

Industrial Views Towards IFRS 4 Exposure Draft

CONTENTS

- Editorial P.2

Feature Articles

- IFRS 4 Exposure Draft: Industry Views..... P.3
- IFRS 4 Revised Exposure Draft: CMS - Creating Stress for Management? P.9
- Advance preparation - What should you be doing now? P.12
- IASB's recent exposure draft on insurance contracts reportingP.15
- IFRS 4 Phase 2 ED Comment Letter – Hong Kong's Voice P.19
- Implication of the new IFRS standard for insurance contractsP.23

Council & Market Update

- President's ReportP.26
- Message from the New President.....P.32
- Market UpdateP.33

Others

- Membership UpdateP.34
- Upcoming Events.P.38
- Events' HighlightsP.39
- Price to Give AwayP.41



Call for Articles or Views for the next issue of Newsletter

While all articles are welcome, we would especially like to receive articles for the Feature Articles and Knowledge Sharing section. If you read any interesting articles from other actuarial organization(s), please feel free to let us know. We will try to reprint it in our newsletter to share with our members. For the above issues, please e-mail your articles or views to Simon Lam by email at slam@munichre.com or ASHK's office by email at actsoff@netvigator.com.

Editorial

DISCLAIMERS

This publication is provided for informational and educational purposes only. The Actuarial Society of Hong Kong makes no endorsement, representation or guarantee with regard to any content and disclaims any liability in connection to the use or misuse of any information provided herein. This publication should not be construed as professional or financial advice. Statement of fact and opinions expressed herein are those of the individual authors and are not necessarily those of the Actuarial Society of Hong Kong.

Dear Readers,

Welcome to the fourth newsletter of 2013! I wish you all a Merry Christmas and Happy New Year with your family.

In this newsletter, we continue to share with you the feature articles of a recent hot topic – Comments on the International Financial Reporting Standard (IFRS) Re-exposure Draft. We are happy to have contributions from several actuarial consultants including Deloitte, Ernst & Young Actuarial Services, KPMG, Milliman Limited, PricewaterhouseCoopers Limited, Asia Pacific and Towers Watson (in alphabetical order). Thank you very much for your kind support towards this newsletter.



Besides, we will share with you the President's Report 2013 and the Message from the New President in the section of "Council and Market Update" so that you could have a better understanding of our achievements in 2013 and the coming initiatives in 2014.

Last but not least, I would like express my deepest appreciation towards the continuous contributions from the Membership and Publications Committee members including Calvin Tang, Iris Lun, Mary Kwan and Sing-Yee Yeoh together with ASHK's colleagues (Patricia Kum, Tiffany Wong and Emily Lye). All of them gave me lots of support to improve the newsletter's quality in 2013. With their continuous support, we will further enrich the newsletter's contents in the coming future. Much appreciation!

Our committee is open to any recommendations towards both membership and publication matters. Please feel free to contact me at slam@munichre.com or ASHK's office at actsoff@netvigator.com regarding any recommendations. We are happy to listen.

Once again, Merry Christmas and enjoy the coming festival!

Simon Lam
EDITOR

IFRS 4 Exposure Draft: Industry views

The revised Exposure Draft ED/2013/7 Insurance Contracts ("ED") was published for comment in June 2013 by the International Accounting Standards Board ("IASB"). Comments were due by 25 October 2013 and have been made available publicly on the IFRS Foundation website. One hundred and ninety six comment letters were submitted by insurance companies, actuarial bodies (including the ASHK), accounting bodies, and industry groups.

As detailed in other articles, there were seven areas that were open for comment. In this article, we seek to summarize the comments submitted concerning these areas by various key insurance companies operating in the region, as well as the 'Big 4' accounting firms and the ASHK.

Question 1 — Adjusting the contractual service margin ("CSM")

Is it appropriate to adjust the CSM for changes to the estimates of the present value of future cash flows related to future coverage and services, while recognizing other changes immediately through profit and loss?

Exposure Draft Proposal

The CSM is a critical component of the building block approach ("BBA" - outlined in paragraphs 18-27) of the proposed accounting requirements. Designed as an unearned revenue balance to adjust profits over the coverage period based on the combined effect of a release pattern and the requirement to account for changes in assumptions related to future coverage periods, the CSM mechanism is a material difference from previous proposals. Originally calculated to eliminate the recognition of profits upon *initial recognition* (essentially inception date), the ED's first question seeks opinions on the manner in which this balance is carried forward throughout the coverage period.

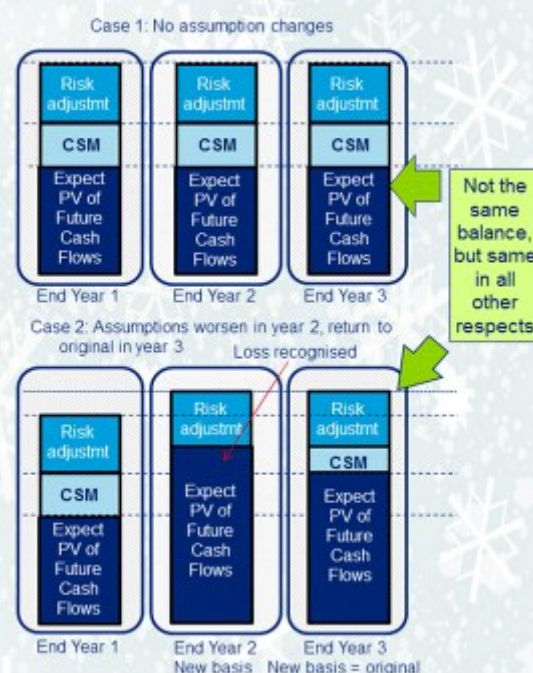
A key change to the CSM introduced in this exposure draft is the requirement to unlock the CSM balance to reflect changes in future cash flows. In the previous exposure draft, the CSM amortization was locked-in and did not reflect changes to projected cash flows so changes flowed unmitigated into the P&L. With the revision, as long as the CSM is not lowered to zero at which it is floored, the CSM absorbs current impacts related to future coverage and services and then, as before, spreads the profits over the remaining contract's coverage period until a subsequent change in assumptions produces a new recalibration.

When losses are larger than the existing CSM (or the CSM is zero), "onerous" losses, the losses in excess of the CSM, immediately impact the P&L. If there is no CSM but changes to applicable cash flows would generate profits, a new

CSM is established to once again be released in the future periods when coverage and other obligations are fulfilled. One pertinent intricacy of the approach is illustrated in the diagram below.

This diagram shows two cases assuming identical contracts. In the first case, the business is given the very simplifying assumption that the PVs of all components remain the same at the end of each year. The experience develops as expected and each component of the liability is the same at the end of each year. In the second case, future expectations change in both the second and third years. In the second year, changes increase the expected present value of future cash flows by an amount greater than the CSM, an onerous loss. This causes the CSM to be written off and a loss to be recognized in the year. In the third year, assumptions are again changed resulting in a present value of future cash flows in line with the original expectations. In this case, no profit is recognized from the change in projected cash flows and the full change in cash flows is used to increase the CSM.

Diagram 1 – Impacts to the CSM



While the expected present values of the cash flows are similar in year 3 under both cases, the total liability held is different. We refer to this phenomenon as a "path-dependent" balance.

Comment Letter Summary

The respondents reviewed universally supported the main ideas of the proposed unlocking approach. However, that is not to say that the responders felt the approach was now ideal. **The mechanics of the unlocking generated responses focused on four main areas of concern: what cash flows were allowed to adjust the CSM, the treatment of onerous losses and subsequent gains, the unit of account for the CSM, and the discount rate to be used for the CSM.**

The determination of which cash flows are allowed to impact the CSM were the most commonly discussed element within this question. At a minimum, the definition of what cash flows are and are not proposed to affect the CSM needs clarification. Many took stronger stances and felt that various changes in cash flows that were excluded (e.g. recognized immediately in P&L) should be included when adjusting the CSM. In particular, it was considered more appropriate to reflect changes to the *risk adjustment* in the CSM. While some other specific cash flows that are currently excluded were mentioned, it was clear that most found the restrictions, just that, restrictive and none of the responses we read suggested strengthening restrictions. In line with this concept, a comment was made that changes in the timing of cash flows (as discussed in paragraph B68(c)) should also be allowed to impact the CSM as they change the present value.

The treatment of onerous losses subsequently followed by favourable changes to applicable cash flows was also repeatedly discussed in the comment letters. As illustrated in the diagram above, path-dependent liabilities were felt to be inappropriate by numerous respondents. It was commonly suggested that onerous loss amounts passed through the P&L should be used to offset favourable cash flow changes if and when such favourable changes occurred.

Use of *portfolios* (per Appendix A of the ED) as the unit of account at which the CSM was calculated was noted by several respondents as inappropriate. However, there was no consensus on what the right answer was in the responses, as the suggestions included calls for increased granularity, consistency with how the business was managed, and reduced granularity.

Lastly, comments on the discount rate to be used occurred consistently throughout the responses. Currently the CSM is to be accreted using the interest rate at *initial recognition*. Closely tied to the answers to question 4 (as discussed below), most respondents felt that rates used should be consistent with the rates used for other elements of the liabilities for P&L purposes; i.e. if Other Comprehensive Income ("OCI") is not applicable and the liabilities are reported as fair value through the P&L, then the CSM should accrete at market rates.

A few other suggestions of note considered the mechanics of the amortization of the CSM. While not considered by the majority of the respondents, suggestions included extending the CSM amortization period to include the settlement period in addition to the *coverage period*, that the pattern of amortization should be clearly defined as straight-line for consistency, and that the pattern of amortization should remain open to determination by the companies as proposed in the exposure draft.

Question 2 — Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items

If a contract requires payments to policyholders that are linked to the returns of specified underlying items should:

- a) ***The value of fulfilment cash flows directly linked should be valued in line with the carrying value of the underlying items, and***
- b) ***The value of fulfilment cash flows not directly linked should be valued in line with the proposed BBA methodology?***

Furthermore, should changes to fulfilment cash flows that are:

- a) ***Directly linked flow through P&L or OCI consistently with the underlying items,***
- b) ***Indirectly linked flow through P&L, and***
- c) ***Not linked (e.g. mortality, expenses) flow through P&L or OCI in accordance with the standard BBA approach?***

Exposure Draft Proposal

Conceptually, the purpose of the proposed requirements is to align the value of contracts with cash flows dependent on or "linked" to specified underlying items (per ED paragraph 33) with the value of those underlying items. These contracts

are commonly referred to in the comment letters as "mirrored contracts". Based on comment letter responses, the definition of the business covered by these provisions is written so that two main categories of policies are expected to be impacted in Asia, unit-linked or variable products and participating products.

The guidance requires splitting the projected cash flows into three components: cash flows directly linked to the specified items, cash flows indirectly linked to the specified items (generally interpreted as cash flows resulting from options and guarantees), and cash flows not linked to the specified items. The cash flows not linked to the specified items are those considered to be linked to other factors like mortality, lapses, expenses, etc.

The directly linked component is then valued and reflected in the P&L or OCI in line with the carrying value of the corresponding specified items. The indirectly linked component is valued using a BBA approach with all changes to the value reflected immediately through P&L. The remaining component would follow the more traditional BBA reserving requirements as outlined in the exposure draft. Changes in prospective cash flows within this final component are absorbed by the CSM, to the extent possible. Neither of the other cash flow components described above trigger unlocking of the CSM.

Comment Letter Summary

Arguably, one of the most complicated components of the exposure draft, the treatment of mirrored contracts was certainly one of the most contested. While some respondents felt that the principle of relating the liabilities directly to the carrying value of underlying items was sound, the application was almost universally considered inappropriate. Two common concerns were the inherent interdependencies of the projected cash flows and the subjectivity of cash flow segmentation which would lead to inconsistent application.

Certain classes of contracts, commonly referred to as participating business here in Asia, that pass investment experience to policyholders while also passing the costs of other risks, such as mortality, morbidity, lapses, expenses, or some combination thereof, are interpreted by respondents as falling under the guidance that requires segmentation of cash flows. Most respondents felt that for this class of products the cash flows were too interdependent and any segmentation of cash flows was an artificial construct and not representative of the realities of the contracts. Given this fundamental

interdependency, the required segmentation of the cash flows for these products was considered inappropriate.

Those respondents that supported the principle of directly relating reported values to the carrying value of the specified underlying items still felt that the complexities inherent in the segmentation of the cash flows in these participating contracts would prove operationally intractable. Maintaining principle-focused, i.e. non-prescriptive, yet clear guidance for the variety of products and designs available in the global market was felt to be impractical. The resulting interpretation of methodology used to segment cash flows as prescribed was deemed likely to result in significant variance in reporting by companies with economically similar contracts.

Whether in support of mirroring" or not, almost all respondents suggested that segmentation of projected cash flows for these contracts should be eliminated. It was felt that the contracts should be treated holistically in an approach more closely aligned to the BBA approach.

Again, while not consistently included by the respondents, a few responses discussed tangential topics for participating contracts. Comments included the concept of the "floating CSM", reflecting shareholder interests in par funds in the CSM in line with the spirit of the unearned revenue concept underlying the CSM, and reflecting the link between fund earned rates and discount rates in accounting for asset dependent cash flows.

