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DSR – öffentliche SITZUNGSUNTERLAGE

DSR-Sitzung:	**153. / 03.02.2011 / 12:45 – 14:00 Uhr**
TOP:	**04 – Diskontsatz für Versicherungsverbindlichkeiten**
Thema:	**Vorgeschlagene Alternativen für den Diskontsatz**
Papier:	**153_04a_Diskontsatz für Versicherungsverbindlichkeiten_Präsentation**

Stand der Diskussion

- Die vom IASB vorgeschlagene Bewertung (risk free rate plus liquidity premium) stößt auf Bedenken, da (1) ein accounting mismatch entstehe und (2) das Ergebnis starker Volatilität unterworfen werde.
- Die Diskontierung spielt eine signifikante Rolle bei Verträgen mit längerer Laufzeit.
- Der ED sieht vor, für participating IC, bei denen die cashflows von der performance von assets abhängen, diese Abhängigkeit entweder im Diskontsatz oder den cashflows zu berücksichtigen.
- Folgende Varianten der Diskontierung werden in den Stellungnahmen an den IASB vorgeschlagen:
  1. Locked-in discount rate
  2. Asset-based discount rate
  3. Pricing-based discount rate
  4. Canadian discount rate proposal

Criteria for selecting the appropriate discount rate

(a) What is the objective of the discount rate for insurance contract liabilities?

(a) What are the factors to include in the discount rate?

(b) How are these factors included in the discount rate?

Factors that are relevant to the measurement of the liability

For non- participating insurance contracts, the following factors should be included in the measurement of the liability:

(a) the risk-free rate; ie, the interest rate that would incorporate the time value of money for cash flows with zero remaining risk and uncertainty; and

(b) a liquidity adjustment; ie taking into account the fact that insurance contracts do not have the same liquidity characteristics as assets traded in liquid markets.

Observable discount rates may also incorporate the following factors (but that are not included in the discount rate proposed by the boards):

(a) credit spread; ie expected defaults and unexpected defaults (the risk that actual defaults may exceed the expected defaults); for the purposes of measuring the liability, credit spread reflects the company's own credit spread;

(b) currency risk; and

(c) Other factors that are not already included in the measurement of the cash flows.

Identifying groups of proposed discount rates

(a) building a discount rate bottom up starting at a risk-free rate and then adding factors identified that are relevant to the measurement of the liability;

(b) starting top-down from actual or estimated asset earnings and then eliminating factors that are irrelevant to the measurement of the liability; or

(c) use an observable discount rate (for example high quality corporate bond rate) as a practical expedient to approximate either a bottom-up or a top-down approach.

Locked-in discount rate

- the main proponents of the locked-in discount rate are preparers
- it mitigates the accounting mismatch that would arise between financial assets measured at amortised cost and the insurance liability
- understanding duration and credit mismatches could be achieved by narrative / qualitative disclosures
- all other variables (except for the discount rate) would be updated
- liability adequacy test needed
- to the extent features are correlated with interest rates, modification necessary
- contracts need to be tracked on eg an underwriting year basis

Asset-based discount rate (1)

(a) The model mitigates volatility as the insurance liability is discounted at a current asset-based discount rate. However, the effects of any maturity mismatch between assets and liabilities remain (e.g. a 2% change in discount rate has a far greater effect on a 30-year liability than it has on a 10-year asset, because the discount factor applied to the liabilities is much higher).

(b) It is important to note that where the maturity of the insurance liability exceeds that of the assets – as will usually be the case for life insurance products – some form of extrapolation may be needed to determine the asset-based discount rate for the entire life of the insurance liability. A future standard would presumably need to provide guidance on how this is done since there are many techniques available for extrapolating the interest rate. It is considered essential that the extrapolation method gives a reasonable outcome in a market where there is limited liquidity in the long end.

(c) Proponents argue that this approach is less complex to apply than using a risk free rate plus illiquidity premium.

Asset-based discount rate (2)

(d) It would allow for the measurement of insurance contracts to be more aligned with assets that are measured at fair value through profit or loss if the insurer has selected assets that are similar to the reference asset portfolio, excluding their credit risk, and thus would be more representative of the insurers' business model.

