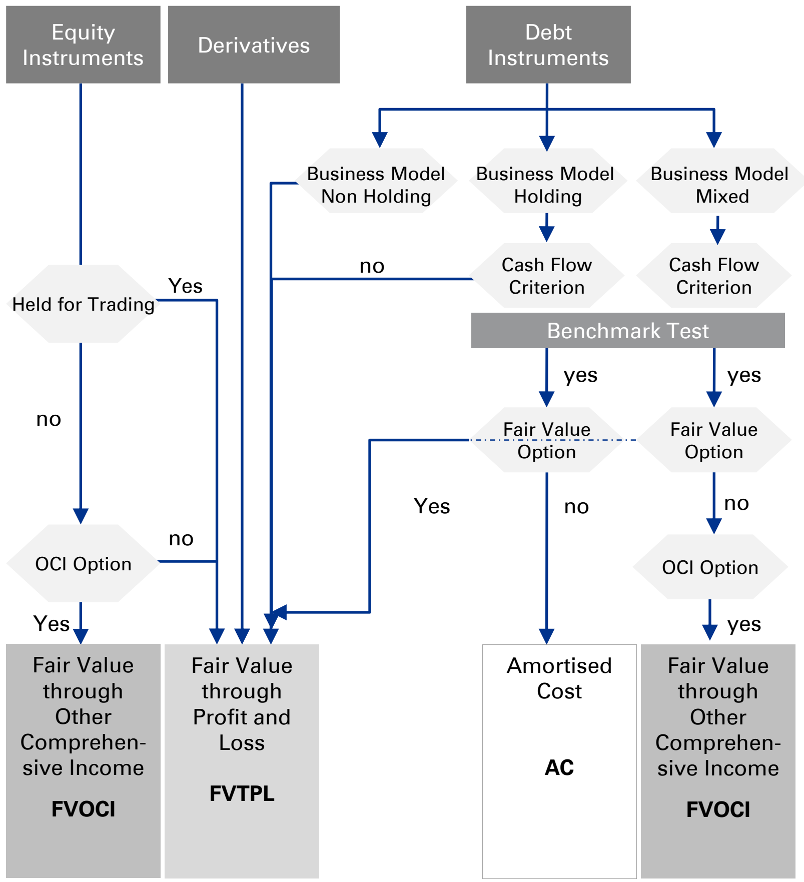
Ind AS 109 classification driven by…

Business Model	Contractual cash flows assessment- SPPI test

Reclassification permitted only in case of change in business model, expected to be rare in practice

Classification and measurement of financial assets (2/3)

Classification of financial instruments on the asset side



Key Considerations

- **Significant level of judgement** in the determination of the business model classification
- Business Model Assessment- **Business model to be approved by the KMP**
- Criterion of Sole Payments of Principal and Interest (SPPI), Held to Collect (HTC) to be evaluated
- **Mixed business model may require more securities being carried at FVOCI, possible examples include:**
  - matching duration of assets & liabilities such that the cash flows from the assets are sufficient to meet the liabilities
  - liquidity requirement to pay off any claims
  - earning returns to pay bonus to shareholder and policyholders
  - Maintaining solvency position of the Company
- **Core 'held to maturity' portfolio to be identified for amortised cost classification**

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Classification and measurement of financial assets (3/3)

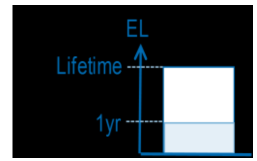
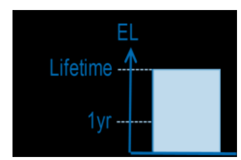
Type of Investment	Valuation under Indian GAAP	Indicative Classification under Ind AS*
Government securities	Amortised Cost	FVOCI-debt / Amortised cost
Treasury Bills	Amortised Cost	FVOCI-debt / Amortised cost
Non-convertible debentures	Amortised Cost	FVOCI-debt / Amortised cost
Equity	Fair value	FVTPL
Preference shares	Fair value	FVTPL
Mutual Funds	Fair value	FVTPL
Fixed Deposit	Amortised Cost	Amortised cost
CBLO	Amortised Cost	Amortised cost
ULIP	Fair value	Fair value

** Indicative, based on business model assessment by each company*

Key Considerations

- **Possible mismatch-** debt instruments may be carried at fair value through OCI and changes in valuation of related liabilities are carried through profit and loss account
- **Straightline amortisation** of premium / discount **not acceptable** under Ind AS
- Criterion of Sole Payments of Principal and Interest (SPPI), Held to Collect (HTC) to be evaluated
- Initial recognition to be at fair value, irrespective of business model
- **Amendments of IT systems** and processes required to provide additional information product features as basis for classification and measurement