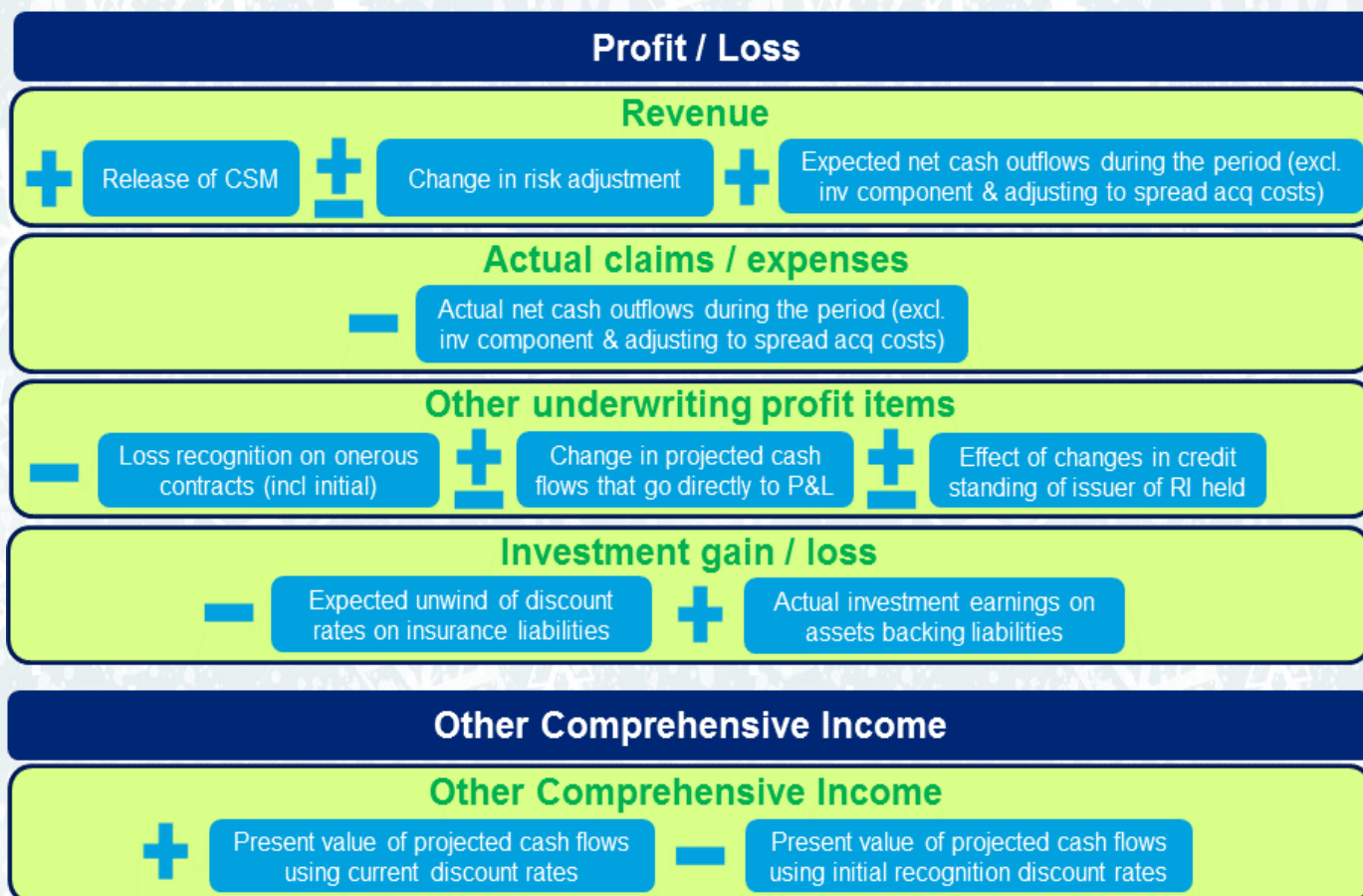
Question 3 — Presentation of insurance contract revenue and expenses

Should financial statements presents, in profit or loss, insurance contract revenue and expenses rather the changes in the components of the insurance contracts?

Exposure Draft Proposal

The proposed revenue recognition presentation outlined in the exposure draft was designed to provide for the intricacies of insurance products while staying as aligned as possible with the general revenue recognition guidance inherent in the universe of IFRS standards (see Diagram 2). This approach was proposed in order to improve consistency with other industries and thus generate more directly comparable financials across insurance and non-insurance entities alike.

Diagram 2 – IFRS 4 Revenue Recognition



Comment Letter Summary

Despite a uniform disapproval of the approach, there was little overlap in the suggestions for a solution.

Support for principle of attempting to align with IFRS general revenue recognition principles was also mixed. Some disagreed with the approach conceptually, feeling that such an alignment was poorly conceived. One respondent provided the concise argument that the very existence of IFRS 4 was necessitated by the differences in the nature of insurance business and that if the general approach was appropriate you wouldn't need IFRS 4 in the first place. At the other end of the spectrum, another respondent applauded the attempt of the draft to achieve such alignment as the resulting comparability would be a valuable outcome.

However, all respondents agreed that the exposure draft's presentation was not appropriate in its current form. Complexity and cost were the most common concerns. A prominent third theme was the value of the information provided. Presentations utilised under current reporting bases were commonly compared favourably to the proposal while some used colourful phrases such as "questionable ... decision-usefulness" to describe the approach.

Often, proposed alternatives weren't provided, but those respondents with suggestions provided various options including reconciliations to traditional volume measures, presenting gross premiums consistent with existing IFRS, and utilizing an alternative presentation being developed by the American Council of Life Insurers.

Question 4 — Interest expense in profit or loss

Should underwriting performance and changes to discount rates be separated by recognizing through the P&L the interest expense "using the discount rates that applied at the date that the contract was initially recognized" and by recognizing through OCI the difference between the carrying amount determined by "discount rates that applied at the reporting date" and the carrying amount determined by the rates used for interest expense?

Exposure Draft Proposal

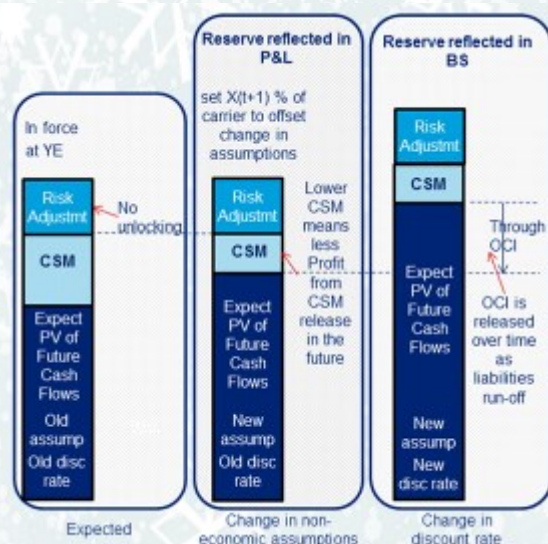
Simply put, the ED proposes to reflect changes to the book value of the liabilities through P&L with a market value adjustment flowing through OCI directly to Shareholder's Equity. Using interest rates that "applied at the date that the contract was initially recognized for P&L purposes" and allowing the change in liability from

at the date that the contract was initially recognized" for P&L purposes and allowing the change in liability from changes in current rates to be recognized in OCI was designed to match the recognition of liability changes with the corresponding changes to assets held in support of the same (see Diagram 3). This valuation approach is commonly abbreviated as FVTOCI compared to FVTPL (or fair value through P&L) where full market value changes are recognized immediately through the P&L.

Comment Letter Summary

Respondents felt this approach was not reflective of reality as Asian insurance companies invest in a broader range of assets than fixed interest securities which are assumed to be held at FVTOCI. Given common investments in equities, real estate, and even derivatives, FVTOCI was expected to result in significant volatility via asset accounting mismatches if made mandatory as the current exposure draft requires. **Proposals to make FVTOCI optional (FVTPL being the other option) were nearly universal** with the added suggestion from several respondents that the option should be made at inception of the business and irrevocable to avoid abuse. This was proposed to allow companies to more closely align their liability accounting with the accounting of the underlying assets.

Diagram 3 – OCI Effects



A notable exception in this category was that one company we reviewed aligned with Stephen Cooper (the only dissenting rules are

dissenting IASB member to the publication of the exposure draft) and stated the entire OCI approach was flawed and all asset and liability values should be reported at fair value at all times. Several companies also suggested revisions to existing hedging rules to more closely match asset and liability accounting as well.

Tangential to the OCI discussion, several companies suggested that using a long-term average rate for long-term rates (when observable market data was absent or unreliable) was appropriate and necessary to reflect the economics of the business and to reduce unjustifiable volatility.

Question 5 — Effective date and transition

Do you agree that the proposed approach to transition appropriately balances comparability with verifiability?

Exposure Draft Proposal

Upon transition, the requirements are proposed to retrospectively apply to all business in-force at that time. The proposed implementation period is three years from final approval of the standard to allow companies to prepare and create the infrastructure to effectively report under the requirements. To facilitate ease of transition, provisions allow for expediency measures in instances where historical data is not readily available for a full theoretically accurate valuation of existing, ostensibly older, blocks of business.

Comment Letter Summary

The retrospective nature of the transition and the included expediency provisions were often favourably referenced in the responses. Several respondents suggested further increasing the expediency measures to allow application to a broader set of business.

An important concern on the minds of the respondents was alignment with IFRS 9 and its corresponding asset classification. While alignment in terms of timing was suggested by several respondents, in its absence, optional asset reclassification at the time of IFRS 4 adoption was felt to be a reasonable alternative.

The 3 year transition period was felt to be acceptable as a minimum by most respondents, but suggestions to extend the period for another exposure period with more field testing were also not uncommon.

Question 6 — The likely effects of a Standard for insurance contracts

As a whole, how do the costs compare to the benefits for the proposed requirements, particularly considering transparency and the compliance costs of transition and an ongoing basis?

Whether adoption would be positive or negative overall varied by respondent. All respondents felt it would be complex and costly to implement, but whether this cost will come with improved transparency and comparability or a regime fraught with accounting mistakes will have to be determined upon adoption.

Related to question 3, several respondents felt that presentation will be one of the more onerous elements to implement.



Jeremy Menzies
Director
Deloitte Actuarial and Insurance
Solutions (Hong Kong) Limited
jmenzies@deloitte.com.hk

Question 7 — Clarity of drafting

Do you agree that the proposals are drafted clearly and reflect the decisions made by the IASB?

Clarification was felt by most to be required in numerous and varying areas. A common thread amongst respondents was the call for an increased set of illustrative examples.

The ability of the proposals to reflect the decisions by the IASB appeared to be largely ignored by respondents.



Jack Walton
Associate Director
Deloitte Actuarial and Insurance
Solutions (Hong Kong) Limited
jwaltoniii@deloitte.com.hk

This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively the "Deloitte Network") is by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.



IFRS 4 Revised Exposure Draft:

CSM - Creating Stress for Management?

Overview of IFRS 4 Revised Exposure Draft

On 20 June 2013, the International Accounting Standards Board ("IASB") issued a revised exposure draft ED/2013/7 *Insurance Contracts* ("revised ED") which takes into account the re-deliberations by the IASB since the July 2010 exposure draft ED/2010/8 *Insurance Contracts* ("2010 ED").

The principles of measurement of insurance contracts set out in the revised ED are similar to those in the 2010 ED but a number of important changes have been made:

- The contract service margin ("CSM") would be adjusted for changes in the estimate of the present value of future cash flows ("PVCF") that relate to future coverage and other future services
- Specified measurement and presentation exception for contracts that require the entity to hold underlying items and specify a link to returns on those underlying items features
- Present revenue and expenses in the statement of comprehensive income
- Present interest expense determined using the "locked-in" discount rates in profit or loss ("P/L") and the effects of changes in discount rates in other comprehensive income ("OCI")
- Amend the approach to transition to allow for a modified retrospective approach where the entity would need to apply the new standard to all prior periods if practical and estimate the CSM where impracticable

This article will look into the first item and the implications of CSM measurement for insurers.

Measurement of the CSM

The CSM is recorded when insurance contracts are initially recognized and eliminates day-one gains. In other words, the CSM is the unearned expected profit of the contracts and, according to the revised ED, should be released into P/L over the coverage period in the systematic way that best reflects the remaining transfer of services that are provided under the contract. As such, the determination and any subsequent change(s) of CSM are important to performance indicators and operational requirements for insurers.

As opposed to the 2010 ED that stated all changes in the estimate of the PVCF should be recognized immediately in P/L, the revised ED proposes to adjust for these changes in the CSM [revised ED Para. 30]:

- The cash flows should relate to future coverage and other future services
- Both favorable and unfavorable changes in PVCF would be adjusted
- Any adjustment made to the CSM should not cause the CSM to be negative

The CSM at the end of the reporting period would be [revised ED Para. 30]:

- The CSM at the start of the reporting period
- *plus* interest accreted on starting CSM based on the initial discount rate
- *minus* the release of CSM into P/L to reflect services provided during current period
- *plus* net change in PVCF

The rate at which the remaining CSM is released into P/L in future periods would then be revised based on the updated CSM.

Considerations for insurers

In releasing or amortising the CSM into P/L, there are two key considerations for insurers:

(i) Level of aggregation

There is some flexibility in this regard as the revised ED does not prescribe any specific approach. Having more cohorts (e.g. quarterly, annual) and portfolios (e.g. line of business, product group, product) for CSM calculation will give more granular P/L recognition but undoubtedly will be computational more intensive. The impact will depend on the variability of profit by "cohort". Also, there is potentially greater risk of loss recognition if a more granular approach is taken.

(ii) Profit driver(s)

Again, the revised ED does not prescribe any specific driver to use as long as it "best reflects the remaining transfer of services that are provided under the contract" [revised ED Para. 32]. Potentially relevant models are Australian Margin on Services and US FAS 97 Limited-Pay that insurers might make reference to when determining what driver(s) to use to release the CSM into P/L. In the latter model, profits of FAS 97 limited-pay traditional policies emerge as a level percentage of insurance in force as well as a release of the PAD.

Illustration

To gauge into the variability of profit emergence, we have studied the effects of different drivers on the pattern of P/L using a sample unit-linked product sold in the Hong Kong market.

Product features:

- 25-year whole life unit-linked
- Fees & Charges: (i) policy establishment fee, (ii) administration charge, (iii) COI charge and (iv) surrender charge
- Bonuses: (i) first-year bonus and (ii) investment & loyalty bonus
- Death benefit is max of (total premium paid, account value + \$2,500)

Insured data:

- Male non-smoker with issue age of 30

Key assumptions:

- Net fund growth rate: 3%
- Discount rate: 3%
- Lapse: 5%
- Risk adjustment (determined by PVCF at padded assumptions *minus* PVCF at best estimate)
 - ◆ Mortality: +10%
 - ◆ Maintenance Exp: +10%

For the purpose of our analysis, we assume there are no fee rebates, no indirect costs and no economic or accounting mismatches in assets. We also assume the building block approach is applied to all cash flows. In reality, cash flows of unit-linked products might need to be separated into investment and insurance components for measurement.

