

30 November 2010

Sir David Tweedie  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
London ED 4M 6 XH  
United Kingdom

Dear Sir David

### **IASB EXPOSURE DRAFT – INSURANCE CONTRACTS**

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The Malaysian Accounting Standards Board welcomes the opportunity to provide comments on the IASB Exposure Draft – Insurance Contracts (ED).

Generally, we support the proposals in the ED which provides a consistent basis for accounting for insurance contracts which would enhance comparability across entities, jurisdictions and capital markets.

However, we would like to express our concern, from an insurer's perspective, about including financial guarantee contracts (FGCs) within the scope of the proposed IFRS on insurance contracts. In the Malaysian market, FGCs are typically issued by non-insurers particularly the banking sector, government-owned corporations and other corporates, where such insurance contracts do not form part of their primary business transactions, and thus, we do not view an FGC as an insurance product.

In this regard, we would like to recommend the Board to reconsider the applicability of the proposed measurement model on FGCs as using fulfillment cash flows and risk adjustments may be overly complex and it does not fit the business model of non-insurer issuers.

Our detailed responses are enclosed in the Appendix of this letter.

If you need further clarification, please contact Ms Tan Bee Leng at +603 2240 9200 or by email at [beeleng@masb.org.my](mailto:beeleng@masb.org.my).

Thank you.

Yours sincerely,



Mohammad Faiz Azmi  
*Chairman*

**Question 1**

**Do you think that the proposed measurement model will produce relevant information that will help users of an insurer's financial statements to make economic decisions? Why or why not? If not, what changes do you recommend and why?**

**Comments:**

*Yes, the proposed measurement model will substantially produce relevant information that may assist users of an insurer's financial statements to make economic decisions. However, the proposed disclosure requirements appear to be onerous. Hence we feel that the Board should reconsider the need to produce such extensive disclosures in light of application and/or implementation considerations.*

**Question 2**

**(a) Do you agree that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract? Why or why not? If not, what do you recommend and why?**

**Comments:**

*Yes, we agree that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfills the insurance contract. The proposed measurement model is similar to the current measurement model applied by the insurers in Malaysia under the Risk-Based Capital ("RBC") Framework.*

**(b) Is the draft application guidance in Appendix B on estimates of future cash flows at the right level of detail? Do you have any comments on the guidance?**

**Comments:**

*Yes, there is sufficient application guidance in Appendix B.*

**Question 3**

**(a) Do you agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?**

**Comments:**

*Yes, we agree that the discount rate used by an insurer for non-participating contracts should reflect the characteristics of the insurance contract liabilities. In measuring insurance contract liabilities, primary emphasis should be on the insurance liability whilst asset-liability matching should be secondary.*

- (b) Do you agree with the proposal to consider the effect of liquidity, and with the guidance on liquidity (see paragraphs 30(a), 31 and 34)? Why or why not?

**Comments:**

*Yes. Conceptually, we agree that the effect of liquidity should be included in the proposed measurement model considering that insurance liabilities are less commutable as compared to assets. Unlike assets, insurance liabilities are neither saleable nor easily terminated, individually or on a portfolio basis. As such balances are usually transferred to a third party in the event of exit, there is a need to consider the effect of liquidity in the measurement model. However, in imputing a liquidity premium within the proposed measurement model, it may result in a higher discount rate being used and consequently, a lower liability being estimated.*

*In addition, it may be challenging to quantify the required liquidity premium in developing insurance markets. Given the lack of an active market, there will be difficulties in determining the liquidity premiums which would lead to ambiguity and non-comparability amongst insurers. Hence, for further clarity, we believe that more examples should be given in the application guidance on liquidity premiums.*

- (c) Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are those concerns valid? Why or why not? If they are valid, what approach do you suggest and why? For example, should the Board reconsider its conclusion that the present value of the fulfillment cash flows should not reflect the risk of non-performance by the insurer?

