

5th Capacity Building Seminar on IFRS 17

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Ind AS 109 and 117 choices and implications

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About the speakers



Keyur Parekh is a Consulting Actuary in the Indian Life Insurance practice and is based in Mumbai. He supports on projects in India and the Asia-Pacific region. Keyur is a Fellow Actuary and a qualified Chartered Accountant.

He has more than 14 years of experience in the life insurance industry across statutory reporting (valuation, solvency, experience analysis, assumptions setting, with profit management, regulatory submissions), business & capital planning, product pricing and Prophet modelling. At Milliman, he works closely with clients in the areas of IFRS, embedded values, capital frameworks, deal advisory and modelling.

Keyur is currently a member of the Life Insurance Advisory Group of the Institute of Actuaries of India.



Pratik Haria is Assistant Vice President at Tata AIA Life Insurance, leading the Financial Reporting team. Having 15 years of experience, including 7+ years in IFRS, he worked at EY, advising Indian and global insurance clients, and began his career at CRISIL as an Equity Research Analyst focused on accounting and tax. His expertise spans life, general, and reinsurance domains. He is a Chartered Accountant and has cleared all CFA levels. Outside work, Pratik is a proud father of two and enjoys exploring new places with his family. His blend of technical depth and industry insight makes him a trusted leader in insurance finance.

About the speakers



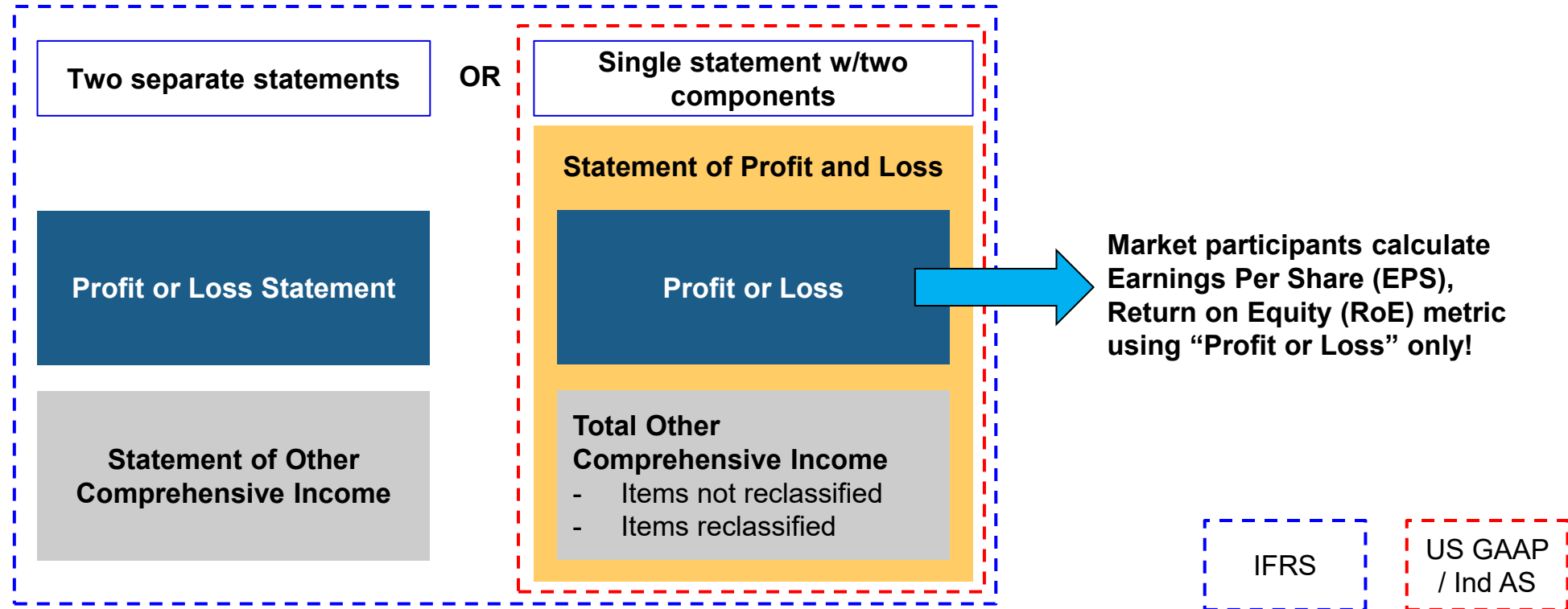
Agenda

- P&L and OCI – Two sides of the same coin?
- Classification, measurement & re-classification of financial assets under Ind AS 109
- Hedging & its accounting implications
- Ind AS 117 – Insurance contract liability and IFIE
- Interplay of Ind AS 109 & Ind AS 117 – GMM

P&L and OCI – Two sides of the same coin?



P&L and OCI – Two sides of the same coin? (1/2)



- OCI was introduced to capture non-core operational earnings from other gains/losses which are unrealized and arise due market driven factors or actuarial adjustments.
- Most of the international life insurers present OCI as a separate statement and DO NOT include it in their EPS calculations

P&L and OCI – Two sides of the same coin? (2/2)

Summary of the components of OCI with and without recycling:

Items recycled to P&L upon realisation

- Effective portion of gains or losses:
 - On hedge of net investment in foreign operation
 - On hedging instruments in a cash flow hedge
- Gains / losses on debt securities at FVOCI
- Gains / losses on translating financial statements of foreign operations (i.e. *pseudo* forex gain/loss)
- Changes in the value of time value of options¹
- Changes in the value of forward element of forward contracts²



Rationale:

- Temporary nature;
- Neutralizes future P&L through its linkage to future income / expenses that will reflect in P&L

Items **NOT** recycled to P&L upon realisation

- Changes in revaluation surplus accumulated by:
 - Revaluation of property, plant & equipment
 - Revaluation of intangible assets
- Remeasurements of defined benefit plans
- Gains / losses on equity securities at FVOCI
- Gains / losses on hedging instruments (i.e. *equity derivatives*) that hedge investment in equity securities at FVOCI
- Gains / losses arising from change in value of financial liabilities arising from change in entity's own credit risk