With the information above, we have derived the CSM and IFRS profit using different profit drivers:

Diagram 1: CSM using different profit drivers

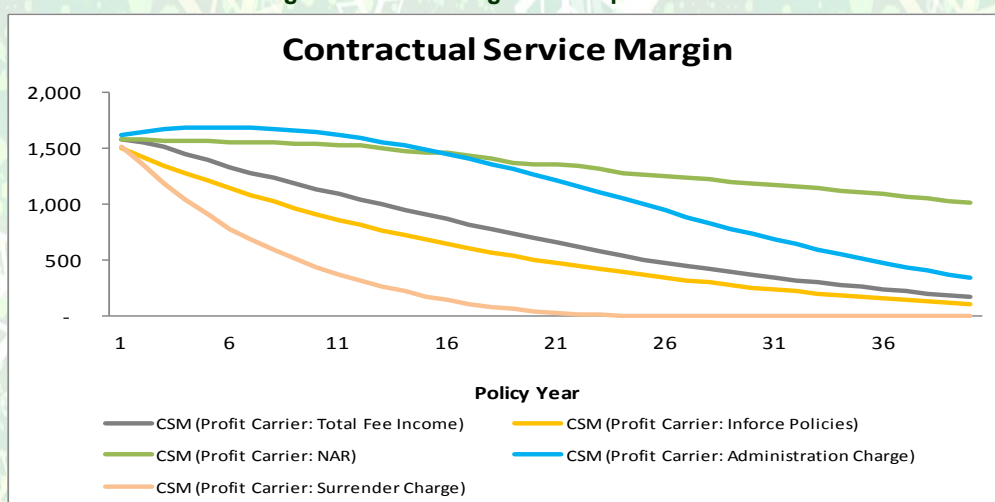
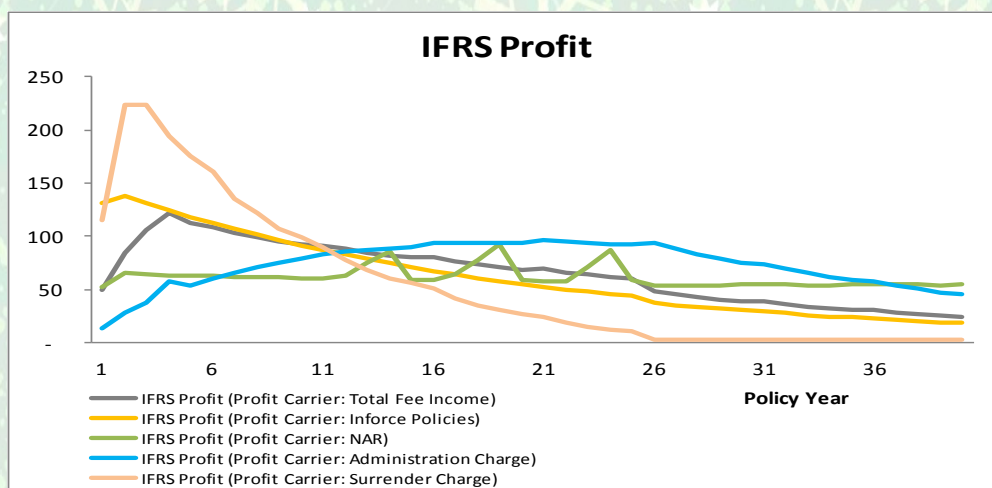


Diagram 2: IFRS profits using different profit drivers



From this, we can see that the pattern of profit emergence could be very different using different profit drivers:

Profit driver	IFRS profit emergence
(1) Total fee income	The release of CSM into P/L is the most even among all the drivers in our analysis.
(2) Number of inforce	More profit will show up in the initial period when the number of inforce is high. The profit then reduces gradually over time as the number of inforce declines.
(3) Net amount at risk ("NAR")	The profit pattern is uneven when the NAR exceeds \$2,500.
(4) Administration charge	Based on the 1.5% administration charge, the profit pattern appears smoother but the profit, compared to that using other drivers, is the lowest in the initial period when the account value has not yet built up.
(5) Surrender charge	Using surrender charge releases the margin completely during the surrender charge period of 25 years and there will be no profit emergence afterwards even though the contract is still inforce.

CSM - Creating Stress for Management?

From the simplified analysis above, the amortization rate of the CSM is highly dependent on the choice of profit drivers. This in turn drives the pattern of P/L emergence. **In light of the varying P/L patterns that could be brought about, insurers would need to perform analysis for all of their products to support their decision on how to amortise, report and manage the CSM at the level of aggregation they consider appropriate.** The analysis would also need to consider both inforce and new business, as the impact from inforce may be more significant.

As a reminder, the principle underlying the determination of the profit driver is that it should amortise the remaining contractual service margin in P/L over the coverage period in the systematic way that best reflects the remaining transfer of services that are provided under the contract.

Although not specified in the revised ED, it is not expected to be likely that insurers could change the drivers from time to time, as it would introduce inconsistency and thus incomparability in financial statements. As such, it is key that management consider and assess the implications of using different profit drivers. With the CSM as a new item on the financial statements under the revised ED, it is anticipated that it will require management to put in place new policies, systems, processes, controls, resources, etc. to support its reporting and management. Although not identified by the IASB as an area for further comments, the implications from these considerations should not be underestimated.



Florence Ng
Senior Consulting Actuary
Ernst & Young Actuarial Services, Asia Pacific
florence-sh.ng@hk.ey.com

The views expressed herein are those of the individual author and do not necessarily reflect the views of Ernst & Young.

Advance preparation - What should you be doing now?

In the wake of the IFRS 4 re-exposure draft and in anticipation of the final standards coming in 2015, what are we recommending that insurers do now?

Although the standard is not in its final form, the changes identified to date, coupled with reporting changes in respect of financial instruments and regulatory developments under way, warrant insurers' continued planning now – if only to think about how implementation will interrelate with other strategic priorities.

The fundamentals of the proposed model are now in place with limited changes expected. For example, the Boards have confirmed the key building blocks of measurement, including: developing estimates of cash flows; using current assumptions in measurement; discounting with a current rate that corresponds with the contract's duration; and determining and remeasuring a risk adjustment plus a contractual services margin. This allows for consideration now rather than later.

There are a number of possible approaches, some of which are more obvious than others.

Watch and wait	Warming things up	An eye to the future	Getting started	Early mover?
<ul style="list-style-type: none"> ◆ Keep informed as to the development of final standards and the areas of contention ◆ Ensure that areas of the business outside finance that will be impacted (e.g. IT, HR, product design) are aware of key aspects of changes 	<ul style="list-style-type: none"> ◆ Ensure that the board, audit committee, senior management know how profound the change is likely to be ◆ Convey key impacts and set expectations around the timing and cost of implementation ◆ Emphasise potential for cost efficiencies in longer term as well as initial cost of compliance ◆ Secure budget for change 	<ul style="list-style-type: none"> ◆ Ensure that changes are considered when planning updates to finance processes ◆ Aim to 'future-proof' processes in preparation for accounting and solvency changes ◆ Consider what additional data requirements you will have. Is this data collected now? ◆ Also consider IT system developments: these will be impacted by accounting and solvency developments ◆ Consider the impact on profit emergence of existing products 	<ul style="list-style-type: none"> ◆ Understand capability to respond <ul style="list-style-type: none"> • Can systems (accounting, admin, modelling) handle change?"? • Who needs to engage in the business? IT? HR? Actuarial? Product design? Board? What resources are needed for transition and BAU? • How will you get buy-in from other areas of the business? • When and what should you tell third parties (investors, analysts, etc)? 	<ul style="list-style-type: none"> ◆ Some elements are not expected to change (future cash flows, discounting) ◆ These components will drive system changes – can begin to assess what it will mean particularly for products, distribution, systems data and modelling ◆ Although an end-to-end project requires final standards, preliminary work on information needs, resource requirements and modelling needs can be used for future planning

Responses to the exposure draft from KPMG, other actuarial advisors, professional organizations, supervisory bodies and insurers have identified a number of concerns. These include the practicality of the mirroring approach, including risk adjustment in contractual services margin unlocking and introduction of accounting mismatches by allocation of movements to OCI or statement of profit or loss. Caution should be exercised before committing to significant amounts of work in these areas, but insurers that can answer the following questions will be in a significantly better position to navigate the changing financial reporting landscape.

Financial management and performance reporting

- ◆ Have you carried out a high-level impact assessment of life in a world in which discount rates and other assumptions are updated at each reporting date? Can you model the key blocks of your business on a simplified basis?
- ◆ Do these changes offer your group the opportunity for larger-scale financial reengineering by enabling the elimination of gaps between local reporting and group reporting?
- ◆ We know that financial reporting will undergo significant change over the next several years. This will be driven not only by the insurance project but also by changing capital requirements, including the introduction of RBC in Hong Kong, and changes in the reporting for financial instruments, consolidation principles and leasing, among others.
- ◆ How will you help investors and other users to navigate this jungle of change? For how long will you provide metrics on a new world basis before switching off the old world?

- ◆ Many insurers focus on presenting a balanced portfolio of metrics that address profitability, cash generation, capital, and value creation. How will the new world affect your choice of key performance indicators? Will you retain the non-GAAP measures that you currently use or can you simplify your choice of metrics? How will you demonstrate stability and consistency of your investors during a period of significant reporting change?
- ◆ Have you considered how to manage the possible increased volatility in the financial statement due to assumption updates at each reporting date?
- ◆ Have you considered how the timing of the proposed changes will interact with other significant reporting changes, such as the new financial instruments standards?
- ◆ Have you considered the impacts with those of the financial instruments standards (IFRS9) and future US GAAP and any consequences for investment strategies?
- ◆ Have you considered the impacts on your current products and changes to patterns of profit emergence?
- ◆ How will the discount rates used in the new measurement model compare with those in your product pricing?
- ◆ Are there any steps you might want to take now to review product design or pricing for future products?
- ◆ If financial reporting drives capital requirements, have you started engaging with your supervisors and rating agencies?

People: Education, knowledge, capacity and creativity

- ◆ Does your financial function have the capacity to assess the impact of the exposure draft and understand what the proposals mean for your business?
- ◆ Have you started educating internally and externally about the implications of the new standard? This needs to include business users, including analysts, investors and stakeholders, as well as those directly affected, the audit committee and board, investor relations and communications.
- ◆ What about your investors as the IASB's and FASB's attention is focused on addressing the needs of analysts and stakeholders? Some companies are beginning to hold discussions with investors and analysts now to prime them on upcoming changes so that they can contribute to the debate.
- ◆ How will the proposed changes in financial reporting impact any other large-scale change programmes that you have under way? How will you guard against change fatigue, particularly if you've been working on implementing Solvency II or other regulatory changes? Have you identified and engaged the change agents in your team?

Systems and processes

- ◆ How flexible and reliable is your modelling capability? Does it have sufficient capacity to handle your existing reporting requirements, such as embedded value and economic capital, as well as being used to determine the impact of an eventual insurance standard? Does it have the flexibility and speed to support 'what if' analyses while you are investigating the impact of these developments?
- ◆ Have your group reporting and consolidation systems got the capacity to handle parallel reporting on both an 'as is' and a 'to be' basis? In our experience, consolidation systems often are the pinch point when handling both business-as-usual reporting and investigating the results of reporting changes.



- ◆ How easily can you derive a market yield curve across the entire duration of your liabilities? What will this mean for the timing of your close process if you are currently using locked-in discount rates?
- ◆ How easily can you model your ceded reinsurance portfolio or do you apply fixed ratios to existing earnings models?
- ◆ What would these proposals (e.g. mirroring approach, unlocking of contractual service margin, use of OCI to present impact of change in discount rate) mean for your asset/liability management?
- ◆ Do outsourcing agreements give you the flexibility that you will need to source new data requirements?
- ◆ Have you contemplated the potential lag time in reporting? Additional time will be required to prepare results under the new measurement and reporting model and may reduce the speed of reporting in the short term as well as creating a capacity crunch during the transition period.
- ◆ Have you planned for sufficient IT resources and how does this dovetail with other IT development priorities?
- ◆ Have you considered the process implications of calculating liabilities using both a discount rate set at inception and a current discount rate, so that an element of the volatility from the movement in discount rates is reflected in other comprehensive income? This may require an element of 'double work' to calculate liabilities using both current estimates and assumptions, and a locked-in discount rate.

Managing the process

- ◆ Implementing the new standards is more than just an actuarial or accounting exercise and KPMG firms' multidisciplinary approach helps to translate accounting impacts into tangible actions to deliver the required changes from systems, processes, people and the wider business. The transition to a new reporting basis will require a comprehensive change programme.

KPMG observations

- ◆ Over the coming years there will be significant changes in the financial reporting landscape for insurers, affecting not only insurance contracts but also financial instruments, the scope of consolidation, leasing and revenue recognition. These changes are mostly running concurrently and are interlinked and taking place against a backdrop of regulatory change here in Hong Kong.
- ◆ Successful change requires careful planning. Stakeholders such as analysts, regulators and policyholders will need to be kept informed. In this economic environment, pressure on costs is rising and this represents either additional pressure or the opportunity for transformational change.