**Comments:**

*Yes, we agree that the concern is valid particularly in an environment where there are no (or lack of) observable rates on financial instruments with similar maturity periods to use as a benchmark to discount long-term duration insurance contracts. Consequently, a mismatch of assets and liabilities may arise. For example, insurers would face difficulties in determining reliable discount rates as they typically have long duration insurance contracts exceeding 20 years, as there is a lack of long dated (risk-free) assets in certain markets.*

*We do not believe the Board should reconsider its conclusion that the present value of the fulfillment cash flows should not reflect the risk of non-performance by the insurer as this will run contrary to the objections already widely expressed against recognising gains as a result of deterioration in own-creditworthiness. The context of insurance should not warrant a different consideration of this issue by the Board.*

**Question 4**

**Do you support using a risk adjustment and a residual margin (as the IASB proposes), or do you prefer a single composite margin (as the FASB favours)? Please explain the reason(s) for your view.**

**Comments:**

*We support using a risk adjustment and a residual margin approach as it reflects the change in the risk underlying the contract over the coverage period. Presently in Malaysia, the requirements of the RBC Framework for regulatory reporting are similar to the risk adjustment and residual margin approach.*

*From our interpretation of the exposure draft, we understand that the composite margin as proposed by IASB will be locked-in and subsequently released/amortised over the passage of time and/or the expected timing of incurred claims and benefits. However, if given the opportunity to apply the composite margin as advocated by FASB (wherein subsequent adjustments to the composite margin are allowed in margin estimations) we would prefer to apply the composite margin instead, as we believe it to be more pragmatic in practice and that a single margin approach may suffice to arrive at the same purpose. In any case, appropriate disclosures as to the level of risk margin embedded in the composite margin could be made in the notes to the financial statements.*

**Question 5**

- (a) **Do you agree that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected? Why or why not? If not, what alternatives do you suggest and why?**

**Comments:**

*We agree that risk adjustment should depict the maximum amount the insurer should rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected as it is consistent with the underlying premise of the measurement model.*

- (b) **Paragraph B73 limits the choice of techniques for estimating risk adjustments to the confidence level, conditional tail expectation (CTE) and cost of capital techniques. Do you agree that these three techniques should be allowed, and no others? Why or why not? If not, what do you suggest and why?**

**Comments:**

*Yes, we agree to limit the choice of the techniques to those methods proposed under the IFRS, i.e. confidence level, conditional tail expectation and cost of capital, to promote and aid comparability of financial information amongst insurers.*

- (c) **Do you agree that if either the CTE or the cost of capital method is used, the insurer should disclose the confidence level to which the risk adjustment corresponds (see paragraph 90(b)(i))? Why or why not?**

**Comments:**

*Yes, we agree that the confidence level should be disclosed with the application in both proposed techniques to aid comparability of financial information amongst insurers.*

- (d) Do you agree that an insurer should measure the risk adjustment at a portfolio level of aggregation (i.e. a group of contracts that are subject to similar risks and managed together as a pool)? Why or why not? If not, what alternative do you recommend and why?

**Comments:**

*Yes, we agree that risk adjustment should be measured at a portfolio level of aggregation.*

- (e) Is the application guidance in Appendix B on risk adjustments at the right level of detail? Do you have any comments on the guidance?

**Comments:**

*Yes, we agree that there is sufficient guidance in Appendix B on risk adjustment.*

**Question 6**

- (a) Do you agree that an insurer should not recognise any gain at initial recognition of an insurance contract (such a gain arises when the expected present value of the future cash outflows plus the risk adjustment is less than the expected present value of the future cash inflows)? Why or why not?

**Comments:**

*We agree with the proposal that an insurer should not recognise any gain at initial recognition even though the insurance contract was priced profitably. Whilst, we agree that it would not be appropriate to recognise all of the gain at initial recognition, we however recommend that due consideration be given for gradual recognition of such gain from the inception date over the service period of the insurance contract.*

- (b) Do you agree that the residual margin should not be less than zero, so that a loss at initial recognition of an insurance contract would be recognised immediately in profit or loss (such a loss arises when the expected present value of the future cash outflows plus the risk adjustment is more than the expected present value of future cash inflows)? Why or why not?

**Comments:**

*Whilst we agree with the requirement to recognise loss immediately at the initial recognition of an insurance contract, we are concerned that this may misrepresent the actual profitability of contracts. It may also imply an artificial strain arising from new insurance contracts, which consequently result in additional capital being required of insurers. This distortion may be more pronounced with Takaful companies applying the Wakalah model (i.e. agency model) wherein the losses are borne by the participants whilst not affecting the results of the Takaful Operator.*

Consequently, we draw your attention to our response to Question 4 wherein we are of the opinion that it would be more appropriate to use the composite margin as used by FASB (with allowed flexibility to change the composite margin) with the necessary disclosures relating to risk adjustments being reflected in the notes to the financial statements.