(e) The insurer would need to select a reference asset portfolio in order to derive the asset-based discount rate. Proponents of this approach argue that this should not be the insurers own actual portfolio, but rather a reference asset portfolio. A future standard would presumably need to provide guidance on determining the appropriate reference asset portfolio.

(f) The model provides insight into the economic mismatch, because the long insurance liability will be more sensitive to discount rate changes that the shorter financial assets.

(g) The approach does not require liability adequacy test and it considers all subsequent changes in estimates, i.e. it remains current.

Pricing-based discount rate (1)

(a) Measuring insurance contracts using a discount rate that is significantly lower than the rate implicit in setting premiums could result in recognition of losses at the inception of contracts expected to be profitable. This could be avoided if the insurer used the discount rate assumptions that bit also uses to price the insurance premium for the initial measurement of the liability, with subsequent measurement reflecting updates of these assumptions in every reporting period. However, the approach does not explicitly address the performance reporting mismatch that exists between financial assets and insurance liabilities.

(b) The approach might result in significant volatility when pricing of products changes significantly. Also, questions might arise about what to do when premiums are depressed as a result of conditions that are expected to be temporary (eg entrance of a new competitor in the market).

Pricing-based discount rate (2)

(c) An insurer whose premiums are decreasing over time (eg as a result of competition), would presumably face an increasing pricing-based discount rate. It is not immediately clear whether this should result in a drecrease in the insurance liability and a reported profit. If this were the case the method might give rise to perverse incentives.

(d) The discount rate is considered current because it takes into account all subsequent changes in market interest rates. Although consideration would need to be given to situations in which an insurer is closed for new business in a particular line of business.

(e) A liability adequacy test would be needed to ensure that losses are recognised for insurance contracts that are ultimately onerous. Such a test would need to compare the cash outflows relating to the insurance liability to the cash inflows on a ‘related’ portfolio of assets.

(f) The insurance liabilities of different insurers are not directly comparable unless their pricing is identical. The insurer would need to disclose the methodology and assumptions (including those used in pricing if relevant) used in determining the discount rate in order to achieve some measure of comparability between insurers.

Canadian discount rate proposal (1)

- The discount rate should be determined by reference to market rates on high quality corporate bonds and, in countries where there is no deep market for such bonds, the market yields on government bonds (risk-free rate)
- A two-step approach for reporting the interest cost
  - in p&l the effect of discounting insurance liabilities using a long-term rate the insurer expects to earn on its investments (ie rate determined based on a probability-weighted estimate of the net cash inflows that it expects to earn on its investments, net of expected defaults/losses, and including a risk adjustment)
  - in OCI an insurer would report the change in the difference between discounting the liability using the current market observable rate and the long-term expected rate of return on investments

Canadian discount rate proposal (2)

- Using an asset independent or market benchmark discount would result in including compensation for bearing the risk of sector credit spread (a risk specific to the liability for that class of borrower in the market) and would avoid the practical challenges of determining an adjustment for illiquidity that faithfully represents that risk.
- The approach would be more complex than using one discount rate as proposed in the ED, because insurers would rerun the basic valuation model with different discount rates.
- The added complexity is offset by the advantages of this approach because it would:

  (i) result in measuring assets and liabilities at consistent current measurements in the statement of financial position

  (ii) reflect the insurer's business model in p&l, as well as providing a measure comparing the insurer to current market expectations in OCI

  (iii) not create an accounting mismatch in p&l

  (iv) improve the transparency of financial reporting by insurers by providing information about

Canadian discount rate proposal (3)

(iv) improve the transparency by providing information about asset management performance separately from underwriting performance

(v) not require any amendment to IFRS 9

- The proposal would not address the volatility in equity that remains because of the accounting mismatch between the measurement of the financial assets and insurance liabilities
- The proposal leads to yet another item being reported in OCI without explaining why this is considered appropriate
- The proposal would lead to different outcomes between countries with and without a deep and liquid market for corporate bonds