Patrick Rowland
Senior Manager
KPMG China
patrick.rowland@kpmg.com



Thomas Tang
Senior Manager
KPMG China
thomas.km.tang@kpmg.com

IASB's recent exposure draft on insurance contracts reporting

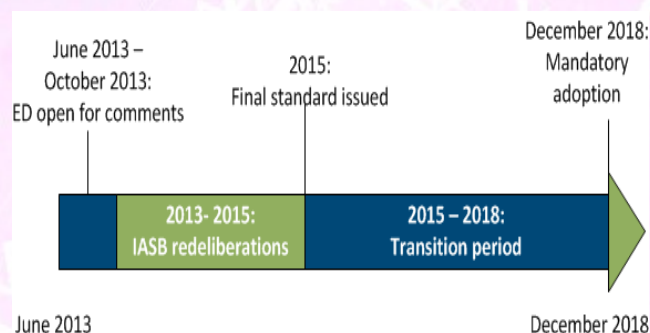
The IASB recently issued an exposure draft (ED) on insurance contracts, which builds on the 2010 ED. The revised ED proposes some far-reaching changes to accounting for insurance contracts, with possible implementation by 2018. In this article, Michael Daly and Sing Yee Yeoh from Milliman summarise the main areas of consultation and consider what it means for liability measurement

BACKGROUND

The 2013 ED is the latest development in the International Accounting Standards Board's (IASB) long-running project on accounting for insurance contracts. The ED is intended to replace the current standard, IFRS 4: *Insurance Contracts*. The consultation period is open until 25 October 2013, although this is only a limited re-exposure which focuses on areas that have changed since the 2010 ED. In addition, the IASB is keen to understand the likely costs of implementing the proposals to feed into its cost/benefit analysis.

Mandatory adoption of the proposals will be three years after the issue of the final standard, recognising the complexity of implementation. Under the proposed timetable, the final standard could be issued in 2015, and so mandatory adoption could be as early as year-end 2018.

Figure 1: Latest Timeline



The proposals will clearly be of interest to companies currently reporting under IFRS, but these are not the only companies potentially impacted by the proposals.

In the United States, the Financial Accounting Standards Board (FASB) has also recently published its own ED on insurance contracts reporting. Whilst the IASB proposals and FASB proposals are similar, there are some important differences. Such differences may reduce the global comparability of (re)insurers' accounts.

The new ED is an important step towards the IASB's aim for comparable and consistent insurance accounting.

Some of the proposed changes are far-reaching and will require considerable effort to implement. Therefore, we encourage insurers to respond to the consultation.

The wider implications of the ED include pricing, financial reporting, systems and investor communication.

The IASB has listened to feedback on the 2010 ED, and in some respects the revised proposals are an improvement on the earlier proposals. However, there are still areas where the proposals are significantly different from current reporting and Solvency II proposals.

The major elements of the proposed 'building blocks' approach to liability measurement are set out below.

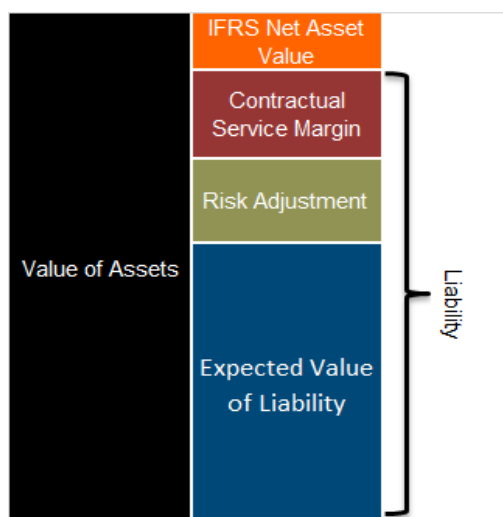
SUMMARY OF BUILDING BLOCKS APPROACH TO LIABILITY MEASUREMENT

For long-term business, the IASB proposes to use a current measurement framework which maximises the use of market observable inputs, and updated estimates and assumptions are used at each reporting date. This approach is intended to reflect the time value and uncertainty of the liability.

In particular, the liability measurement uses as a *building block approach* that consists of:

- *Expected value of liability (EVL)* – the unbiased present value of future fulfilment cash flows discounted at current yield curve
- *Risk adjustment* – an adjustment to reflect uncertainty as to the amount and timing of the future cash flows
- *Contractual service margin (CSM)* – a liability set up to eliminate any gain at policy inception

Figure 2: IFRS Assets and Liabilities – Building Blocks ¹



The EVL includes the time value of options and guarantees. A bottom-up or top-down approach can be used to determine the discount rates for the expected value of liability calculation.

The discount rates should also reflect the illiquidity of the liabilities, and so may include an illiquidity premium. Unlike the currently proposed Solvency II approach, there is no prescribed approach to determining the illiquidity premium and only broad principles are set out.

Estimates of future cash flows underpin the EVL calculation. These calculations may be stochastic Monte Carlo simulations, although the ED makes it clear that deterministic modelling is allowed provided it is sufficiently accurate. It is unclear how the assessment of accuracy of alternative methods should be performed.

The contract boundary of the cash flows is similar to the proposed definition under Solvency II, and focuses on where the insurer has the right to reassess the premium so that it fully reflects the risks.

The risk adjustment can be calculated under any one of a number of specified approaches, in contrast to Solvency II and the 2010 ED which both specify the calculation approach. However, insurers must disclose the confidence level associated with the risk adjustment to assist comparability.

The CSM is effectively a liability set up to limit profits at issue to zero and to recognise these over the lifetime of the contract. The role of the CSM in both initial and subsequent measurement is discussed further below.

The IFRS net asset value is calculated as the difference between the value of the assets and liabilities. The revised ED does not discuss asset valuation, as this is covered under other standards such as IFRS9 or, currently for European insurers, the EU carve-out of IAS39: *Financial Instruments*.

Short-term contracts

Where the original contract term is one year or less, insurers are permitted (but not required) to use a simplified measurement approach. This approach sets the pre-claims liability equal to the unearned premium liability. Claims liabilities follow the building block approach.

Initial measurement

Under the proposals, there is no profit recognised at the point of issue of a contract and this is achieved through establishing the CSM. However, any losses are immediately recognised through P&L.

The CSM is measured separately for ceded reinsurance contracts and directly written insurance contracts. This potentially creates an accounting mismatch if the directly written business is, when considered in isolation, loss making but the reinsurance makes the overall new business profitable.

In this case, a loss would be recognised immediately on the directly written policies, and on the reinsurance contract the CSM would be established such that it eliminates any initial profit. Hence, net of reinsurance there would be a time zero loss, despite the portfolio being economically profitable on a post reinsurance basis.

Subsequent measurement

The liability balance sheet components are re-calculated at each reporting date.

For the EVL and risk adjustment, this involves re-running the actuarial model calculations at each valuation date with updated data and assumptions.

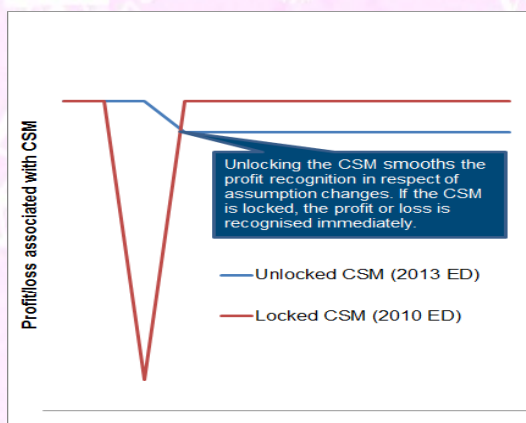
The CSM is calculated using a prescribed roll forward calculation from its initial value. Consequently, the CSM roll forward becomes a material driver in the P&L statement.

If estimates of future cash flows underpinning the EVL change, the CSM is unlocked to reflect the revised cash flows. This unlocking potentially achieves smoothing of profit and loss related to future assumption changes.

¹ Not to scale

Figure 3 illustrates the impact of unlocking the CSM in a simple worked example compared to not unlocking the CSM, which was the proposal in the 2010 ED.

Figure 3: Impact on P&L of unlocking the CSM



In this example, the assumed future cash flows are revised to be more onerous in Year 3. If the CSM is unlocked, as proposed, the profit follows the blue line in the above figure and the loss is smoothed over the future lifetime of the contract. If it is not unlocked, profit follows the red line and the full loss associated with the assumption change is immediately recognised and the original profit level is maintained going forward.

The unlocking of the CSM is a welcome change (to the 2010 ED) for those in favour of smoothing profits, as it effectively spreads the impact of changes in future assumptions. Such unlocking also helps to avoid potential accounting differences between in-force and new business which existed in the 2010 ED, as in-force and new business profits will be similarly smoothed rather than the former being immediately recognised in P&L.

However, there is some complexity to unlocking the CSM, and so there may be an associated cost. For example, we understand that the IASB intends that a zero CSM can subsequently be reinstated given sufficient profits. So it may be necessary to continue monitoring portfolios with zero CSMs to see if there is an opportunity to subsequently reinstate the CSM.

Additionally, it is noted that changes in the risk adjustment still flow directly to P&L with no smoothing mechanism. Some may argue that the CSM should absorb changes in the risk adjustment too.

Furthermore, the requirement to disclose the corresponding confidence level for the risk adjustment may be potentially onerous, especially if an approach other than confidence levels is used for the calculation.

Some aspects of the measurement requirements in the ED, such as the setting of discount rates and risk adjustment methodology, are high-level principle-based, and allow some welcome flexibility to insurers. However, the issues lie in the detail.

KEY POINTS OF THE 2013 EXPOSURE DRAFT

Summarised below are some of the key points to note in the detail of the 2013 ED and our understanding of the potential impact these may have.

Locked in assumptions apply in P&L

Balance sheet liabilities will reflect current discount rates, but the impact of changes in discount rates will be split on the income statement. A portion of these will be recognised in the P&L and a portion through other comprehensive income (OCI).

Under the proposed ED, the impact of changes in discount rates from the point of sale (initial recognition) to current discount rates will be recognised through OCI. This creates the potential for accounting mismatches. Under proposed changes to IFRS 9: *Financial Instruments*, some of the movement in asset values will be recognised in OCI, but some will need to flow through P&L.

There will undoubtedly be significant system implications around needing to store locked-in discount rates in the form of yield curves in addition to current yield curves. This will also give rise to challenges in understanding and communicating the unwind of multiple yield curves in P&L to investors and analysts.

Mirroring approach

Where payments to policyholders depend on underlying assets, the accounting for cash flows which vary directly with the underlying asset will follow the accounting on the underlying asset. This proposal affects unit linked and potentially with-profits contracts.

There may be a need for different accounting for different aspects of the product. Potentially, parts of the contract will be accounted for as an insurance liability and other parts will be consistent with the underlying assets. For example, changes to asset share may need to be disaggregated into an underlying mirrored portion and a portion following the building blocks approach. Furthermore, under the proposals, all changes to the value of the shareholders' interest in the estate appear to flow through directly to P&L, which is likely to create additional balance sheet volatility.

Under these proposals, it appears that the liability for a with-profits contract would be the asset share plus other items such as the cost of guarantees and smoothing. If smaller with-profits companies are required to report under ED proposals, it appears that they will need to develop realistic reporting methodologies. This may entail significant cost.

Unit-linked contracts will also be impacted, and there is uncertainty over the treatment of annual management charges (AMCs). If AMCs are deemed to vary directly with the underlying asset, then the accounting for AMCs will follow the accounting for the asset and not follow the proposed insurance standard. We understand that the

IASB intends that the liability will be the unit value (under the mirroring approach) plus a non-unit reserve based on expected future expenses minus future charges. Further clarification from the IASB in the final standard would be useful.

Revenue recognition no longer linked to written premium

Revenue will be recognised as services are delivered to the policyholder. Under this model, revenue arises from the run-off of the liability due to expected claims and expenses and any reduction in the CSM and risk adjustment over the period. Consequently, for single premium contracts, the premium will no longer be immediately recognised as revenue on day one but effectively earned over the contract period. This 'earned premium' style approach to reporting revenue will potentially have a significant impact on the reporting of revenue.

The revised approach is in line with the IASB's draft conceptual approach to revenue recognition. However, there may be practical issues with implementation as revenue will no longer be linked to typical cash general ledger items (as it will be linked to the release of benefit reserves and margins). Furthermore, explanation of results to users of the accounts is likely to become more challenging.

Bifurcation of contracts

Distinct investment and insurance components for a contract will need to be split and accounted for separately. The revised ED will apply to the insurance components of the cash flows and IFRS 9 will apply to investment components. This potentially has significant implications for annuities with guaranteed periods, where cash flows related to the guarantee period may need to be separated from the non-guaranteed period. This would be an onerous requirement which is likely to involve substantial costs in systems development as well as lead to a change in the profile of revenue recognised.

Unlocking the CSM to smooth profit or loss related to future assumptions

Although locked in discount rates (at the point of sale) apply in determining the P&L, the CSM is updated for expected changes in best estimate future cash flow assumptions. This change appears to smooth profits or losses (see Figure 3) in line with revenue recognition.

Transition

At transition, for in-force business, the existing liability will be de-recognised and replaced with a liability consisting of the building blocks described above. The ED allows various simplifications in the calculation of the liability at transition, which appears to be a pragmatic approach providing users of the accounts with useful information. However, the transition calculations will potentially be onerous for insurers due to the need to calculate the CSM for the in-force business.

Profit and loss

There is a revised definition of profit and loss, where unwind of the CSM is an important driver of profitability. The revised definition may require significant systems changes to

implement, and there may be challenges in explaining the new presentation to analysts and investors.

CONCLUSION

The 2013 ED is an important milestone in the IASB's insurance project. The IASB has listened to feedback on the 2010 ED, and the revised proposals contain many improvements.

There are seven areas where the IASB is seeking feedback, namely:

- 1) The CSM and whether or not this should be adjusted for changes in estimates of future cash flows
- 2) The mirroring approach, which will apply to contracts where payments to policyholders directly depend upon the returns on the underlying assets or liabilities
- 3) The presentation of insurance contract revenue
- 4) The movement in discount rates and how these should be recognised in P&L versus OCI
- 5) The effective date and transition requirements
- 6) The cost of implementation and the likely impact on transparency and comparability
- 7) The clarity of drafting

The IASB is only consulting on the above areas and has stated that it does not intend to revisit issues or approaches it has previously considered or rejected.

