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來函檔號 Your ref.

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To : Chief Executives of All Authorized Insurers

Dear Sirs,

Implementation of Hong Kong Accounting Standards 39 and 32 and Hong Kong Financial Reporting Standard 4

With an aim to converge with international accounting and financial reporting standards, the Hong Kong Institute of Certified Public Accountants ("HKICPA") has issued Hong Kong Accounting Standard 39 – Financial Instruments: Recognition and Measurement ("HKAS 39"), Hong Kong Accounting Standard 32 – Financial Instruments: Disclosure and Presentation ("HKAS 32") and Hong Kong Financial Reporting Standard 4 – Insurance Contracts ("HKFRS 4"), which are essentially verbatim versions of the corresponding standards issued by the International Accounting Standards Board ("IASB"). All these Standards have significant implications on the financial statements of insurers prepared under the Generally Accepted Accounting Practice ("GAAP") basis.

The above Standards are available on the HKICPA website at http://www.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumeII/hkfrs4.pdf and http://www.hkicpa.org.hk/professionaltechnical/accounting/standards. They should be adopted for accounting periods beginning on or after 1 January 2005.

In short, HKAS 39 provides a definition of financial instruments and

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requires their separation into equity or liability, or into equity or liability components. It also prescribes valuation rules for financial assets and liabilities and provides for derecognition rules (i.e. removal of a previously recognised financial asset or financial liability from the balance sheet).

HKAS 32 mainly deals with disclosures. It requires quantitative and qualitative disclosures on the terms, conditions and accounting policies of financial instruments, the fair value for each class of financial assets and financial liabilities and certain other pertinent information.

HKFRS 4 has serious ramifications on insurers. An insurer will need to examine all its "insurance" contracts to determine whether they transfer significant insurance risks, financial risks or a mix of both. For insurance risks, they will have to be accounted for as insurance contracts under HKFRS 4, which means that the existing accounting practices for insurance liabilities could continue to be adopted. For financial risks, such as investment-linked insurance contracts (without transfer of significant insurance risks) sold by long term business insurers, they will be accounted for as financial instruments under HKAS 39. Mixed products, i.e. contracts comprising both insurance and financial risks, will also have to be unbundled into a deposit and an insurance component, being accounted for under HKFRS 4 and HKAS 39 respectively. HKFRS 4 also requires expanded disclosures, such as claims development versus previous estimates and amounts, and timing and uncertainty of cash flows, in order to promote transparency.

In view of the significant implications of the above Standards, you are advised to liaise with your accountants and auditors to assess how these Standards may impact on you and start to make necessary arrangements for their implementation.

While the above Standards are primarily applicable to the financial statements of insurers prepared under the GAAP basis, they may also impact on the financial statements prepared under the Insurance Companies Ordinance ("ICO") ("the statutory basis"). As the above Standards may be subject to further refinements as a result of the Phase II project on Insurance Contracts recently embarked on by the IASB, we consider that the financial statements and returns prepared under the statutory basis should remain intact and continue to be governed by the provisions of the ICO. Specifically and for the avoidance of doubt :-

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(a) Classifications of insurance contracts should follow the First Schedule to the ICO, e.g. investment-linked insurance policies should continue to be accounted for as Class C business.

(b) Insurers are allowed to follow prudent accounting practices, such as to maintain catastrophe and equalisation provisions where appropriate, measure insurance liabilities on an undiscounted basis and recognise only realised but not unrealised gain on an asset, provided that there is a reasonable and consistent basis to do so.

(c) Where there is any conflict between the Standards and the valuation regulations or guidance notes issued by the Insurance Authority (“IA”), the latter should prevail.

If your financial statements or returns submitted under the ICO are affected by the above Standards, for monitoring purposes you are expected to submit supplementary information to explain and elaborate any mismatch of valuation bases of assets and liabilities; and to detail any changes in accounting policies or treatments and if applicable, quantify the effect or implication on your assets/liabilities.

You are welcome to discuss with us early if you envisage any problem in complying with the statutory reporting requirement following the implementation of these Standards.

Should you need any clarifications, please contact Mr. Raymond Ho at 2867 2559 or Ms. Carol Hui at 2867 2551.

Yours faithfully,

(Richard Yuen)
Commissioner of Insurance

c.c. Appointed Auditors of All Authorized Insurers
Chairman, The Hong Kong Federation of Insurers
The Hong Kong Institute of Certified Public Accountants