Impairment of financial instruments (1/2)

Stage allocation / Transfer criterion	Measurement (EL recognition)	Interest revenue
Stage1: Financial instruments without significant increase in credit risk ■ Instruments (including sub-prime) upon initial recognition irrespective of their credit quality	**Recognition of 1yr EL**  	Contractual effective interest rate (EIR) **based on the gross carrying amount**
Transfer out of Stage 1 / Return		
Stage 2: Financial instruments with significant increase in credit risk ■ Significant increase in the risk of default (may be measured as PD) since initial recognition ■ Financial instruments with low credit risk at the reporting date may be allocated into Stage 1 ("low credit risk exception") ■ Measure for assessment is generally Lt-PD	**Recognition of EL for the remaining life of the instrument (Lifetime EL)**  	
Transfer into Stage 3 / Return		
Stage 3: Credit-impaired financial asses ■ Events with a detrimental impact on estimated future cash flows have occurred		EIR **based on amortised cost (i.e. net of loss allowance)**

Impairment of financial instruments (2/2)

Key considerations

1

- Impairment provision under Ind AS 109 based on expected loss model
- Possible impact on capital
- Higher degree of volatility in provisioning depending on use of 12 month or lifetime expected loss

2

- Need to consider leading economic indicators in your PD, LGD and EAD models
- Models to be sensitive enough to ensure that variables that may trigger impairment are identified

4

- Possible impact of Ind AS 109 on the governance frameworks
- Need to ensure that the required controls are in place and operating effectively

3

- Systems to have the data required for Ind AS109’s modelling and disclosure requirements
- Processes and data sources to be identified for collection, cleansing, and integration of data in accounting and reporting systems

Financial instruments: presentation and disclosures

- **Nature and extent of risks arising from financial instruments-** credit risk, liquidity risk and market risk
  - Entity's objectives, policies and processes for managing the risk
  - Methods used to measure the risk

- **Credit risk disclosures**
  - Information about credit quality of assets neither past due nor impaired
  - Analysis of age of financial assets that are either past due or impaired
  - Information about collateral

- **Liquidity risk**
  - Maturity analysis for financial liabilities based on remaining contractual maturities

- **Market risk**
  - Sensitivity analysis showing how profit or loss and equity would have been affected by changes in the relevant risk variable

Financial instruments: presentation and disclosures

Fair valuation and fair value related hierarchy disclosures

- Fair value for **each class** along with the carrying amount
- Methods used to arrive at fair value and key assumptions used

Fair value hierarchical disclosures

- Level 1: unadjusted quoted prices in active markets for identical assets or liabilities
- Level 2: Inputs other than the quoted price included in level 1 that are observable either directly or indirectly
- Level 3: Unobservable inputs

Financial statement presentation and disclosures

- Restrictions on offsetting of assets and liabilities for reinsurance assets, may result in grossing up of assets and liabilities in certain cases

What will change in practice for you

Complexity of computation

Data requirements

Volatility

Increased use of estimates and fair value

Thank You

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Ahmedabad
Commerce House V, 9th Floor, 902
& 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23
1st floor. Sector 8 C
Madhya Marg
Chandigarh 160019
Tel : 0172 3935778
Fax 0172 3935780

Chennai
No. 10, Mahatma Gandhi Road,
Nungambakam,
Chennai 600 034
Tel +91 40 3914 5000
Fax +91 40 3914 5999

Delhi NCR
Building No.10,
Tower B, 8th Floor,
DLF Cyber City, Phase – II
Gurgaon 122002 Haryana
Tel +91 124 3074000
Fax +91 124 2549101

Hyderabad
8-2-618/2
Reliance Humsafar,
4th Floor
Road No. 11, Banjara Hills
Hyderabad 500 034
Tel +91 40 6630 5000
Fax +91 40 6630 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Infinity Benchmark, Plot No.G-1,
10th floor, Block - EP & GP,
Sector - V, Salt Lake City
Kolkata 700091
Tel: +91 33 44034066
Fax: +91 33 4403 4199

Mumbai
Lodha Excelus, 1st Floor,
Apollo Mills Compound,
N.M. Joshi Marg, Mahalakshmi,
Mumbai 400 011
Tel +9122 39896000
Fax +91 22 39836000

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3058 5764/ 65
Fax: +91 20 30585775