As a result, it is unclear whether responses to areas outside the above questions will be taken into account by the IASB in finalising the new insurance contract standard.

Some of the proposals are significant changes to the previous ED, current reporting and proposed Solvency II standards.

We urge insurers to fully participate in the consultation process.



Michael Daly
Principal and Consulting Actuary
Milliman Limited
michael.daly@milliman.com



Milliman does not certify the information

Sing Yee Yeoh
Consulting Actuary
Milliman Limited
singyee.yeoh@milliman.com

in this article, nor does it guarantee the accuracy and completeness of such information. Use of such information is voluntary and should not be relied upon unless an independent review of its accuracy and completeness has been performed. Materials may not be reproduced without the express consent of Milliman.

IFRS 4 Phase 2 ED Comment Letter – Hong Kong's Voice

Introduction

A new standard for insurance contracts is an opportunity to create more consistent and comparable reporting among insurers and to improve the way in which the performance of insurance business is presented to investors. The development of a comprehensive standard is essential because the current standard (IFRS 4 Phase I), that was only intended to be a transition standard, does not provide the level of transparency and comparability needed by the users of financial statements.



In June 2013 the International Accounting Standards Board ('IASB') issued a revised exposure draft ('ED') asking for comments on the five key areas that had changed from its 2010 ED on the accounting for insurance contracts. This paper outlines the Hong Kong based insurance groups and companies' response to the ED.

In its current draft form, the proposed standard would be one of the most complex standards to be adopted. In addition, it will likely frame the insurance reporting landscape for at least the next generation. With this complexity in mind, the IASB has listened to the need for practical expedients that will help companies in certain cases adopt and maintain the provisions of the proposals more easily and at a lower cost. We have made a number of suggestions in our comment letter that we believe will help achieve this objective. However, we believe that some complexity is necessary for the wide variety of insurance contracts and insurance business models that exist around the world, while at the same time considering the need for a high quality standard that will stand the test of time. On balance, we believe that a certain level of complexity is justified and reflects the fact that some insurance contracts are complex in nature and often contain multiple components.

Our key messages

Overall, we support the proposed model in the ED that measures the current value of the future cash flows and services of insurance contracts. In our response we broadly agree with changes made to the model proposed in the original ED such as:

- ◆ Adjusting the contractual service margin for changes in cash flows related to future coverage and other services.
- ◆ The revised transition requirements.
- ◆ The notion of revenue.
- ◆ The recognition of discount rate changes in other comprehensive income ('OCI'), although we believe it should not be mandatory, rather it should be optional at the portfolio level.

Our response highlights our concern with:

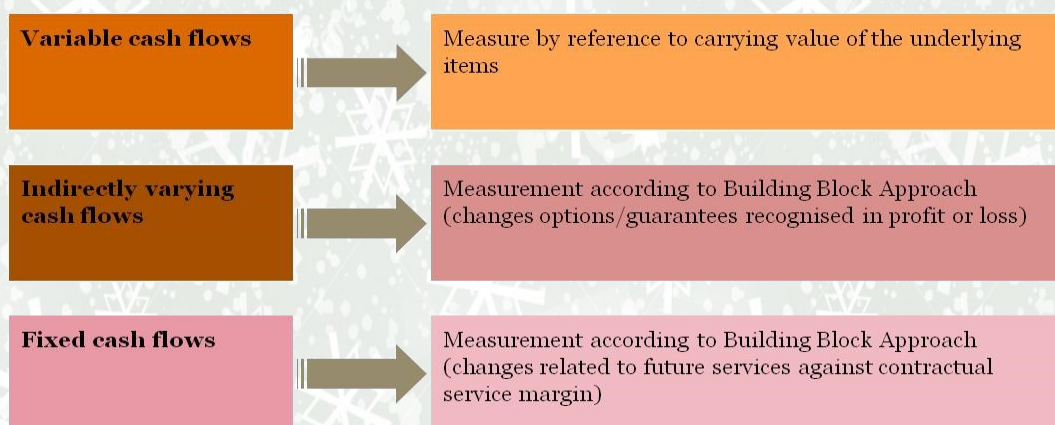
- ◆ The proposed accounting for contracts that include a linkage between the payments to policyholders and the returns on underlying items
- ◆ Interest expense
- ◆ Contract boundaries for contracts that can be re-priced at contract level

The following sections discuss these concerns in greater details.

Contracts linked to returns on underlying items

The area of the revised ED that has given rise to a great deal of debate concerns the treatment of accounting for contracts where one or more components are linked to returns on underlying items, often broadly referred to as participating contracts. These come in many forms. For some, such as unit-linked contracts, where there is a direct and immediate contractual link to underlying assets. For others, such as contracts with discretionary participation feature, including gated version, that is common in Singapore and Malaysia, and non-gated version such as participating contracts in Hong Kong as well as universal life contracts in general. For these contract types, the insurer has discretion regarding the amount and timing of returns on underlying items that are passed on to policyholders. Options and guarantees are often included in these contracts, such as minimum interest rate guarantees, guaranteed annuity options. The existence of these options and guarantees as well as the available use of discretion in allocating returns complicates the measurement of these contracts.

The IASB recognised that where there is no possibility of a cash flow mismatch in a component of these contracts, that part of the liability should be measured in the same way as the underlying assets (which some describe as 'mirroring'). The revised ED requires the decomposing of cash flows into directly varying, indirectly varying and fixed cash flows for some participating contracts as shown below:



The Mirroring approach was introduced to deal with a common issue of accounting mismatch. However, in our view, decomposing the cash flows is very difficult to implement in practice. For example, a portion of the premiums received is to service the guaranteed sum assured, but the rest is for investment for future dividends which are not guaranteed. It is very difficult to come up with an approach to split the premium without being seen as arbitrary. Similarly, part of the expense and surrender benefits vary with the performance of the participating fund, while part of these is fixed. It is very difficult to decompose these cash flows into fixed or indirect cash flows.

Decomposing the cash flows in these contracts can be performed in more than one way, which could lead to different accounting results. The IASB prescribed in its proposed application guidance how to decompose cash flows to prevent diversity in practice. Not only is this decomposition of cash flows complex, but the prescribed method may lead to values of options and guarantees that do not reflect how the contracts are priced or managed. In the simplified example included in the revised ED, the prescribed decomposition will lead to mirroring of 90% of the assets, a fixed amount and a written put option. From our discussions with insurers, we understand that they view and market these participating contracts as predominantly providing a fixed benefit (the guaranteed amount) with a written call option, which would lead to a very different accounting result than under the model prescribed in the revised ED.

Under the insurers' view of these contracts, the decomposition of the cash flows would not result in any mirrored amount. In addition, the lack of separately identifiable components in many discretionary participating contracts also complicates splitting up of the contracts' cash flows, because the different components can cross-subsidise each other. We believe that an approach which requires mirroring and decomposing cash flows cannot work effectively for many discretionary participating contracts and does not properly reflect the management and economics of these contracts.



Contractual Service Margin

Regardless of how options and guarantees are valued, another area of significant debate has been how changes in their measurement should affect the income statements. The revised ED requires that changes in indirectly varying cash flows, such as options and guarantees, are recognised directly in the income statement. We believe that these changes should be treated consistent with all other cash flows that fulfil insurance contracts by following the building block approach. To the extent that these relate to future services and coverage, we believe that changes in the value of options and guarantees should be recognised in each reporting period against the CSM in line with our views on adjusting the CSM as discussed further below. If a contract becomes onerous, the changes in options and guarantees would immediately be recognised in the income statement, similar to other changes related to future coverage or other services.

Another key issue in the accounting for discretionary participating contracts in some countries is the accounting for future cash flows attributable to shareholders. In our response we express the view that these changes should be recognised against the CSM. We recognise that there are arguments for and against this treatment, but we believe that this is one of the compromises that will be necessary to obtain support for the standard in some key territories.

Interest expense

The use of OCI for changes in discount rates is probably the second largest area of debate in the revised ED. The reason is that today insurers worldwide are used to different accounting and regulatory regimes and utilise different investment strategies and product types. Insurers in some countries apply a model where changes in discount rates flow through the income statement, whereas in other countries they take a cost view in the income statement. Additionally, insurers categorize differently the assets supporting the liabilities: some insurers mainly invest in debt instruments held at fair value through OCI or at amortised cost, while others also invest in equity instruments, investment properties or derivatives that are usually measured at fair value through profit or loss. The longstanding diverse accounting practice and investment strategy make it difficult to reach a 'one size fits all' solution.

In our response we recognise that IFRS is a mixed measurement model today. IFRS 9: 'Financial Instruments' envisages that debt instruments could be measured at fair value through profit or loss, fair value through OCI or amortised cost. In the latter two cases interest income and expense in the income statement would be based on the original yield or discount rates. In contrast, under the measurement model for provisions in IAS 37, changes in discount rates on provisions are recognised in the income statement using a current rate.

Given the mixed measurement models used and despite the fact that we are aware that users and standard setters are not fond of optionality, we see no other solution than providing companies with an irrevocable choice at transition or on inception of a portfolio of contracts to recognise changes in discount rates in measuring insurance contract liabilities in the income statement or in OCI.

Contract boundary

Another area worth mentioning is the unintended consequences of applying the existing contract boundary guidance to certain products. We understand IASB's rationale for specifying recognition and measurement of contract boundaries as a means of measuring the liability for remaining coverage. We also recognize that the revisions to the definition since the original 2010 exposure draft allow for a broader inclusion of contracts. However, the revised definition falls short of appropriately classifying a large number of products.

In many jurisdictions, there are insurance products that are priced and managed with the expectation that they will remain in place for many years but with premiums or fees that are not guaranteed for more than one year. These products will be treated as one year contracts under the ED, resulting in an accounting treatment that is inconsistent with the economics of the contract or the expectations of the insurer or policyholder.

The risk sharing in these products is similar to participating products in the same jurisdictions but instead of having the right to vary the future benefits, insurers have the right to vary future premiums which otherwise remain level. In most cases, prices have never been changed while these products have remained active for a decade or more. We recommend the contract boundary definition be changed to better reflect the economics of these products so that the real expected fulfilment cash flows are included in the valuation.

We note the change in the contract boundary definition since the original 2010 exposure draft introduces a new consideration for portfolios of insurance contracts. The concept that the initial pricing considered risk beyond the date at which the premium can be changed is consistent with the treatment of these products. They are priced and acquired with the expectation the contracts will remain in-force long beyond the initial premium guarantee. We believe these considerations should also apply equally to individual policies and groups within a portfolio. We also suggest that a boundary exists when entities have both the right and practical ability to make changes that are fully reflective of the risks, not one or the other.

Closing remarks

We are pleased that the IASB has responded to comments made on the previous ED and has carried out an extensive outreach programme. Given the complexity of the proposed standard, we believe preparers need more time to fully test the proposals. We have recommended that the IASB continues to work closely with the industry during its re-deliberations and that once this process is complete a review draft of the final standard is made available. This would provide sufficient time for preparers to perform adequate field tests of the proposal and resolve any material issues identified during the re-deliberation process.



Peng Jin
Partner, Actuarial Service
PricewaterhouseCoopers Limited
peng.jin@hk.pwc.com

Implications of the new IFRS standard for insurance contracts

The issue of the revised exposure draft on the International Financial Reporting Standard ("IFRS") for insurance contracts (the "ED"), by the International Accounting Standards Board, in June 2013 has led to greater certainty around the framework and the timeline for its introduction.

Prior to the ED being issued, industry focus was on agreeing a basis that:

- a) does not introduce significant accounting volatility in earnings; and
- b) reflects how the business is managed.

While questions remain in these areas, companies are now also considering how the introduction of the new framework will impact systems and models, business strategy, and internal and external reporting.

In this article we look at some of the potential implications of the proposed new IFRS for insurance contracts as set out in the revised ED.

Reporting systems, data requirements and actuarial models

In this section, we look at the implications of the basic calculation and transition requirements set out in the ED and management reporting needs on systems, data and actuarial models.

Basic calculation requirements

Under the new IFRS for insurance contracts, the value of liabilities for long-term business is calculated using a building block approach (building blocks include: the probability weighted present value of future cash flows,

a risk adjustment and a Contractual Service Margin ("CSM")). While cash flow models are very widely used by insurers, this approach is quite different to the current reserving basis applied under the Hong Kong Insurance Company Ordinance ("HKICO"). In addition, the liabilities under the new IFRS will include the Time Value of Options and Guarantees ("TVOGs"), calculation of which will, for most insurance companies, require a stochastic simulation model. This is a major change from current accounting and regulatory capital standards in Asia which are largely based on deterministic valuations.

The focus of primary accounting is typically on the operating profit and earnings over the period rather than the balance sheet, and the change in the measurement approach and presentation of the Profit & Loss ("P&L") account under the new IFRS proposals will require more and different information from your actuarial models to produce the accounts. In particular:

- ♦ Following industry lobbying, the ED proposes to split the effect of interest rates and discounting into two parts when determining the earnings. The interest expense in the earnings will reflect the change in liabilities based on "locked-in" discount rates set at the time the policy was sold and the effect of movements in interest rates on the liabilities will be allocated to the other comprehensive income component of the shareholder equity. This will require companies to maintain information about the discount rates from the point of sale and perform additional model runs in order to allocate the movements to the appropriate line of the P&L account.



- ◆ The IASB has considered alternative presentations of the P&L account including a “summarised margin” and an “earned premium” approach. The latest ED proposes an earned premium approach, meaning that the earned premium, recognition of which follows the pattern of expected claims, is included in the P&L. This is different to the current revenue cash flow presentation where the premium reflected is typically based on when premiums are charged. Under the proposed IFRS, the premium will also exclude the investment component for savings business. The derivation of the earned premium and exclusion of the investment component may require additional data and model runs. If the IASB reverts to a summarised margin approach, which is similar to a sources of surplus analysis used for embedded value reporting, the information required would also be significantly different than that currently used in preparing the P&L account.