Rationale:

- Strategic / permanent nature;
- Restrictive basis adopted v/s IAS 39 requirements (i.e. to avoid another 2008-09 financial crisis)

¹ when separating the intrinsic value and time value of an option and designating as a hedge instrument only the change in intrinsic value

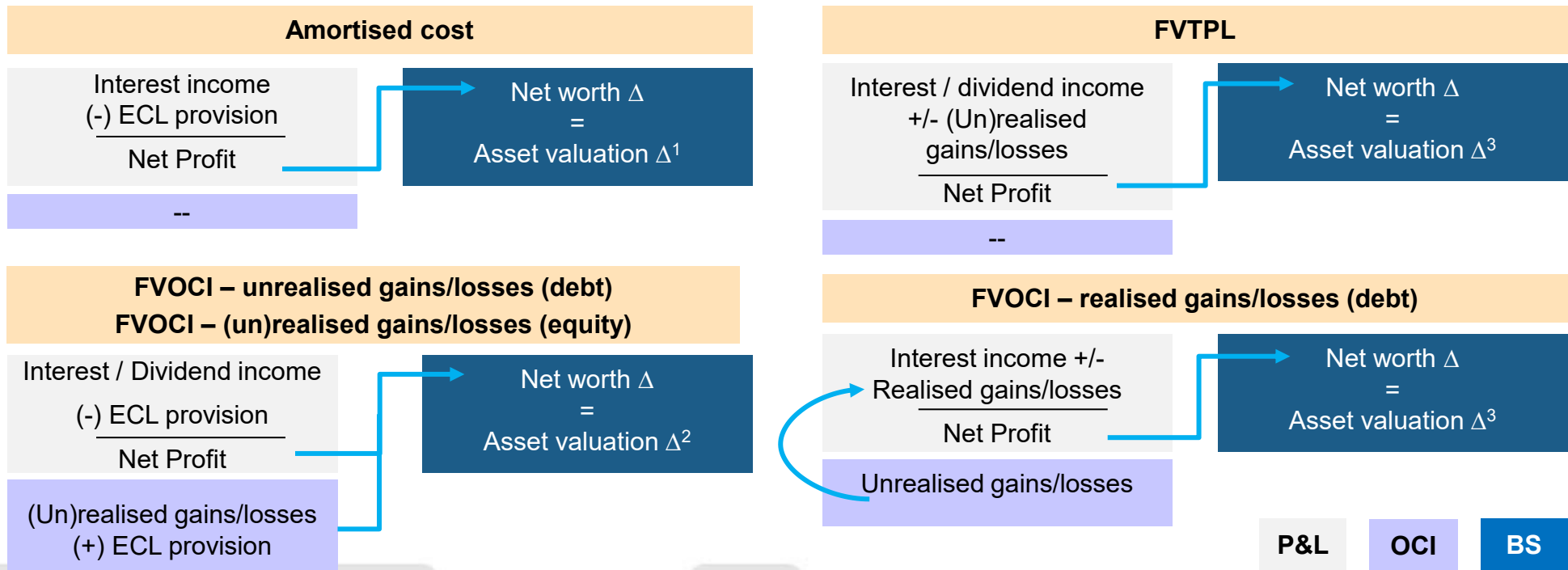
² when separating the spot and forward element of a forward contract and designating as a hedge instrument only the change in the spot element

Classification, measurement & re-classification of financial assets under Ind AS 109



Broad flow of asset valuation $\Delta \rightarrow$ into net worth Δ

- Period-to-period net worth Δ differs basis the measurement model selected
- Lifetime net worth Δ is agnostic to measurement model selected



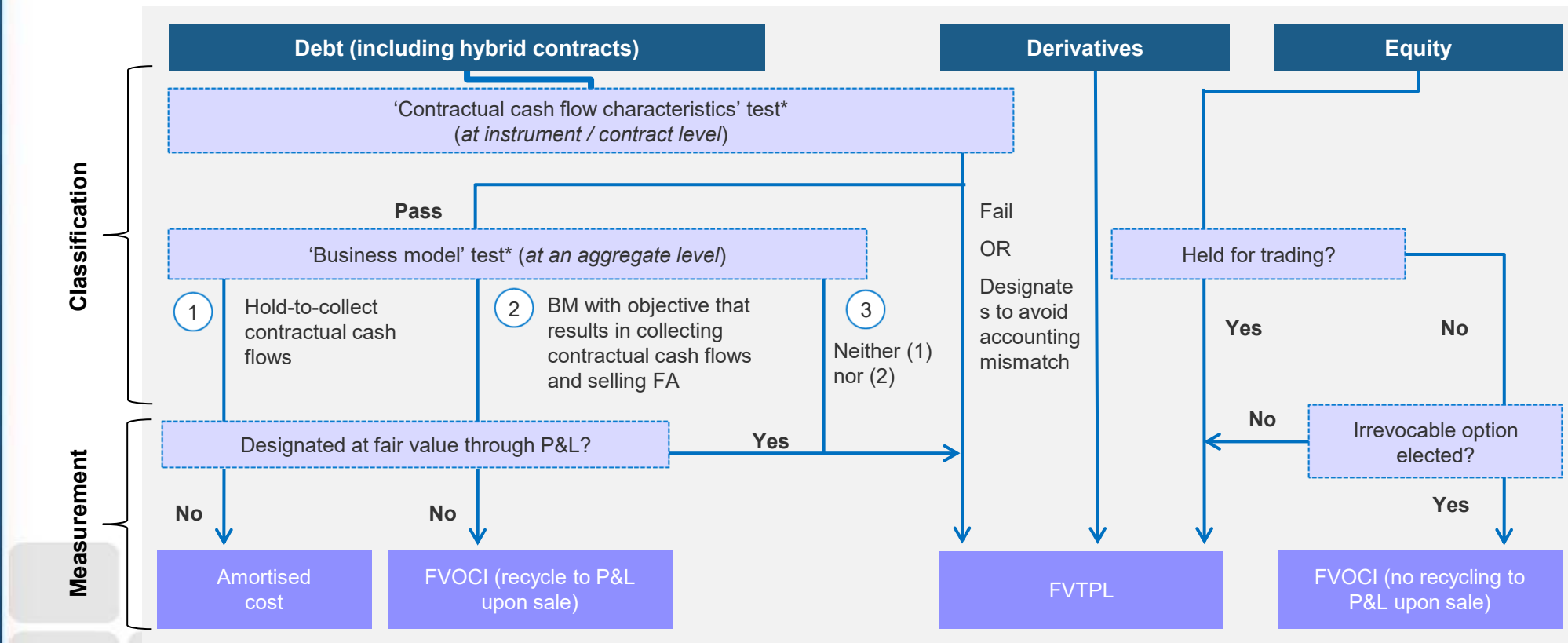
1. Amortised cost = Purchase price + Interest income at EIR – ECL provision

