Asia-Pacific Economic Cooperation

ABAC

APFF Insurance and Retirement Income Workstream

MAIN ISSUES REGARDING PROPOSED IFRS ON INSURANCE CONTRACTS

Overview of the proposed ABAC comment letter to IASB and FASB

Background

- ABAC submitted a comment letter to IASB and FASB on August 25, 2011 on insurance contracts
- ABAC submitted a comment letter in September 2013 on leasing
- APFF insurance and retirement income workstream has a mandate to identify and address accounting standards that may constrain insurers from playing expected roles in long-term funding and aging society

Planned timeframe

- Initial draft letter circulated for comments: September 13
- Discussion on the revised letter, based on the comments received prior to the meeting, in Hong Kong on September 30
- Submit a revised draft to the ABAC Secretariat by the morning of October 2
- Present the letter during the ABAC Finance and Economic Working Group (FEWG) in Bali on October 3 for approval

Basic positions of the letter

- An ABAC letter should identify and address high-level issues and not be too technical
  - ABAC is not a group of insurance experts, but the business community
  - The insurers, supervisors, and actuaries are still working on technical solutions. The ABAC letter does not intend to duplicate or conflict with those initiatives and aims to support and complement them by identifying the issues which must be addressed and providing high-level recommendations

Basic positions of the letter *(cont.)*

- An ABAC letter should focus on the issues relevant to the objective of the APFF to promote insurers' roles to :
  - effectively provide long-term funding;
  - support financial stability and economic and infrastructure development and;
  - serve the needs of aging society.
- and also identify problems from a users/investors/customers perspective.

Basic positions of the letter *(cont.)*

- An ABAC letter should avoid “one-size-fits-all” approach and respect different business models in the region
  - ABAC letter should promote a flexible approach to capture a wide variety of insurance contracts and business models of insurers in different jurisdictions in the Asia Pacific region
  - and avoid taking a specific position where there are conflicting views

The ABAC letter on August 25, 2011

- The previous ABAC letter commented on:
  - determination of discount rates to be used in the valuation of life insurance liabilities;
  - use of Other Comprehensive Income (“OCI”) for reporting of market value fluctuations in insurance company assets and liabilities;
  - presentation of life insurance company financial statements; and
  - measurement of short-duration insurance contracts, primarily for non-life insurance companies

Acknowledgement of improvements

- Identified improvements of the revised exposure draft from the discussion paper in 2007 and the exposure draft in 2010:
  - the use of OCI for presenting changes in discount rates
  - unlocking contract service margin (“CSM”), and
  - presenting some volume information in the statement of comprehensive income

Main issues : Scope

- The scope of consistent measurement of assets and liabilities could be expanded:
  - The “mirroring approach” would limit the scope to contracts which require an entity to hold underlying items and specify a link between the payments to the policyholder and the returns on those underlying items
  - It would not capture a wide range of participating policies and products with discretionary participation feature that are sold in the Asia Pacific region
  - It would result in inconsistent treatment among products and non-economic volatility, which may produce unintended consequences on long-term business

Main issues : Complexity

- The model should be as simple as possible, and complexities should be minimized:
  - The current proposal is highly complex and would impose excessive practical burdens and costs on insurers. Lack of understandability would reduce transparency
  - the proposed requirement for bifurcation of cash flows is difficult to implement and inconsistent with how contracts are designed and managed
  - the retrospective measurement for existing and past long-duration contracts would be extremely costly and often practically impossible due to lack of data. One solution might be to take a full prospective approach

Main issues : Consistency

- The measurement model should be consistent with how insurance contracts are designed, priced, and managed:
  - Proposed measurement is not consistent between treatment of changes in estimated cash flows and that of discount rates
  - For example, the present value of future profits are partly reported in OCI and partly reported in CSM
  - It would not be consistent with the economic reality faced by insurers and therefore does not provide relevant and useful information to users
  - It might cause adverse consequences in those jurisdictions where interest rates may decline

Main issues : Consistency *(cont.)*

- The valuation method, including the choice of discount rate, should be reflective of the business model of the issuer of the contract
  - The use of OCI for presenting changes in discount rates is potentially a significant improvement but not in isolation
  - The proposals would be enhanced if either the OCI treatment were optional, or if the population of assets qualifying for OCI treatment were to be expanded, in order to avoid accounting mismatch with the treatment of corresponding assets

Main issues : Presentation

- Premium received is the most essential and reliable information for users and preparers:
  - We support the IASB's decision to reject the summarised margin approach
  - The proposed earned premium volume metric is unhelpful and incomparable with revenues reported by insurers not using IFRS. Neither the insurance industry nor investors/analysts/policyholders use or understand the proposed metric
  - Separation of investment components from revenues and claims payment would be practically difficult and would not reflect the business reality

Main issues : Field testing

- Proposed standards should be properly tested before they are finalized
  - Early comments from companies doing field testing express concerns regarding the complexity and lack of understandability of the Exposure Draft
  - Planned testing is selective and does not consider the interaction with the proposed financial instruments standards
  - Another series of full "real world" field testing is needed.
  - It is preferable to have a set of high quality of standards that have been adequately tested rather than have quality compromised by a compressed completion process