Transition requirements

In response to significant industry lobbying, the transition arrangements require companies to estimate the value of in-force business as if the new IFRS standard applied from inception to the valuation date. A significant amount of data might be required to derive items such as the cash flows from inception to the valuation date and to determine the discount rates that would have applied at the point of sale. The ED does allow some approximations of these items, such as using actual cash flows from the initial recognition data to set the CSM and assuming the risk adjustment at the point of sale is equal to the risk adjustment at the transition date. However, even with these practical expedients the transition requirements will be onerous.

Management reporting capabilities

In addition to the production and output requirements for calculating the new IFRS balance sheet and P&L account, companies will need to consider what information they need for management reporting and business planning purposes. With current accounting standards based on revenue accounts and a deterministic valuation of liabilities, it is relatively easy to calculate these metrics quickly to keep management up-to-date and to project values for business planning and strategic assessments. Under the new IFRS, this information, which is vital to robust financial management, will require different and more sophisticated systems and actuarial models.

Implications for business and product strategy

On one level, changes in IFRS should not significantly affect a company’s strategy if the strategy is profitable, on a risk-adjusted basis, and reflects the objectives and risk appetite of shareholders and management. However, practically, changes in IFRS will need to be considered in assessing many aspects of a company’s strategy such as product design and asset-liability management.

The potential effect of the ED on reported results include:

Less significant accounting mismatches: Under current accounting bases, such as the HKICO, there can be significant differences between the accounting and economic value of liabilities and, more importantly, major differences in how these change with economic and operating conditions. The resulting accounting mismatches can penalise companies for managing on an economic basis or result in sub-optimal business strategies.

Potential volatility in results: While many of the changes since the prior ED such as allowing a “top-down” discount rate to value future cash flows and unlocking the CSM should mitigate the volatility in the headline earnings, the insurance contracts ED utilises a prospective valuation of future cash flows (allowing for the TVOGs), which may result in more volatility in the earnings and shareholder equity than occurs under existing regimes. This additional volatility reflects that economic mismatches between assets and liabilities will now come through earnings or OCI. Companies will need to be able to understand, explain and manage this volatility and the different components of the new IFRS balance sheet and earnings.

Given these potential implications, companies will need to assess how introducing the new framework will impact their existing investment, product and risk management strategies.

Bringing it all together for financial reporting – dealing with complexity?

The new IFRS is intended to give a more realistic measure of the profitability of a company that is more comparable across jurisdictions, companies and industries than the existing framework. However, the new IFRS will not provide information on the solvency and capital position, the economic value of the in-force business and that being created by new business, or on the expected future shareholder dividends. Therefore, we expect companies to continue to use a number of different metrics to manage the business and communicate with shareholders.

There will be work involved in understanding the differences between the different balance sheets (solvency, IFRS, embedded value, etc.), but more important than quantifying these differences is being able to explain how the different balance sheets relate to each other and are expected to evolve over time. For example, illustrating how the value of future profits on the EV balance sheet is expected to develop into IFRS earnings and ultimately into shareholder cash flow in excess of the regulatory capital requirements.

For external reporting purposes, insurers will need to cut through a lot of the complexity around the metrics and be

able to communicate their business strategy clearly, and how this generates value, profit and shareholder dividends. In itself, the new IFRS will not solve the current communication issues for the insurance industry.

What should companies be doing now?

A key first step for companies is to understand the revised ED, if they have not already done so. This should cover the main issues and potential moving parts, and the comments of key industry and professional bodies provided on the ED. An important part of this can be carrying out a simple impact analysis based on a few key products, allowing for in-force and new business, and looking at how earnings are expected to emerge relative to the current reporting metrics, as well as the effect of certain methodology and assumption choices, and the variations in experience and key assumptions.

While it may be too early to start a full-scale implementation, companies should look to “plan the plan”; setting out the steps and resources required for implementation based on the current expected timeframe. This will help to identify potential issues as well as possible synergies with existing projects.

A key area for assessment is a company’s current actuarial models and systems. Companies should consider the requirements of the new framework and reporting requirement relative to their existing and planned systems to see if these will be met. Also, if companies are undertaking model and system development projects, a small amount of work now may help to ensure that the new systems will be suitable for new IFRS reporting.

Many firms may look to develop existing models particularly if they have already been developed significantly for other reporting requirements like Solvency II; they should not, however, underestimate the amount of work that will be required. Others may need to completely reassess their actuarial systems and are considering developing alternative modelling solutions once the implementation timeline becomes more certain.

Finally, companies should review the transition arrangements and consider the availability of the information needed. Here, a few relatively simple changes now such as capturing data on cash flows and assumptions may make implementing the transition arrangements much simpler in the future.

Final thoughts

The structure and timing of the new IFRS for insurance contracts are now becoming more certain. It is important for individuals and companies to work through the technical aspects of these developments, and to consider the most efficient way to address the challenges they bring. Also, we should not lose sight of the potential business and strategic implications and must ensure that these are managed effectively in implementing the new IFRS, both with key internal and external stakeholders.



James Creedon

Director, Towers Watson

Head of Financial & Regulatory Reporting, Asia-Pacific

james.creedon@towerswatson.com



DARWIN RHODES

PART OF
DRYDEN HUMAN CAPITAL GROUP

UK & EUROPE | HONG KONG | CHINA | INDIA | AUSTRALIA | USA

www.darwinrhodes.com

So what's your plan for
2014?



T +852 3101 0930

F +852 3101 0989

W www.darwinrhodes.com

Unit A & B 15/F, Entertainment Building,
30 Queen's Road, Central, Hong Kong

President's Report 2013

It has been my privilege to act as the president of the ASHK over 2013. Traditionally, this is the time when I will give you a detailed report on what the ASHK and each of its sub-committee have been up to over the year.

However, as a non-typical actuary which a lot of people have commented before, I would like to break the tradition this year. I will still say a few words on some of the significant development of the ASHK, but I will leave the detailed committee reports behind in the Appendix of the online version of this report.

Instead, I would like to share with you my experience being the president over the past year. But first of all, I would highlight a key development of the ASHK this year.

Only this month, we have reached a great milestone where our membership number has just passed the 1,000 mark. As of today, we have 1,013 members, including 627 fellow members, 153 associate members and 233 student members. 75% of our members work in insurance and reinsurance companies, 17% in consulting firms and the rest in other industries such as investments.

Last year when I stood here I mentioned about our membership list in 1984, on which we only had 54 members. Now, almost 30 years later, our number has increased 20-fold. But with the growth in our number, what does that mean to our profession in Hong Kong?

In my acceptance speech last year, I said I believed there should be 3 key changes to our role as actuaries, with our growing membership. These 3 key changes are:

- As well as being specialist, we also need to be generalist to remain relevant;
- We need to become more involved and influential among the general public, so that we can use our unique skillset to contribute to issues in the society.
- We need to be more global.

And I think some of the development of ASHK this year fits nicely into these themes.

1. The statutory path project – we have indeed reached a milestone with this project this year. Just now, we have voted in favour in the EGM that we will approve the current proposal for the statutory body framework. This is the beginning of a new chapter for the ASHK.

Personally, I am very excited with this project. In fact, how can you not be? This is the pathway for us to raise our profile among the general public, and hopefully our profession will be as well recognised in the public as other professions such as lawyers and accountants. This is the springboard which we can use to exert more influences to social issues or even government policies, as we can see in other parts of the world such as the UK where actuaries' opinions are highly valued in tackling important social issues.

2013 is a year for all of us to remember – as it is a turning point in the ASHK's history.

2. Speaking of social issues, the ASHK has been formally engaged by a taskforce under the Commissions on Poverty. The taskforce has been asked to produce a paper on the topic "Universal Pension in Hong Kong", and the ASHK has been asked to review and to endorse this study. As you may know, the Universal Pension has been a highly debated political topic for the past few years. Political parties have rather diverse views on the topic. Given the political sensitivity of the topic, there are some risks for the ASHK to be involved in the debate of this matter. However, what I see more is that it is a tremendous opportunity for the ASHK to raise its profile and to offer our knowledge to contribute in this very important topic.
3. Periodically, the International Monetary Fund ("IMF") will conduct formal assessments in different financial centres in the world, through its Financial Services Assessment Program (FSAP). This is a big event as the findings of the FSAP can directly and indirectly affect how competitive that particular geographical location will be as a world-class financial centre among its peers.



Jack Mak
FIA
President 2013

In 2013, the FSAP has been conducted for the insurance sector of Hong Kong, and the ASHK, as well as some major insurers in town, have been interviewed by the FSAP assessors. The ASHK has worked very closely with the OCI, the insurance regulator, to coordinate our responses, and we have received very good feedbacks from both the FSAP assessors and the OCI.

Events such as these will continue to help us actuaries to build a professional image and improve our reputation.

4. As part of being global, the ASHK has taken up the challenge this year to bid for the right to host the 2022 International Congress of Actuaries, which has an expected number of attendees of over 1,500. Two months ago, Billy and I went to Singapore to present our bid to the International Actuarial Association (“IAA”), and we are now in the shortlist of last 3 contenders, alongside Australia and Malaysia. We expect to hear the results following the IAA meetings in Washington DC next March.

If we win, this will be the largest conference that the ASHK will have ever organised, and we will require a lot of volunteers to help in this effort. I hope that we will be able to call on a lot of you to help when the time comes.

On the other hand, I personally have also joined two of the IAA committees and a few of us in the council are eager to get more involved with the work of the IAA as well, with the objective of getting Hong Kong and Asian actuaries better represented in the international arena.

If you ask me what are the things that I treasure most in the past year being the president of the ASHK, I would say they are the opportunities to learn, and to meet so many fascinating people inside and outside of our profession, in Hong Kong and also all over the world.

Being a pension actuary, I am in that minority of 25% of our members who do not work in insurance. However, as part of my job as the president, I have been giving speeches and talks in different conferences and seminars and vast majority of them, if not all of them, are insurance related. As a result of that, I have actually learnt quite a bit on Solvency III! So I guess my CPD should be met this year.

However, the most important thing that I have learnt is not the technical topics, but on what people normally call “soft skills” – e.g. how to deal with conflicts, how to manage expectation of different parties, influencing, negotiation, etc. This kind of skill set is not what we study in our exams but it has to be acquired through experience.

Few weeks ago, I was having dinner with the president of the Institute and Faculty of Actuaries, David Hare. We were having this discussion how to get our members to be more engaged with the Institute and Faculty, or in our case in Hong Kong, the ASHK – and one thing that David said was that in the past, we have always been asking our members to give back to the profession, by volunteering to serve on different committees, working groups, council, etc. Perhaps we have been doing it all wrong. In fact, we should be showing them how much you actually can enrich yourself by volunteering to serve the profession – it is all these “soft skill” that you will learn through this kind of opportunities, that you may not necessarily have the chance to learn on your job until you reach a certain career level.

But why is such “soft skill” important? That is because the traditional advantage that we have as actuaries over other professions is fading away. As actuaries, we are good at number-crunching, building models, analysing data. In the past, we are probably quite a unique breed to have this kind of skillset. However, with the advance in technology and development of other professions, our skillset is not as unique as it was say 30 years ago. Someone who has a CFA may probably be able to build models as good as we do. Someone who has a statistical degree may be able to analyse data better than we do. To remain relevant, we as actuaries must identify and further develop our skillset so that we remain competitive in the market place.



This is especially important if you have an aspiration to become a business leader one day. Quoting David Hare again, when he wrote in the November 2013 issue of the Actuary magazine, he wrote “Actuaries who want to get to the top must (therefore) adapt. Technical expertise is important, but it is not all that is needed. Personality may not feature highly when listing the attributes of an actuary, but perhaps this should change.”

I was having a conversation only a couple of days ago with someone who is an expert in leadership training. He has a disgust in people using the term “soft skill”. He explains, “In the post-war era, businesses are usually run in a more harsh, military way. People will just follow the chain of commands from the top. What gets you a promotion is that your technical knowledge. Things such as communication skill, negotiation skill, etc. do not exist in the work place. They are considered as “soft” behavior and hence they are called the soft skill. However, with the evolution of business environment and culture, the importance of such so-called “soft skills” has overtaken that of the traditional technical knowledge, and have become the critical elements people are looking for in a good business leader.” That is why he thinks the term “soft skills” is wrong – if anything they should be called the “hardcore skills”. I don’t know if you will agree with that but it shows the importance of us actuaries diversifying our skillsets to cover a much wider area.

With that, I would urge all of you to participate more actively in the work of the ASHK, not just because you want to give back to the profession, but also to reward from it the experience and other skillset that you will earn and develop.

As I said, I believe that we are at a turning point of our profession in Hong Kong. With the continuous progress of the statutory path project, I believe there are many opportunities for the work of the ASHK to expand. This shall provide plenty of chances for our enthusiastic volunteers to join us in the journey to transform our profession.

Personally, I would like to see the ASHK to continue in its effort to help enhancing the wider skillset of our members, to become more active in public issues and to raise actuaries’ profile in the public, and to become more involved in the international actuarial arena.

With that, I would like to say thank you to my team of council members who have done a tremendous job in achieving all those that we have done over the year, especially to Mr. Peter Duran, our immediate past president, and Mr. Billy Wong, our president-elect for their support and advice during my term as president.