2. FVOCI = Purchase price + Interest income at EIR +/- Unrealised gain/loss

3. FVTPL = Purchase price +/- Unrealised gain/loss EIR = Coupon rate adjusted for amortisation / discount to par value and transaction costs

Classification & Measurement of financial assets

- Classification criteria are applicable to debt securities only → management intent needs substantiation
- Measurement models once chosen need to be followed till substantive changes in business operations



Reclassification of financial assets

Understanding reclassification

- Is reclassification possible & for **which** assets? → Yes. Non-derivative debt instruments.
- At **what** frequency is it possible? → Infrequent. Only when an entity changes its “business model”
- **When** is it said that a business model has changed? → External or internal changes in business operations that are significant and are demonstrable to external parties
- **Who** determines a change in BM? → Senior management (viz., ALCO)
- **How** is the reclassification applied? → Prospectively from the ‘reclassification date’ i.e. from the reporting period beginning after the change in business model that results in reclassifying financial assets (e.g., decision taken on 26 Sep 2025 will be given effect from 1 Oct 2025, if reporting quarterly)

What’s not a change in business model

- Change in “management intention” w/o significant change in operational activities → no change in business model
- Intention refer to the manner of managing existing portfolio of assets, whether significant or not
- Examples of change in management intention not regarded as change in business model:
 - Change as a response to deal with the impact of some external events (e.g., economic / monetary policy);
 - Changes in regulatory requirements (e.g., tightening / relaxing the definition of investment grade assets by IRDAI);
 - Changes in market variables (e.g., yield curve, inflation rate, etc.)
 - Changes in market structure affecting particular class of financial assets (bond issuances, inclusion / exclusion from index, temporary disappearance of market for some bonds, etc.)
 - Change in internal ALM parameters (thereby leading to a shift in assets, within the entity, between two funds having different business models.

Financial statement impacts upon reclassification

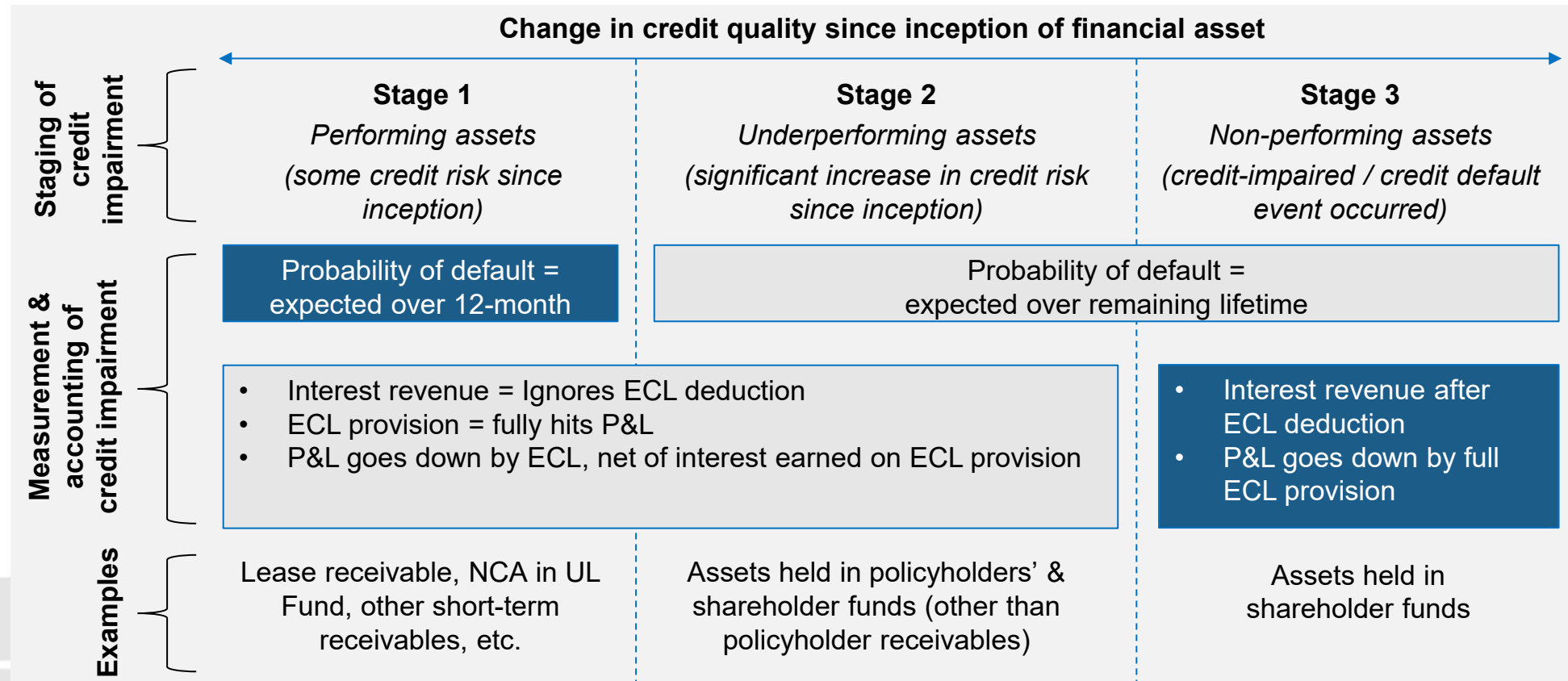
Summary table showing key financial statement impacts of change in business model:

Original Valuation	New valuation	Underlying yield used	P&L impact	OCI impact	Impact on asset valuation
Amortised Cost	FVOCI	Original locked-in yield	Interest accrual: at original locked-in yield ECL: no change to P&L hit till reclass date	Unrealised FV gain/loss & ITD ECL: from reclass date	Increases / decreases to the extent of unrealised FV gain/loss
	FVTPL	Switch to current yield	Interest accrual: at original locked-in yield ECL: P&L hit till reclass date to be reversed Unrealised FV gain/loss: from reclass date	No impact	
FVOCI	Amortised Cost	Original locked-in yield	Interest accrual: at original locked-in yield ECL: no change to P&L hit till reclass date	Unrealised FV gain/loss :	FV becomes the carrying value (gross of ECL)
	FVTPL	Switch to current yield	Interest accrual: at original locked-in yield ECL: P&L hit till reclass date to be reversed Unrealised FV gain/loss: reclass from OCI but maintain it as "unrealised"	- reverse ITD value on reclass date - reverse ITD ECL	No FVC after reclass date
FVTPL	Amortised Cost	Yield on reclass date becomes the new locked-in yield	Interest accrual: at new locked-in yield ECL: measure hit basis new locked-in yield Unrealised FV gain/loss: ITD amount realised on the reclass date	No impact	FV becomes the carrying value (gross of ECL) No FVC after reclass date
	FVOCI		Interest accrual: at new locked-in yield ECL: measure hit basis new locked-in yield Unrealised FV gain/loss: reclass from P&L to OCI but as "unrealised"	Unrealised FV gain/loss & ECL: show ITD amount from reclass date	No change

Note: The 'locked-in' yield referred above is calculated as a single effective interest rate

Expected Credit Loss → Critical in ‘measurement’

- Measurement of financial assets to reflect the change in credit quality since inception
- Applicable only for those financial assets measured at ‘Amortised Cost’ or ‘FVOCI’
- Expected Credit Loss (‘ECL’) model in asset measurement is applied as shown below:

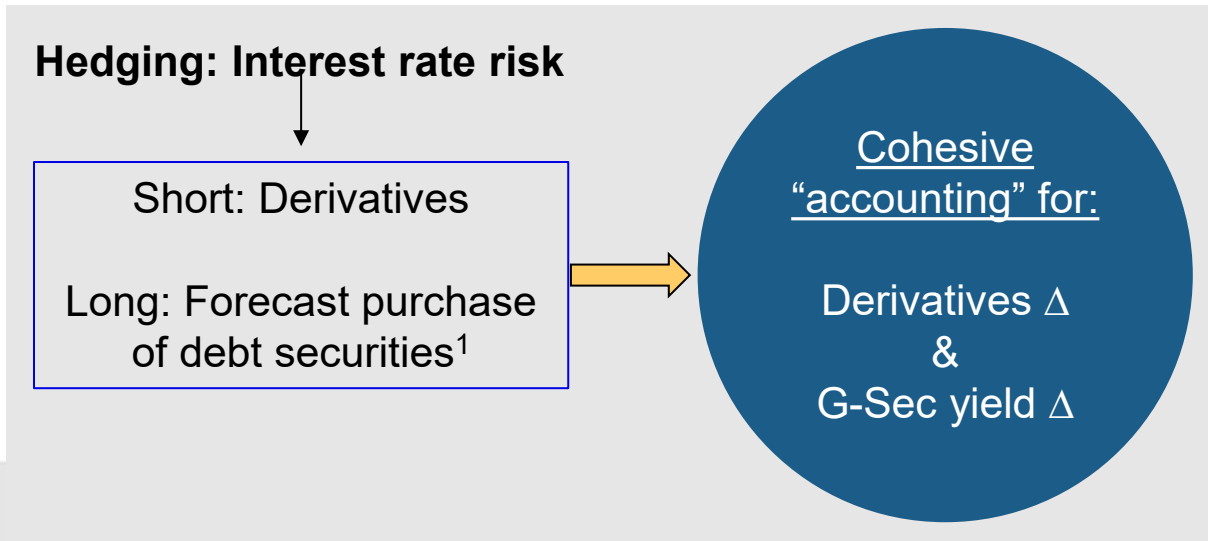


Hedging & its accounting implications



Precursor to hedging & its accounting implications

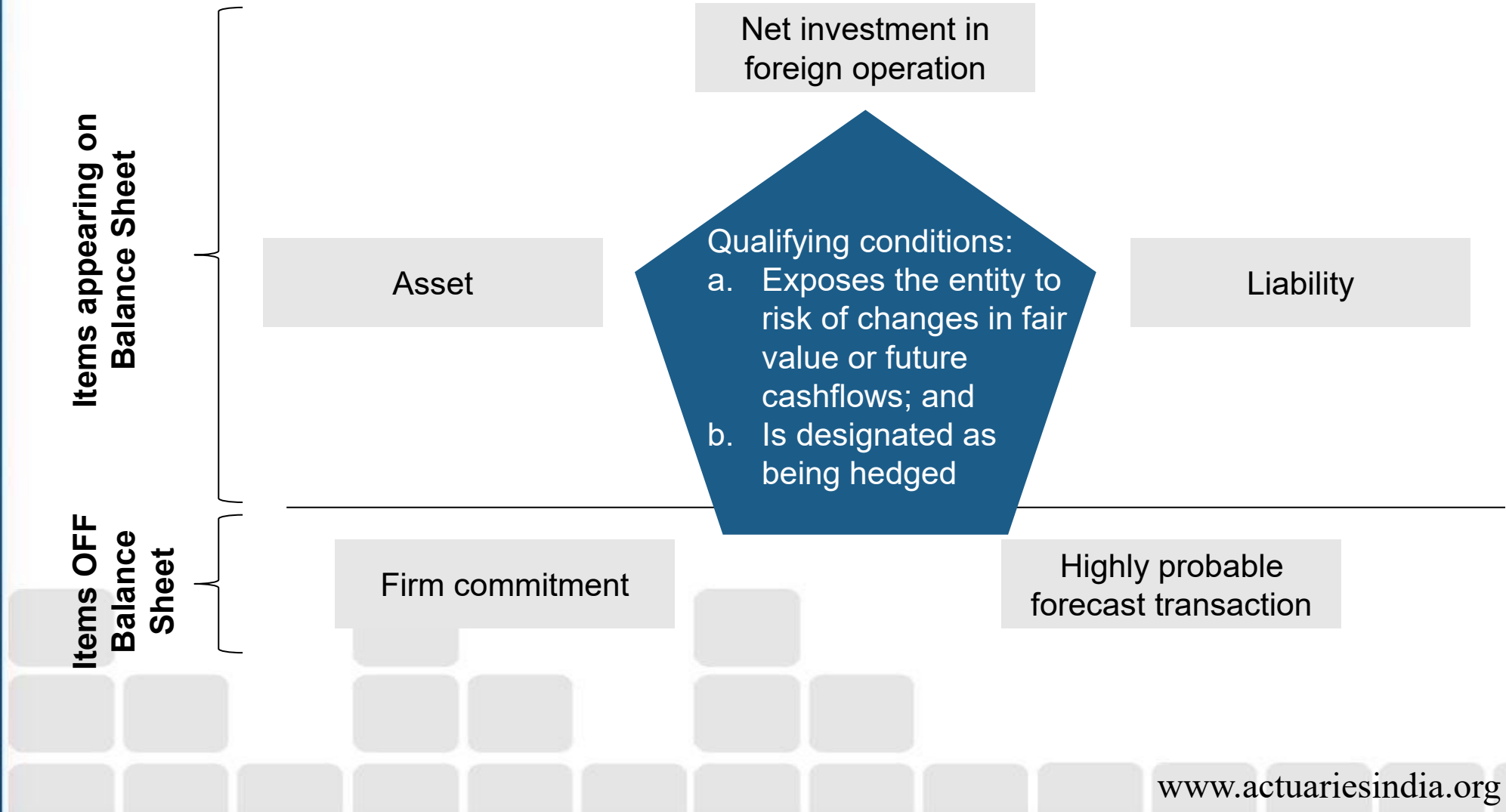
- **Derivatives** held in a portfolio / fund are **mandatorily** measured at FVTPL:
 - Business model test is not applicable
 - Instrument does not meet SPPI
- **Relationship between hedging and hedge accounting:**



- You have a “choice” to enter the circle!
- Following hedge accounting requires **meeting several conditions** along with **extensive documentation**

¹ Future premiums will be invested in G-Sec at the then prevailing current yields (giving rise to an exposure to interest rate movements)