- (c) Do you agree that an insurer should estimate the residual or composite margin at a level that aggregates insurance contracts into a portfolio of insurance contracts and, within a portfolio, by similar date of inception of the contract and by similar coverage period? Why or why not? If not, what do you recommend and why?

**Comments:**

*The proposed aggregation basis, i.e. into a portfolio of insurance contracts and, within a portfolio by similar dates of inception and by similar coverage periods would be more applicable to short-duration insurance contracts. Applying such an aggregation basis would be onerous for long-duration insurance contracts, unless for purposes of re-pricing. We suggest that the aggregation consideration be based on 'similar nature' and 'similar risk' criteria.*

- (d) Do you agree with the proposed method(s) of releasing the residual margin? Why or why not? If not, what do you suggest and why (see paragraphs 50 and BC125–BC129)?

**Comments:**

*If the residual margin method is to be used, the release or amortisation should be based on the type of the insurance contract and accordingly, the type of services rendered.*

- (e) Do you agree with the proposed method(s) of releasing the composite margin, if the Board were to adopt the approach that includes such a margin (see the Appendix to the Basis for Conclusions)? Why or why not?

**Comments:**

*If the composite margin is used, then the release of the margin should co-relate or be proportionate to the service that is provided under the insurance contract.*

- (f) Do you agree that interest should be accreted on the residual margin (see paragraphs 51 and BC131–BC133)? Why or why not? Would you reach the same conclusion for the composite margin? Why or why not?

**Comments:**

*We disagree with the proposal to accrete interest on either the residual margin or the composite margin, as it is cumbersome to apply in practice. The proposed measurement model refers to a fixed interest rate. Such fixed accretion rates at*

*inception may result in the estimates being artificially stated and being not representative of the observable market interest rates over the duration of the insurance contracts.*

*We also request for further clarity on the need to accrete interest on residual margin and/or composite margin through appropriate examples.*

#### **Question 7**

**Do you agree that incremental acquisition costs for contracts issued should be included in the initial measurement of the insurance contract as contract cash outflows and that all other acquisition costs should be recognised as expenses when incurred? Why or why not? If not, what do you recommend and why?**

#### **Comments:**

*We agree with the proposal to include incremental acquisition costs in the initial measurement of the insurance contracts. However, the interpretation of what falls under incremental and non-incremental acquisition costs may differ from one insurer to another dependent on the type of distribution channels applied, (e.g. bancassurance, tele-marketing, e-marketing, direct marketing and via brokers). To facilitate consistency in treatment of acquisition costs by insurers, the Board should consider further elaboration in the proposed standard.*

#### **Question 8**

**(a) Should the Board (i) require, (ii) permit but not require, or (iii) not introduce a modified measurement approach for the pre-claims liabilities of some short-duration insurance contracts? Why or why not?**

#### **Comments:**

*We support the introduction of the modified measurement approach for short-duration insurance contracts.*

*The proposed premium allocation approach using the Unearned Premium Reserves ('UPR') method should be made mandatory for purposes of comparability amongst insurers with similar short-duration insurance contracts.*

*However, there are insurance products in the market place that contain embedded options, e.g. certain healthcare insurance products with renewal and re-pricing features, which may not fall within the ambit of the existing definitions in paragraphs 54 and 12 of the proposed standard. Hence, further clarity is required for the treatment of such products.*

- (b) Do you agree with the proposed criteria for requiring that approach and with how to apply that approach? Why or why not? If not, what do you suggest and why?

**Comments:**

*We agree with the proposed approach. However, there should be clarity in the proposed standard as to the treatment of certain expenses (e.g. claims handling costs, certain management expenses, and the required margins to service the policies for the unexpired period) in determining premium deficiency reserves.*

**Question 9**

Do you agree with the proposed boundary principle and do you think insurers would be able to apply it consistently in practice? Why or why not? If not, what would you recommend and why?

**Comments:**

*Yes, we agree with the proposed contract boundary principle and are of the opinion that insurers would be able to apply it in practice.*

**Question 10**

- (a) Do you agree that the measurement of insurance contracts should include participating benefits on an expected present value basis? Why or why not? If not, what do you recommend and why?