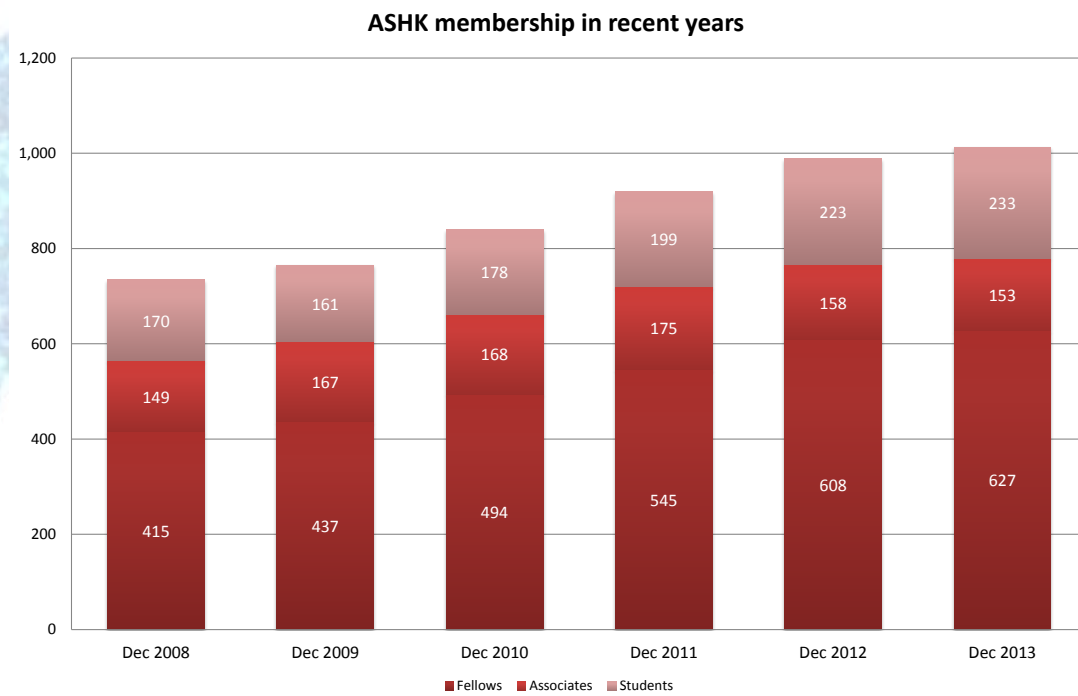
I look forward to continue serving in the council and I would like to give my best wishes to our incoming president Mr. Billy Wong to lead the ASHK during such an important time of the Society.

Thank you.

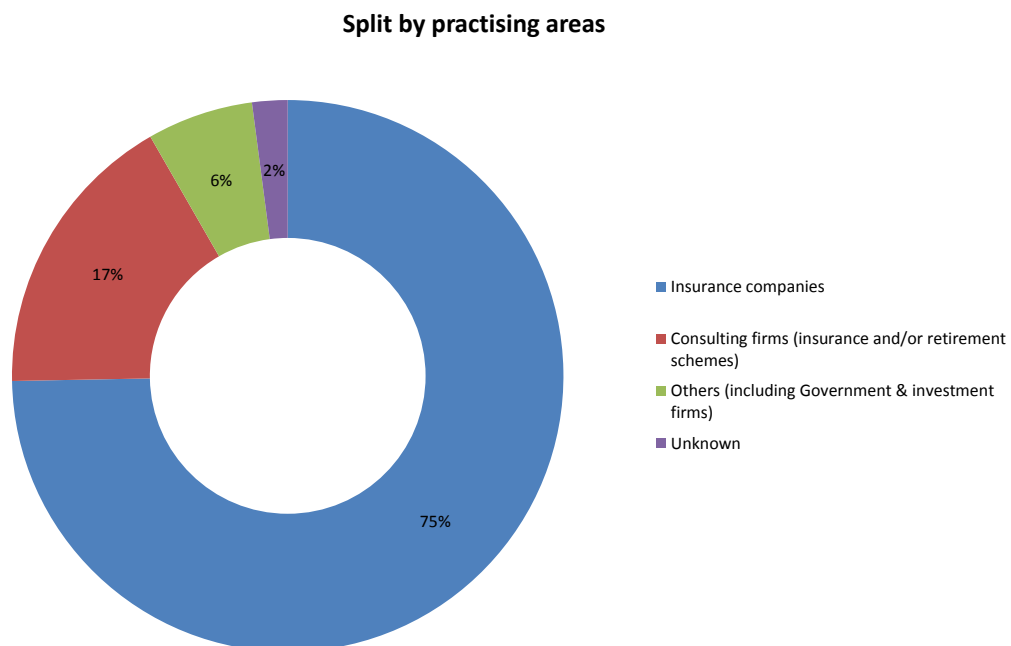
Jack Mak
President
12 December 2013.

Appendix A - Break down of membership

Development of membership numbers



Split of practising areas



Appendix B – Progress of various committees of the ASHK

Asia regional support committee

To support our members working in a regional role in Asia, the committee produced a summary of key information in relation to statutory reserving and solvency margin regulations throughout the Asian region in 2013. The information tables which are posted on the ASHK website are being reviewed by the committee for any updates.

China committee

Through the committee, the ASHK has kept close communications with the China Association of Actuaries (“CAA”). Representatives from the council had recently participated in the CAA Annual Meeting in Changsha. In November 2013, the CAA was formally accepted as a member of the East Asian Actuarial Congress (EAAC) joining the rest of the Asian actuarial societies.

Education committee

The committee continued to deliver career talks at universities and high schools. This year, one career talk was aimed at high school students.

An evening talk by a consultant focusing on the use of Derivatives by the Life Insurance Industry Globally was held. The Chinese actuarial exam centre in Hong Kong was maintained with the support of the University of Hong Kong and the Education Committee.

Experience committee

The committee persisted with its analysis of the critical illness data submitted for the experience study and posed questions to several of the participating companies seeking clarification on the data. The possibility of using the data for a study on the impact of suicide exclusive periods on life insurance is being considered pending the availability of such data.

General insurance committee

Two joint seminars were held in conjunction with the Hong Kong Federation of Insurers (“HKFI”) by the committee, on the subjects of Understanding your portfolio performance and Economic Capital Modelling - Practices and Issues.

The committee is considering to organise a GI conference next year. The committee had also arranged for an article on the discount rate to be published in ASHK newsletter. The committee has also initiated talks with the OCI to propose the implementation of an appointed actuaries system (similar to the one for life insurance) for non-life insurance.

Healthcare working group

In 2013, the working group put on a very successful healthcare seminar over two days which targeted at actuaries and other professionals involved in the aspects of financing healthcare and dealt with the complex challenges of health insurance.

Investment and risk management Committee

The committee held several meetings in 2013. The committee is in the midst of collecting information to prepare for a paper on Risk Based Capital in view of the growing importance of the requirement to enhance ERM and RBC frameworks in major jurisdictions around the world.

Life insurance committee

The committee and its working parties have had a busy year providing additional professional guidance to the local actuarial community.

As new and comprehensive guidelines on benefit illustrations were issued by the HKFI, the committee decided to fine-tune the existing AGN5 (Benefit Illustrations) to cater for these changes. Slight modifications were made to AGN5 and the corresponding working party is expected to move onto phase II which would involve reviewing linked products and then developing guidance for participating products.

The Reserve working party had developed draft guidance on valuation rate. At the request of OCI, ASHK had sought independent legal opinion in respect of the legal interpretation of sections 8(1) and 13 of the Insurance Companies (Determination of Long Term Business) Ordinance (Cap.41E), in particular whether assumptions on policy termination may be made when projecting the cash flows for the determination of valuation interest under the said section 8(1) and had provided to OCI a detailed framework in the determination of the valuation interest assumptions. After securing comments from Appointed Actuaries, the committee responded to the consultation of IFRS Phase II exposure draft. As soon as the consultation on RBC framework is issued, the committee will form an RBC working group consisting of representatives from the committees of Life insurance, Non-life and Investment and Risk Management as well as other actuaries.

The committee organised the annual Appointed Actuaries Symposium in November 2013, with a theme focusing on the future of supervision and regulation.

Membership and publication committee

The committee has a prolific year producing four newsletters during the year and on the relevant themes of alternative careers, statutory path, health care protection scheme and the year end issue on IFRS respectively.

Professional matters committee

Over 2013, the committee has been monitoring CPD compliance, conducting a random audit among members, and reviewing 2012 experience with CPD implementation and the existing CPD By-Law. Minor adjustments were proposed for the By-Law for implementation in 2014.

Several CPD reminders have been circulated to members to advise them to attest to CPD compliance by year end or else disciplinary actions may be taken against them for failure to comply with CPD. The committee has also reviewed AGN6 on CPD which was developed some years ago. Since some parts of AGN6 were found to be inconsistent with the existing By-Law on CPD, the ASHK Council decided to repeal AGN6. An announcement about this will be included in the year end issue of the ASHK Newsletter.

The committee is scheduled to present a half-day Professionalism Course on 17 December.

Retirement schemes Committee

The committee has continued working on the revision of PS2, the Professional Standard which provides guidance to actuaries while preparing actuarial valuation reports and certificates for occupational retirement schemes as required under the Occupational Retirement Schemes Ordinance.

The committee is currently engaged in reviewing further feedback from members and the MPFA on the latest exposure draft. In addition, the committee is considering a study on how to teach the public to read MPF statements.

Statutory body committee

The committee has made a notable achievement in 2013 by advancing its progress tremendously in our journey to gain statutory recognition in Hong Kong. Having said that, we are still far from reaching our ultimate goal.

The committee appointed a new law firm in assisting the ASHK on this project and the law firm had provided excellent support to the committee in the past year. Two evening meetings were held to update members on the progress of the project, as well as securing their views on the project and proposed statutory model and key features.

The committee also contributed an article to the ASHK newsletter updating members on the progress of the project. Letters were also sent to the regulators to inform them of the progress of the statutory body project and also to gain their support for principles underlying the project. Representatives of the committee and council met with the OCI and the MPFA, and both regulators showed support that actuaries in Hong Kong should be fully regulated.

Upon gaining members' approval on the current proposed statutory model, the committee will continue in this direction, and to get support of more key stakeholders. The committee will also start considering a draft private member's bill (for passing in the Legislative Council), review the disciplinary code and membership entry requirements of the ASHK.





Financial Recruitment Services

Oliver James Associates specialise in recruiting actuaries to the insurance sector throughout Asia. We work on vacancies from newly qualified up to executive level, working only with the market-leading multinational firms (Life and Non-Life Insurers, Reinsurers, Brokers and Consultancies).

Our team is made up of senior consultants, each with a minimum of five years actuarial recruitment experience, so we understand your profession. We help candidates throughout their career and we help clients develop entire recruitment strategies. Our strength is in building long-term relationships.

Our presence in Asia is already well established, though we aim to expand rapidly in the years ahead. Our strategy is to become Asia's leading actuarial recruitment firm, but we will never lose sight of what's important – to consistently deliver a high quality of service.

Recent Testimonial:

I confirm that Prudential Corporation Asia has used the services of Oliver James Associates, who have successfully placed a number of actuarial professionals within our Regional Head Office in Hong Kong.

We are satisfied with the quality of service provided by Oliver James Associates and we have benefited from the professional nature of their consultants, the knowledge they hold about the insurance industry and the thorough network they have clearly developed within the actuarial and insurance market.

We would happily recommend Oliver James Associates to other businesses.

Your sincerely,
Kim Lan Wong
Head of Human Resources
Regional Head Office, Asia



Key Contacts

Jonny Plews
Philip Chau
Gary Rushton

+852 5804 9200 jonny.plews@ojassociates.com
+852 5804 9287 philip.chau@ojassociates.com
+852 5804 9223 gary.rushton@ojassociates.com

Toby Weston
Hamza Mush
Annie Yan

+852 5804 9042
+852 5804 9048
+8613 81610 7995

toby.weston@ojassociates.com
hamza.mush@ojassociates.com
annie.yan@ojassociates.com

MESSAGE FROM THE NEW PRESIDENT

President Jack, fellow actuaries, good afternoon.

I am delighted to stand here today with all of you to deliver my first speech. I am happy to become the ASHK president in the coming year. My experience tells me that if I speak less, you could probably remember more. So I will keep my speech concise. We have 400 actuaries in this room. We have a sizable profession and we have a lot of reputable senior actuaries in our society. I could not make any changes to this society but we, as a whole, can do so, if we want and we go for the same direction.

So what is the direction? Everyone here should give an answer but, since I am on the one with a microphone, let me start first.

I have 3 little stories to be shared today.

Beijing -- in the past, being an actuary, I am recognized as being good in numbers and working long hours in the office. I am glad that we are recognized as being good in numbers, but I am not sure that we like working long hours in the office. I got a recent work assignment, more on business, and I had to travel to Beijing quite extensively. So one day, my colleague asked me how my new role was going, I said this was fun but still long working hours. I need to work until midnight or sometimes 2 or 3 am. My colleague was very surprised. I told her that after the day time meetings, every night, I went to dinner with local colleagues, and then drinks and then drinks and then drinks. My job needs me to understand and then to exert influence on the local people, or in other words, I need to be good with people. So, actuaries are working long hours in the office and are good in numbers. Others are also working long hours outside the office and are good with people. Good actuaries can remember a lot of numbers. Good business people can remember a lot of people. If all of us simply focus too much on numbers only, actuaries tend to be managed by others, but not manage others. So the question to all of you is -- if we want our profession to advance, shall we put more time to understand other people?

Professor -- one day I met an old friend of HKU and we talked about a professor we knew in the past. He seems to look down on this professor while I said this professor is quite popular among the students. My old friend continued to say that, in the university, the success of a professor should be measured by the academic achievement and that professor does not do well in this area. I continued to argue that this professor communicates very well and students can learn from him rather than those "very-academic" professors. The arguments do not end, but the conclusion is that, if we look at each other within the profession, a good actuary may mean good analytical skills and being strong in numbers. But for all non-actuaries, they could not distinguish who of us in this room is slightly better in numbers than the others. So their judgment will be on other soft skills, such as communication. So, question again, for our profession, how do we communicate better to non-actuaries?

Football -- my favorite story. I talked about a football analogy last year. For this year, I will like to share that I played a football match in Vietnam last month. This is part of a social function in my company's regional conference. First of all, if you know me, I am not a sporty guy and I do not have any football gears. I bought it all in Vietnam. I have no idea how to play. After some discussion, I was assigned as the side back. My role is to stand there, follow the opponent's striker movement, ensure the striker is not comfortable in shooting. In fact, this is not very difficult although our side lost 5 goals, but luckily our strikers made 6 goals and we won the game. This story told me that whether I am the expert does not matter, there is always a role which I can contribute. For this society, we have actuaries with 30 or 40 years of experience, we have newly qualified actuaries. Everyone can have a role in the ASHK and can contribute. What our society needs to sort out is how to utilize everyone's commitment effectively. My question is, how do you think you, as an individual, can help to develop this profession?