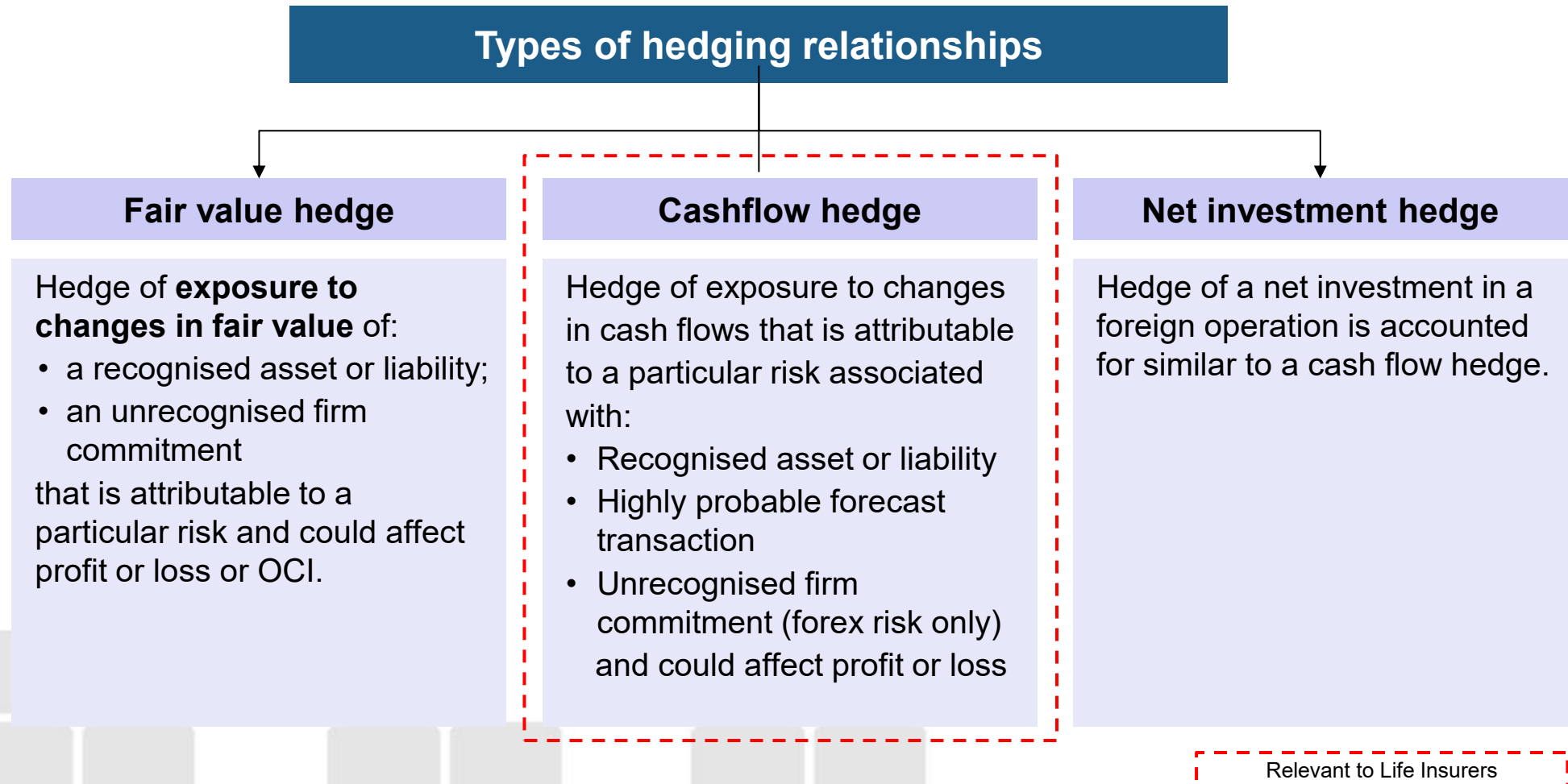
Characteristics of hedge item



Characteristics of hedging instruments

- All hedging instruments must be on balance sheet
- Hedging instruments → whose fair value or cashflows are expected to offset changes in fair value or cashflows of a designated hedged item
- Internal hedging instruments → **designated non-derivative** financial asset or financial liability:
 - E.g., foreign currency receivable or payable → naturally hedges forex risk
- External hedging instruments →
 - **designated derivative** financial asset or financial liability; or
 - **designated non-derivative** financial asset or financial liability

Types of hedging relationships



Hedge effectiveness testing – local v. global comparison

- Hedge is effective when the following 3 conditions are met:
 - Economic relationship exists i.e. change in fair value of hedging instrument offset changes in the fair value / cashflows of the hedged item
 - Credit risk does not dominate the economic relationship
 - Hedge ratio is maintained within the set limits
- Ind AS 109 requirements for hedge accounting are verbatim of those given in IFRS 9:
 - involves an item-by-item approach (i.e. single item or a group of items – but static)
 - Hedge relationship designation requires identification of specific hedge items and link it to specific hedging instruments
 - suitable for closed portfolios (i.e. static exposures)
- IFRS 9 provides a choice to apply hedge accounting requirements (as above) or continue applying hedge accounting requirements of its predecessor standard i.e. IAS 39 → **option only available for fair value hedge of interest rate exposure in a portfolio of financial assets or financial liabilities**
- Ind AS 109 does not provide the above option for fair value hedge of interest rate exposure in a portfolio of financial assets or financial liabilities.

Accounting for hedge relationships

	Hedged item	Hedging instrument																		
Fair value hedge	- Asset / Liability remeasured at fair value Fair value changes routed through P&L	- Derivative asset / liability and non-derivative financial instrument is remeasured at fair value Fair value changes routed through P&L																		
Cashflow hedge	Asset / Liability is measured using respective Ind AS principles: <table><tr><th></th><th></th><th>Ind AS 117 Liabilities</th><th>Ind AS 109 Assets</th></tr><tr><td rowspan="2">GMM portfolios</td><td>P&L impact</td><td>Locked-in rate</td><td>Effective interest rate</td></tr><tr><td>OCI impact</td><td>Current rate movements</td><td>Fair value changes</td></tr><tr><td rowspan="2">VFA portfolios</td><td>P&L impact</td><td>Constant / crediting rate</td><td>Effective interest rate</td></tr><tr><td>OCI impact</td><td>Current rate movements</td><td>Fair value changes</td></tr></table>			Ind AS 117 Liabilities	Ind AS 109 Assets	GMM portfolios	P&L impact	Locked-in rate	Effective interest rate	OCI impact	Current rate movements	Fair value changes	VFA portfolios	P&L impact	Constant / crediting rate	Effective interest rate	OCI impact	Current rate movements	Fair value changes	Derivative asset / liability is remeasured at fair value Effective portion: Fair value changes recognised in OCI and recycled to P&L to match the timing of NII on future cashflows in P&L Ineffective portion: Fair value changes recognized in P&L
		Ind AS 117 Liabilities	Ind AS 109 Assets																	
GMM portfolios	P&L impact	Locked-in rate	Effective interest rate																	
	OCI impact	Current rate movements	Fair value changes																	
VFA portfolios	P&L impact	Constant / crediting rate	Effective interest rate																	
	OCI impact	Current rate movements	Fair value changes																	

Ind AS 117 – Insurance contract liability and IFIE

- No option to value liabilities at amortised cost, as standard requires discount rates to be current.
- Hence holding debt assets at amortised cost largely not an option from a Ind AS balance sheet matching perspective.
- Liabilities 'incur' interest expense called Insurance Finance Income or Expense (IFIE) – unwind in actuarial words!
- IFIE can be recognised either entirely in P&L, or can be recognised partly in P&L and partly in OCI ('OCI disaggregation').
- In VFA, the IFIE is largely equal to the investment income and hence there is a perfect match if:
 - Debt assets – FVTPL, Equity – FVTPL, Ind AS 117 – No OCI disaggregation
- In VFA, OCI disaggregation to be performed as per para 89 and B134 – requires mirroring asset side P&L OCI split. Hence there is also a perfect match if:
 - Debt assets – FVOCI, Equity – FVTPL & Ind AS 117 – OCI disaggregation; OR
 - Debt assets – FVOCI, Equity – FVOCI & Ind AS 117 – OCI disaggregation;
- Neither of the above three VFA choice combinations affect bottom line of either P&L or OCI – merely presentational.

