



APEC Business Advisory Council

The Office of ABAC Chair 2013



10 October 2013

Mr. Hans Hoogervorst

Chairman
International Accounting Standards Board
30 Cannon Street
London EC 4M 6XH
United Kingdom

Mr. Russell G. Golden

Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856

Dear Messrs. Hoogervorst and Golden:

As the private sector dialogue partner of the Asia-Pacific Economic Cooperation (“APEC”) Forum, the APEC Business Advisory Council (“ABAC”) is charged with providing private sector perspectives to policy makers and stakeholders from the APEC region, and to facilitate APEC initiatives.

In ABAC’s previous reports to APEC Economic Leaders, we have consistently expressed our support for adoption of IFRS throughout the APEC region, as part of APEC’s goal of encouraging regulatory coherence, enhancing the development of regional capital markets and promoting sustainable economic growth. At the same time, ABAC noted that the implementation of IFRS should be undertaken in a manner that minimizes adverse consequences for real economic activities and that reflects each economy’s business practices.

We welcome the opportunity to continue our exchange of views with the IASB and FASB on the proposed standards for Insurance Contracts. These standards would have a large potential impact on the insurance sector. The insurance industry plays an important role in the development of the Asia-Pacific region. In our recent meetings, we identified the development of the region’s insurance industry as a provider of long-term investment and the development of retirement systems as priority issues, and highlighted the need to address any accounting and regulatory requirements that might discourage insurers from playing such roles.

In our 25 August 2011 letter, we noted the following areas that were primary concerns:

- determination of discount rates to be used in the valuation of life insurance liabilities;
- use of Other Comprehensive Income (“OCI”) for reporting 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 .

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ABAC appreciates the changes that the FASB and IASB have made since then to address some of the issues we have raised. We acknowledge a number of improvements in the revised exposure draft from the discussion paper in 2007 and the exposure draft in 2010, including 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.

We believe that the revised exposure draft still contains a number of problems, which will cause significant challenges and disadvantages for insurers in the APEC region if the proposals are adopted as currently drafted. The following are some areas that, in our view, require further improvements to avoid unintended consequences, to increase the relevance and usefulness for users of financial reports, and to enhance practicality for preparers.

1) Scope

The “mirroring approach”, which limits 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, 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 in balance sheet of insurers selling certain products. It could have unintended consequences for insurers’ ability to support long-term investment, sustainable economic growth and market stability.

We propose that the scope of contracts for which the insurance liabilities and the related assets are consistently measured and presented reflecting their interaction could be expanded to include all contracts, including those where all or a part of the cash flows are dependent on returns from underlying items. We believe that this would improve the consistency of treatment of economically similar contracts and reduce non-economic volatility.

2) Complexity

The proposed measurement model is highly complex, and would impose excessive practical burdens and costs on insurers. Lack of understandability would reduce transparency. We believe that the model should be as simple as possible and complexities should be eliminated in circumstances where any additional information provided is not considered useful. For example, the proposed requirement for bifurcation of cash flows is difficult to implement and inconsistent with how contracts are designed and managed.

Also, 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 and define the remaining future profit as CSM at the transition date.

3) Consistency

The proposed measurement model is not consistent between the treatment of changes in estimated cash flows and that of discount rates. For example, changes in the present value of future profits are partly reported in OCI (unrealized investment gains/losses) and partly reported in CSM (mortality and expense gains/losses related to future periods). We believe 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. An objective of the measurement model is that it should be consistent with how insurance contracts are designed, priced, and managed to be useful to preparers and users.

Also, 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.

4) Presentation

While we support the IASB's decision to reject the summarised margin approach, the proposed volume information is not consistent with the needs of users in most Asia-Pacific jurisdictions. The premium received is considered the most essential and reliable information for users and preparers. 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. Life insurance contracts are different in nature from bank deposits. Such differences should be properly reflected.

Lastly, the 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. We believe that another series of full "real world" field testing is needed. Fundamentally, we believe that it is preferable to have a set of high quality standards that have been adequately tested rather than have quality compromised by a compressed completion process.

Again, we appreciate the opportunity to provide comments to the Boards. Given the potentially adverse impact that major accounting change for insurance contracts may have on the insurance industry and its roles in long-term investment and in funding of retirement security in the APEC region, we hope that the IASB and FASB will take into careful consideration the concerns and recommendations we have provided. We would be happy to continue a dialogue with you on these matters.

Sincerely,



Wishnu Wardhana
ABAC Chair 2013