**Comments:**

*Yes, we agree that the measurement of insurance contracts should include participating benefits on an expected present value basis.*

- (b) Should financial instruments with discretionary participation features be within the scope of the IFRS on insurance contracts, or within the scope of the IASB's financial instruments standards? Why?

**Comments:**

*Yes, we agree that financial instruments with discretionary participation features should fall within the scope of the proposed standard on insurance contracts as long as they contain significant insurance risk.*

- (c) Do you agree with the proposed definition of a discretionary participation feature, including the proposed new condition that the investment contracts must participate with insurance contracts in the same pool of assets, company, fund or other entity? Why or why not? If not, what do you recommend and why?



**Comments:**

*The accounting treatment of financial instruments with discretionary participation features should not be restricted or explicitly defined to a specific accounting standard. We are of the opinion that the accounting treatment of such investment contracts with discretionary participating features should follow the treatment of those contracts, e.g. investment-linked contracts if identified as insurance contracts, the measurement basis will follow accordingly.*

- (d) **Paragraphs 64 and 65 modify some measurement proposals to make them suitable for financial instruments with discretionary participation features. Do you agree with those modifications? Why or why not? If not, what would you propose and why? Are any other modifications needed for these contracts?**

**Comments:**

*Yes, the measurement proposal appears to be consistent with the current approach under IFRS 4.*

**Question 11**

- (a) **Do you agree with the definition of an insurance contract and related guidance, including the two changes summarised in paragraph BC191? If not, why not?**

**Comments:**

*Yes, we agree with the definition of insurance contract and the related guidance in the proposed financial reporting standard.*

- (b) **Do you agree with the scope exclusions in paragraph 4? Why or why not? If not, what do you propose and why?**

**Comments:**

*Yes, we agree with the scope exclusions in paragraph 4 in the proposed standard which are similar to the exclusions in the existing IFRS 4.*

- (c) Do you agree that the contracts currently defined in IFRSs as financial guarantee contracts should be brought within the scope of the IFRS on insurance contracts? Why or why not?

**Comments:**

*Conceptually, we agree that financial guarantee contracts ('FGC') should be brought within the scope of the proposed IFRS on insurance contracts from an insurer's perspective. FGC, by its nature, provides coverage on default of credit risk; consequently, one should consider the expected experience or probability of default of that coverage and the risk features of the contract. Hence, to apply fair value on such contracts may be misleading as there may not be observable market value or characteristics on the insurable risk of an FGC.*

*However, we recommend that the Board reconsiders the applicability of the proposed measurement model on FGCs as there may not be a portfolio of homogenous risks or nature as each FGC is unique. The insurance risk of an FGC, i.e. credit risk is different from other insurance risks, i.e. mortality, morbidity, and hence, less certain. This has a significant impact in determining the 'expected' insurance liabilities arising from FGCs.*

*It is important to note that in the Malaysian market, FGCs are issued by non-insurers particularly the banking sector, government-owned corporations and other corporates, where such contracts do not form part of their primary business transactions. These entities do not view an FGC as an insurance product. Typically for banks, FGC is a financial instrument, generally short term in tenor and renewable periodically, and is usually packaged with other financial products. Each FGC is usually unique to a particular borrower and is, thus, not portfolio driven. The existing measurement methods under IAS 39, IAS 18 and IAS 37 are currently applied on FGCs by non-insurers. The proposed measurement model advocated under this exposure draft on insurance contracts, using fulfillment cash flows and risk adjustment is thus, overly complex and does not fit the business model of non-insurer issuers.*

**Question 12**

**Do you think it is appropriate to unbundle some components of an insurance contract? Do you agree with the proposed criteria for when this is required? Why or why not? If not, what alternative do you recommend and why?**

**Comments:**

*Unbundling components of an insurance contract would be appropriate if there is sufficient clarity and guidance on how unbundling should be applied. In addition, the practicality of unbundling is questionable as insurers may have to apply certain assumptions when considering unbundling, and these may be onerous and very judgemental. We recommend that the guidelines prescribed under the existing IFRS 4 be retained.*

**Question 13**

- (a) Will the proposed summarised margin presentation be useful to users of financial statements? Why or why not? If not, what would you recommend and why?
- (b) Do you agree that an insurer should present all income and expense arising from insurance contracts in profit or loss? Why or why not? If not, what do you recommend and why?