Ind AS 117 – Insurance contract liability and IFIE

- In GMM (for guaranteed products), OCI disaggregation to be performed as per para 88, B130 & B131
- It broadly requires us to:
 - compute total IFIE expected over duration of a group
 - allocate ‘systematically’ entire IFIE to P&L over duration of the group using discount rates determined at inception of the group
 - (which will result in amount recognised in OCI to total to zero over duration of the group)
- Unlike VFA – systematic allocation not based on expected recognised returns on assets
- Hence P&L v/s OCI choice and its implications are important to be understood for GMM, as it has potential to affect bottom line of P&L and OCI

Interplay of Ind AS 109 & Ind AS 117 – GMM

Simplistic representation of what might lead to matched outcomes

Ind AS 117 liabilities	Debt (G-sec and corporate debt)	Derivatives	Ind AS 117 liabilities	Broad outcomes
Non-par liabilities managed under an interest rate hedging program and corresponding assets*	FVOCI	Cashflow hedge (FVOCI)	OCI disaggregation	Economic volatility broadly out from P&L – may be better choice if not confident about ALM. Potential to introduce accounting mismatches from calculation methods and management actions.
	OR			
	FVTPL	No hedge accounting (FVTPL)	No OCI disaggregation	Economic volatility in P&L – but fine if confident about ALM. Avoids accounting mismatches.
Any surplus assets not backing liabilities and not used for hedging program	Amortised cost	Not applicable	Not applicable	P&L and Ind AS equity stable
	OR			
	FVOCI	Not applicable	Not applicable	P&L stable but Ind AS equity volatile.

* Assets may typically include all assets backing Non-par fulfilment cash flows, CSM and Ind AS Equity (excluding the equity locked in ring-fenced Par or UL funds)

Interplay of Ind AS 109 & Ind AS 117 – GMM

What does “confident about ALM” even mean (1)

- Various philosophies to ALM:
 - hedge the PVBP (dollar duration) gap between assets and liabilities using derivatives
 - cash flow matching – buy assets and derivatives to match the timing, amount and required length of investment based on expected premiums and expected outgoes. Such an approach may ignore surplus assets.
 - Closed book v/s open book basis – say expected NB premiums assumed to pay outgoes in the near term and so going long on assets to earn term spreads
 - Multiple metrics!
 - Immunise EV or Ind AS equity? – some differences due to non-attributable expenses, illiquidity premium, contract boundaries (e.g. Group OYRT)
- OR
- Immunise available capital / solvency ratio? – many differences both in existing solvency regime and proposed RBC vis-à-vis EV/Ind AS

Interplay of Ind AS 109 & Ind AS 117 – GMM

What does “confident about ALM” even mean (2)

- Recent example - a costly lesson to learn in the real world!

Why has the Phoenix Group share price fallen 7% today?

Investors sent the Phoenix Group share price lower today (8 September) after the long-term savings and retirement business published its latest results.



James Beard

Published 8 September, 5:00 pm BST



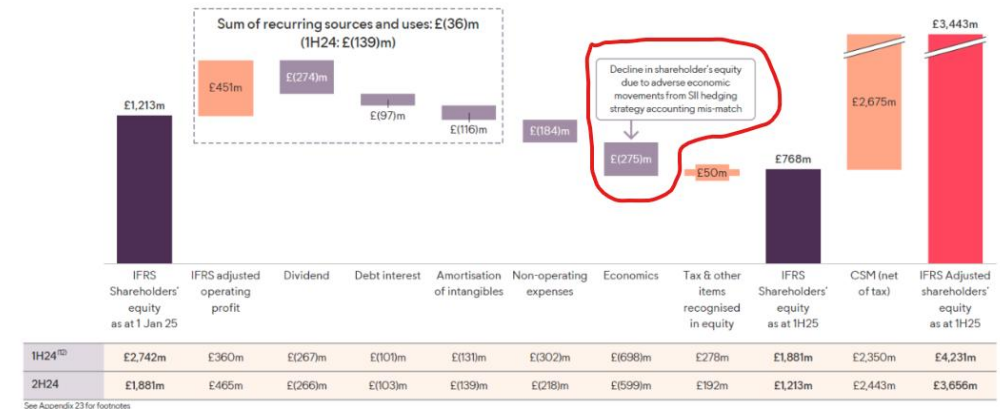
A confusing picture

The problem with assessing the financial performance of groups like these is that accounting standards require certain key items to be presented differently to the way in which management teams prefer to report things.

The upshot is that there's often a large differential between statutory (accounting) and management numbers.

For example, during the six months ended 30 June (H1 25), diluted operating earnings (net of financing costs) per share were 25.1p. In contrast, the group's income statement is showing a loss of 18.2p a share.

Declining shareholders' equity a known consequence of hedge-related volatility, but recurring sources and uses are converging



Phoenix

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Interplay of Ind AS 109 & Ind AS 117 – GMM

What does “confident about ALM” even mean (3)

- Is a perfect ALM a possibility given multiple practicalities?
- Change in Economic Assumptions and Investment variance in IEV of listed private players over years

Amounts in INR crores							
	FY18	FY19	FY20	FY21	FY22	FY23	FY24
Insurer 1	260	360	-1,000	2,060	-50	-1,590	1,350
Insurer 2	113	-122	-1,476	2,567	-437	-1,449	1,691
Insurer 3	-47	384	-317	382	64	-1,044	-54
Insurer 4	-180	250	-710	2,320	-450	-2,420	2,390

- Ideal to look at this excluding any amounts from participating and unit-linked business, but this is more to set the context - while this may not be a huge % of IEV but imagine these amounts as a % of Ind AS profit for the year!