Beijing, professor and football are the 3 things I want you to remember, but not numbers.

Last but not least, I will like to thank the upcoming council members and upcoming committee members, for your support. Personally I will spend more time to each of you to listen and to understand what you think. One year is too short for the implementation of any major changes, but I hope my one year will help our society to establish a clear and sustainable direction in the future.

Thanks.

Billy Wong
ASHK President 2014



Billy Wong
BSc, FSA, CFA, LLB
President 2014



Revised MPF Guidelines

The Management Board of the MPFA has recently approved nine sets of revised Guidelines:

1. Guidelines on Enrolment and Contribution Arrangements for Relevant Employees Other Than Casual Employees (Guidelines IV.8);
2. Guidelines on Contribution Arrangement of a Self-employed Person (Guidelines IV.17);
3. Guidelines on Contribution Arrangement of a Self-employed Person Who Sustains a Loss (Guidelines IV.18);
4. Guidelines on Minimum and Maximum Levels of Relevant Income of a Self-employed Person (Guidelines IV.19);
5. Guidelines on MPF Exempted ORSO Schemes - Preservation of Benefits (Guidelines V.4);
6. Guidelines on MPF Exempted ORSO Schemes - Illustrative Examples (Guidelines V.5);
7. Guidelines on Payment of Accrued Benefits - Documents to be Submitted to Approved Trustees (Guidelines IV.4);
8. Guidelines on MPF Exempted ORSO Schemes - Withdrawal of Minimum MPF Benefits (Guidelines V.11); and
9. Guidelines on Annual Returns to be Delivered by Registered Intermediaries (Guidelines VI.3).

Copies of the revised Guidelines can be downloaded from the Authority's website at <http://www.mpfa.org.hk>.



Withdrawal of AGN6

Following a review by the Professional Matters Committee, and a decision by Council, the current AGN 6 (Continuing Professional Development) is found to be inconsistent with the CPD By-Law and therefore has been withdrawn in the Council Meeting on 19 November 2013.

Membership Update

New Membership

Fellow

Gary Ming-Yin Chan	AIA	FSA (2013)
Sylvia Wai-Yan Chan	AIA	FSA (2013)
Philip Siu-Fung Cheng	AIA	FSA (2012)
Chong Voon Chek	PwC	FIA (2012)
Jin Peng	PricewaterhouseCoopers	FFA (2004)
Andrew Kirchner	CIGNA	FSA (2012)
Leo Chi-Lo Kwan	AIA	FSA (2013)
Winnie Kwan	HSBC Insurance	FSA (2010)
Joseph Tsun-Yin Kwok	AXA China Region	FSA (2011)
Angelina Lai	HSBC Insurance	FIA (2009)
Chandler Chun-Sheng Lin	Ernst & Young	FSA (2013)
Jason Mok	Manulife (International)	FSA (2012)
Mark Redfearn	Prudential Corporation Asia	FIA (2000)
John Wai-Yeung Tso	AIA	FSA (2013)

Associate

Leo Wai-Ho Cheung	Manulife (International)	ASA (2012)
Elke Oi-Ying Lau	Manulife Financial	ASA (2007)
Christine Yuen-Ting Lee	Manulife Financial	ASA (2012)
Joyce Jie Luo	HSBC Insurance	ASA (2011)
Kevin Yan-Wing Ng	Cosmos Services Co Ltd	AIAA (2013)
Maveau So	Manulife	ASA (2013)
Soo Hak Hong	Munich Re	ASA (1995)
Wilson Wing-Hong Wong	AXA China Region	ASA (2009)

Membership Update

New Membership

Student

Eric Tze-Yin Cheung	ACE Life	SOA Student
Thomas Siu-Chung Cheung	MassMutual	SOA Student
Kelvin Kin-Cheung Choi	ACE Life	SOA Student
Alan Pok-Him Choi	BOC Group	SOA Student
Choi Tat Ming	MassMutual	SOA Student
Nelson Chun-Wai Chong	Manulife (International)	SOA Student
Tina Xiaoting Deng	Ageas	IAAust Student
Terry Kwai-Lok Fung	ACE Life	SOA Student
Shanna Pui-Shan Ho	ACE Life	SOA Student
Shelly Hui	Manulife (International)	SOA Student
Zoe Ting-Lam Hui	Sun Life	SOA Student
Phoenix Tingting Jiang	Milliman	SOA Student
Elvis Wah-Chun Ko	Manulife Financial	SOA Student
Anna Kwan	FWD	SOA Student
Billy Tze-Chun Lam	ACE Life	SOA Student
Jacky Wing-Tai Lam	Manulife (International)	SOA Student
Steven Wai-Ming Leung	ACE Life	SOA Student
Fiona Lim	Deloitte	CAS Student
Joseph Lo	FWD	SOA Student
Anthony Hoi-Hang Ma	Manulife (International)	SOA Student
Victor Chun-Hei Ng	Peak Re	CAS Student
Tenny Chi-Hang So	Ageas	SOA Student
Steven Ming-Hong Tam	Ageas	SOA Student
Hanna Huan Wang	Aon Benfield	SOA Student
Wong Chun Wai	-	IoA Student
Wilson Wai-Sing Wong	PwC	SOA Student
Jessie Cheuk-Kwan Wong	Sun Life Financial	SOA Student
Tikki Yutao Yang	Milliman	SOA Student
Anthony Wing-Bong Yeung	Sun Life	SOA Student
Paul Pui-Yuen Yip	Manulife (International)	SOA Student
Tom Lik-Hang Yu	Ageas	SOA Student
Cassie Ying Yuan	Deloitte	IoA Student
David Chi-Hin Yuen	Ageas	SOA Student

Membership Update

Membership Upgrade

Fellow

Donald Sze-Lnog Chan	Ageas	FSA (2012)
Erwin Chung-Hong Chan	BOC Group	FSA (2012)
Fiona Sze-Man Chan	FWD Life	FSA (2012)
Joanne Lok-Man Chan	Prudential	FSA (2012)
Iby Ho-Ming Cheung	Ageas	FSA (2012)
Simon Sai-Man Chiu	Sun Life	FSA (2013)
Enoch Kin-Chung Chow	Prudential	FSA (2013)
William Goh	Sun Life	FSA (2012), ACIA (2013)
Wesley Hong	FWD Life	FSA (2013)
Anna Yee-Ching Ieong	AEGON	FSA (2013)
Sharon Kit-Kwan Kong	Manulife	FSA (2013)
Derek Ho-Yin Lam	Manulife	FSA (2013)
Lam Tang Hao	MassMutual	FSA (2011)
Lo Wing Fung	MassMutual	FSA (2013)
Ken Tze-Hing Ng	HSBC Insurance	FSA (2012)
Jennifer Kin-Wah Shum	Manulife (International)	FSA (2012)
Cheryl Cheuk-Yee Sin	AIA Group	FSA (2013)
Cannes Yuk-Ching Tam	Ageas	FSA (2013)
Ben Ming-Tak Tang	MassMutual	FSA (2012)
Daphne Oi-Yee Wong	SCOR Reinsurance	FSA (2012)
Matthew Wai-Kin Wong	Sun Life	FSA (2012)
Christopher Tak-Fai Yip	SCOR Reinsurance	FSA (2013)
Fiona Wai-Long Yiu	Standard Life	FSA (2013)
Shelley Yuhao Zhou	Manulife Financial	FSA (2012)

Membership Update

Membership Upgrade

Associate

Cathy Ching-Yee Chan	HSBC Insurance	ASA (2011)
William Kwun-Wa Chan	Prudential	ASA (2013)
Ivan Lok-Chun Cheung	BOC Group	ASA (2013)
Ivan Shu-Lung Hui	Manulife Financial	ASA (2013)
Emily Yujia Jiang	HSBC Insurance	ASA (2013)
Marcus Lee	MassMutual	ASA (2013)
Teresa Wing-Yee Leung	Ageas	AIA (2013)
Carrie Hoi-Yi Leung	Prudential	ASA (2013)
Harry Chi-Tak Lui	Prudential	ASA (2013)
Jessica Yee-Man So	MassMutual	ASA (2011)
Zack Man-Shek Tong	HSBC Insurance	ASA (2013)
Caspar Yick-Ho Wong	Manulife Financial	ASA (2013)
Wu Cheuk Ki	BOC Group	ASA (2013)
Jason Chit-Sum Yeung	FWD Life	ASA (2013)

Membership Reinstated

Fellow

Choo Oi San	Towers Watson	FIA (2006)
Kathleen On-Lee Chu	AIA	FSA (2000)
Edmond Ho-Yeung Kam	AIA	FSA (2010)
Alan Pun-An Kwan	AIA	FSA (2006)
Stella Wing-Suet Leung	AIA	FSA (2013)
Alex Ka-Chun Yue	Hong Kong Life	FSA (2005)

Student

Kwan Chi Kit	Manulife Financial	SOA Student
Morris Ka-Yau Tse	Manulife Financial	SOA Student

Upcoming Events 2014

Date	Event
Feb	IFoA event (tbc)
17 - 18 Feb	16 th Global Conference of Actuaries of the Institute of Actuaries of India and IAA, Mumbai
Late Feb – Early Mar	SOA ERM Webcast – Asia Pacific
4 Mar	IAAust event, Hong Kong
8 - 9 Apr	SOA EBIG Seminar, Hong Kong
Apr	SOA APC, HK
Apr	SOA APC, Beijing
Jun	SOA Annual Symposium, Macau
Jul / Aug	Joint Regional Seminar in Asia
Sep	CAA Annual Meeting, China
19 - 22 Oct	18 th EAAC, Taipei
Nov	SOA APC, HK
Nov	SOA APC, Shanghai
Dec	ASHK AGM

Actuaries
on the move

- Harald Braun
- Ken Chan
- Lawrence Cheung
- Edmund Fong
- Robert Fok
- Felix Fung
- Andy Ho
- Nicholas Ho
- Ronald Kwok
- Irene Tam
- Cindy Lau
- Yen Liu
- Dennis Tang

Others

Events Highlights

ASHK Annual Dinner 5 November 2013



There were over 180 members and guests attending the Annual Dinner. We were honoured to have Ms. Anna Wu as our distinguished guest speaker and also the VIPs joining us. The ASHK would like to extend sincere thanks to the organizing Committee (Ivan Lee and Ka-Lun Lau), our Master of Ceremony (Alan Liu) and the following companies which had provided raffle draw sponsorship for the 2013 Annual Dinner (in alphabetical order): AIA Group Limited; BNP Paribas; Darwin Rhodes; Deloitte Actuarial and Insurance Solutions (Hong Kong) Limited; Drummond Scott; Ernst & Young; General Reinsurance AG; Hannover Life Reinsurance; Manulife (International) Ltd; Oliver James Associates - Actuarial Recruitment Specialist; RGA Reinsurance; Swiss Reinsurance and Towers Watson Hong Kong Limited.

Events Highlights

ASHK AA Symposium 6 November 2013



Mr. Jack Mak and Ms. Carol Hui



Mr. Kelvin Yu and Mr. Billy Wong



Mr. KC Chan and Mr. Michael Ross



Mr. Roddy Anderson, Mr. Frank Buck, Mr. Sai-Cheong Foong, Mr. Mark Stamper, Mr. Mike Conwill and Mr. Billy Wong



Mr. Simon Walpole and Mr. Billy Wong



Mr. Ben Siah and Mr. Billy Wong



Mr. Jin Peng and Mr. Billy Wong



Mr. Mike Ross and Mr. Billy Wong

Prize to Give away



Solutions for Oct 2013

Prize to Give Away!

Compare the 2 photos and circle on the **EIGHT** spots of difference. A prize will be presented to the member who submits the first correct answer of **the Photo Hunter**.

Join the game and submit your answer to ASHK Office by email: actuaries@biznetvigator.com **NOW !!!**



Corporate Advertisement

The ASHK will accept corporate advertisements in the ASHK Newsletter provided that the advertisements do not detract from the actuarial profession. Acceptance and positioning of advertisement will be at the editor's discretion.

File Formats

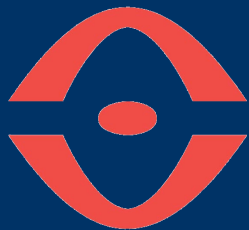
Advertisers have to supply the artworks which should be created in MS Word/PowerPoint/JPEG/PDF formats.

Advertising Rate

	One Off	Whole Year
Full page	HKD 4,000	HKD 3,600@

To advertise, please contact the ASHK Office by
Tel: (852) 2147 9420 or e-mail: actuaries@biznetvigator.com

**ASHK
NEWSLETTER**
Volume 04/2013



Contributions to the ASHK Newsletter

We welcome members' contribution to the following sections of the ASHK Newsletter: Feature Articles, Knowledge Sharing and Industrial Update, Actuaries on the Move and Puzzle Corner.

Send correspondence to the ASHK Office at the address below. When sending in correspondence which has been created in a word processing program, when possible, email a copy of the file to either the editor's or the coordinators' e-mail address. Publication of contributions will be at editor's discretion.

Editor

Simon Lam

E-mail: SLam@munichre.com

Assistant Editors

Mary Kwan

E-mail: mary.kwan@ageas.com.hk

Iris Lun

E-mail: Iris.HY.Lun@prudential.com.hk

Calvin Tang

E-mail: calvintangyc@yahoo.com

Sing-Yee Yeoh

E-mail: singyee.yeoh@milliman.com

Coordinators (ASHK Staff)

Patricia Kum

Tel: (852) 2147 9418

E-mail: patkum@netvigator.com

Tiffany Wong

Tel: (852) 2147 9419

E-mail: actsoff@netvigator.com

Emily Lye

Tel: (852) 2147 9420

E-mail: actuaries@biznetvigator.com