**Comments:**

*Generally, the proposed summarised margin presentation, whilst demonstrating and reflecting the underlying measurement model, may be overly complicated to understand even for an informed user of the financial statements. It is doubtful whether such margin presentation would deliver or provide relevant information to the users to make useful and informed decisions, as the embedded value disclosures or the relevant risk-based capital disclosures required in various jurisdictions would be more meaningful.*

*We thus suggest retaining the existing presentation of financial statements, i.e. to present all income and expenses arising from insurance contracts in profit or loss but include the proposed summarised margin presentation as a note to the financial statements.*

*We would like to draw the Board's attention to present regulatory requirements for insurers whereby they are required to submit monthly, quarterly, half-yearly and audited annual financial statements. The proposed standard advocates compliance with this presentation format at each measurement date. Perhaps, this requirement should be confined to annual financial statements only.*

**Question 14**

- (a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?
- (b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?
- (c) Are there any disclosures that have not been proposed that could be useful (or some proposed that are not)? If so, please describe those disclosures and explain why they would or would not be useful.

**Comments:**

*Yes, generally we agree to the proposed disclosure principles. As for variation of disclosures, please refer to our responses to the previous questions.*

**Question 15**

**Do you agree with the proposals on unit-linked contracts? Why or why not? If not what do you recommend and why?**

**Comments:**

*Yes, we agree with the proposals that assets associated with unit-linked contracts should be recognised at fair value through profit or loss to the extent that the changes in the assets relating to the unit-linked contracts will eliminate accounting mismatches.*

**Question 16**

- (a) Do you support an expected loss model for reinsurance assets? Why or why not? If not, what do you recommend and why?**
- (b) Do you have any other comments on the reinsurance proposals?**

**Comments:**

*We agree to the proposal that reinsurance contracts be measured as with other insurance contracts given that similar assessment of risk is applicable to the reinsurers, and that the expected loss model is applied for reinsurance assets.*

**Question 17**

- (a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?**
- (b) If the Board were to adopt the composite margin approach favoured by the FASB, would you agree with the FASB's tentative decision on transition (see the appendix to the Basis for Conclusions)?**
- (c) Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?**
- (d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.**

**Comments:**

*We are of the opinion that the full retrospective application may not be practicable particularly where insurers have made distributions to policyholders and shareholders prior to the implementation of this proposed standard. It is also legally not possible to 'claw-back' previously distributed surpluses to policyholders and shareholders. Furthermore, it is impracticable to determine composite margins, residual margins and risk adjustments for legacy insurance contracts, should retrospective application be advocated. It is also doubtful whether this requirement would address cost-benefits to insurers and users of financial statements.*

*Thus, we prefer the use of the prospective application of the proposed standard for new insurance contracts and that the effective date of the proposed standard be aligned with that of IFRS 9 to avoid having to apply two significant accounting standards within a short period of time between each other.*

#### **Question 18**

**Do you have any other comments on the proposals in the exposure draft?**

**Comments:**

*We would like to bring to the Board's attention for guidance, the issue of risk margin liabilities and financial statements presentation for Takaful operators.*

*For Takaful companies (which operate similar to that of mutual funds), the underwriting risk of a Takaful contract lies with the pool of participants, i.e. the Takaful Fund which includes the participants' risk fund. Such underwriting risk is not transferred to the Shareholders' Fund, i.e. Takaful operator. The Shareholders' Fund does however, retain operating risk.*

*The proposed statement of income and expenditure in the exposure draft implies a 'one entity reporting' basis in relation to presentation of financial statements. We would need to consider the application of the proposed measurement model on Takaful contracts and its implication to disclosing the liability.*

#### **Question 19**

**Do you agree with the Board's assessment of the benefits and costs of the proposed accounting for insurance contracts? Why and why not? If feasible, please estimate the benefits and costs associated with the proposals.**

**Comments:**

*We are doubtful of the Board's conclusion that the proposed standard would improve the financial reporting of insurance contracts at a reasonable cost, as the proposed presentation and disclosure requirements would be onerous for the insurers to comply. The costs involved in preparing and presenting the financial statements in the proposed format would involve significant additional costs which may outweigh the benefits to users.*