Interplay of Ind AS 109 & Ind AS 117 – GMM

Volatility from credit spreads on corporate debt

- The illiquidity premium to be applied to discount rates under Ind AS 117:
 - Reflects illiquidity of liability cash flows
 - Can be determined based on own corporate debt holdings or without reference to own holdings
 - May be taken as a flat number at times agnostic of duration
 - Is only a certain % (lower than 100) of the total credit spread to strip out expected and unexpected defaults
 - Is further lowered when applied by use of an application ratio (say 25%, 50%, 75%, 100%) based on “level of illiquidity” of the contract group
- Given all the above, it is very difficult to ensure that expansion or contraction in credit spreads of corporate debt over G-secs and the consequent change in insurance contract liability are similar in magnitude
- In fact, a company could be holding no corporate debt, but still having an illiquidity premium causing impacts on only one side of the balance sheet!

Interplay of Ind AS 109 & Ind AS 117 – GMM

Equity investments in non-par / shareholder fund

- Could be there to:
 - Back unit-linked policies' RSM
 - Earn real-world uplifts
 - Reduce effective tax rate
- Choose from two difficult outcomes:
 - FVTPL – Equity volatility will impact P&L as no corresponding effect from liabilities
 - FVOCI without recycling – Remove volatility from P&L but lose all returns received through price appreciation over the lifetime of the P&L.

Interplay of Ind AS 109 & Ind AS 117 – GMM

OCI split of Ind AS 109 and 117 works in silo (by design not accident) (1)

- OCI on the debt security arises when:
 - Interest rates change from those at the date of purchase of the asset – leading to MTM gains/losses.
- Balance sheet value (FV) represents market yield;
- P&L earnings represent EIR at date of purchase
- OCI earnings reflect difference between EIR and market yield.
- Simplistic example – G-sec bought at 7%. Interest rates after a year change to 6%. MTM gain on G-sec of 7% v/s 6% booked in OCI. In future, OCI will bear a loss of this 1% gap over the lifetime of the asset – while FV can only support earning of 6%, P&L earning will be at 7% (+1%) and OCI earning at -1%.
- Similar story for insurance contract liability – the BEL will increase when computed at 7% v/s 6% and will be booked in OCI. In future OCI will have gain of this 1% gap **over the lifetime of the contract** – while FV will incur only 6% interest cost, P&L cost will be at 7% (+1%) and OCI cost at -1%.

Interplay of Ind AS 109 & Ind AS 117 – GMM

OCI split of Ind AS 109 and 117 works in silo (by design not accident) (2)

- All is great – UNTIL – debt security is sold midway. Could be due to:
 - Deterioration in credit rating
 - Another debt security with a better yield or better cash flow timing matching being available
 - Intention to time the interest rate cycle and intending to go long or short
 - Intention to book profit/loss due to statutory solvency considerations
- Lets continue the example. Say asset sold and re-bought post the interest rate move to 6%. This causes the accumulated past OCI of the security to move from OCI to P&L.
 - Simpler way to understand – unrealised gain now realises and now reduced from OCI (loss) and recycled in P&L (profit)
 - Actuarial way to understand – OCI suffers a loss of the future -1% differences immediately while P&L accrete gains of the +1% differences immediately (Mismatch 1)
- Insurance contract liability unaffected by the above transaction on asset side. So, in the years post sale, debt earning in P&L will be 6% and in OCI will be 0%, while liability IFIE in P&L will continue at 7% and in OCI at -1%, thereby creating 1% loss every year in P&L and gain in OCI (Mismatch 2)

Interplay of Ind AS 109 & Ind AS 117 – GMM

Fair value transition – the importance of “starting correctly” if OCI chosen

- If FVOI selected on debt securities – transition provisions of Ind AS 109 require retrospective application
- So accumulated OCI (AOCI) needs to be computed on debt securities
- On date of transition, this is the difference between market value of the security and the amortised book value based using the effective interest rate at the point of purchase
- In other words, unrealised MTM gains/losses since purchase of security shown in AOCI
- Need to be careful with the new business cohorts transitioned using fair value
- Ind AS 117 offers two options:
 - C24(a) – compute AOCI IFIE retrospectively
 - C24(b) – assume zero
- C24(b) clearly the easier option, but creates lifetime mismatches in P&L and OCI results
 - but may be presentation-ally beneficial if yields low and OCI IFIE will be negative – choosing the easier mismatched option may increase lifetime EPS!
- Past buying selling which has already restated existing debt securities' book yields cannot be remedied now...

Interplay of Ind AS 109 & Ind AS 117 – GMM

Ensuring consistency in the math underlying “locked-in” between debt securities and insurance contracts if OCI chosen

- Debt security locked in at a flat EIR – which is the GRY at the date of purchase
- Insurance contract liability computed at inception using a yield curve
- May lead to mismatched timing of “locked-in” calculations in the P&L, unless yield curve relatively flat
- May need to evaluate other methods to compute P&L IFIE expense which is “more matched” with EIR
 - While ensuring the requirements of disaggregation of para 88, B130 & B131 are still met
- In case of a locked-in curve, need to decide on a method to unwind the yield curve. Three possibilities:
 - No change in yield curve – shifting the spot curve to the right
 - Dropping the first x months of forward rates – uses no arbitrage principle
 - Dropping the first x months of spot rates
- One of these leads to a more consistent math underlying “locked-in” between debt securities and insurance contracts

Interplay of Ind AS 109 & Ind AS 117 – GMM

Conclusion on P&L or OCI – Choosing between a rock and a hard place

- When there is not a potentially perfect solution, a possible mitigant could be disclosures
- May resort to non-GAAP measure of profit – say an “operating profit”
- Non-GAAP measures:
 - Are widely used by companies to provide supplemental insights into performance
 - Help in enhancing understanding of underlying business trends
 - Typically lack comparability between companies
 - Risk misleading investors through selective adjustments
- Most large global insurance groups use a non-GAAP measure to communicate management’s view of profit. A walk is then usually provided against P&L bottom line for transparency.
- Point to ponder – how important is profit in Ind AS world?
 - Will companies be valued based on $\text{EPS} \times \text{PE ratio}$? – if so, may as well report a “Operating EPS”; or
 - Valuation will continue to be driven based on Ind AS balance sheet and NB CSM + loss on initial measurement...

Thank you!



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