Study on the Performance of Banking Insurers and Their Transformation Strategies Under the New Standard

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Abstract. The implementation of new accounting standards has become a key change in the development process of bank-based insurance companies as the regulatory and standardization requirements of the financial industry continue to improve. Driven by the new accounting standards, the business model and financial accounting system of bank-based insurance enterprises are facing deep adjustments. Against this background, 10 bank-based insurers realized a net profit of nearly 10 billion yuan in 2024, a change from the loss in 2023, but the net assets of some insurers showed a rapid shrinkage. The new accounting standards have redefined the definition of contract, revenue recognition and classification of financial assets for insurance companies, resulting in significant changes in measurement methods and financial indicators for bank-based insurers. The rebound of net profit and the decrease in net assets reflect the opportunities and challenges faced by insurers under the implementation of the new accounting standards. Based on this, this paper analyzes the changes in measurement methods and financial indicators of insurers under the new standard and explores the impact of the new standard on the financial position and operating results of enterprises. This paper provides suggestions for unlisted insurers to cope with the changes in the new standard and promote the healthy transformation of the industry.

Keywords: New Accounting Standards, Insurance Companies, Impact and Response.

1 Introduction

According to the latest operating data released by 2024 bank-based insurers, 10 authoritative listed bank-based insurers have changed their loss-making status from previous years and realized nearly tens of billions of net profits. However, in stark contrast, while their net profits have rebounded significantly, their net assets have generally declined. This paradoxical phenomenon stems mainly from the changes in accounting measurement rules brought about by the implementation of the new accounting standards [1].

International Financial Reporting Standard 17-Insurance Contracts (IFRS 17) issued by the International Accounting Standards Board (IASB) is effective January 1, 2023.

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IFRS 17 adopts a single accounting treatment, which solves the problems of fragmentation and inconsistent caliber of the original standard, and enhances the insurance companies' consistency and comparability of financial reporting.

In order to maintain convergence with international accounting standards, the Ministry of Finance (MOF) embarked on a study and analysis of IFRS 17 and revised the original insurance contract standards, in an effort to improve the quality of accounting information of China's insurance enterprises and international comparability. In 2020, the Ministry of Finance of China issued the newly revised ASBE No. 25-Insurance Contracts. It stipulates that enterprises listed both domestically and internationally, as well as enterprises listed abroad and adopting IFRSs or ASBEs for the preparation of financial statements, are required to start implementing the new standard from January 1, 2023 onwards; other enterprises implementing enterprise accounting standards effective January 1, 2026, with early implementation permitted [2]. In particular, the new financial instruments standard, which is aligned with IFRS 9 in the new accounting standards, has led to significant changes in the classification of financial assets, and the designation rights of some assets have a direct impact on the stability of the core indicators of the statements.

This paper starts from the core changes of the new standard and explores in depth the mechanism of its impact on key financial indicators such as net assets, net profit, other comprehensive income and total operating income of bank-based insurers. The study found that while the new standard accurately reflects the operating results of insurers, it also brings challenges such as increased financial volatility and asset valuation adjustments.

The application of the new standard has resulted in changes in revenue recognition and financial statements of insurance companies. They currently in a critical period when unlisted insurers are converting between the old and new accounting standards, and the choice of timing and strategy for their conversion will have an impact on the stability of the key indicators of their performance statements. The purpose of this paper is to provide a theoretical basis for unlisted insurers to cope with the standard switch by analyzing the changes in the measurement methods and financial indicators of insurers under the new standard, so as to make them well-prepared and to promote the healthy transformation of the industry.

2 Main Changes in the New Standard

2.1 Definition of Insurance Contracts and Splitting of Contracts Into Mergers

The original insurance guidelines did not clearly define the specific contents of insurance risks and their impact on policyholders, resulting in the parties' misunderstanding of insurance contracts in practice. The new standard improves the definition of an insurance contract by clarifying that an insurance contract must have an "adverse effect" on the policyholder and transfer a "significant insurance risk" in order to meet the definition of an insurance contract. To reflect the commercial substance of insurance contracts, the new standard also regulates the consolidation and splitting of insurance contracts [3].

2.2 Measurement of Insurance Contracts

Similar to IFRS 17, the new standard introduces a new measurement approach for insurance contracts. Instead of distinguishing between life and non-life insurance contracts, the new standard requires insurers to categorize insurance contracts that have similar risks and are managed in a uniform manner into a portfolio of insurance contracts, which are further subdivided into groups of contracts based on, for example, profitability levels. This approach aims to more accurately reflect the value of insurance contracts and their associated risks [4]. The new standard recognizes and measures liabilities for insurance contracts on the basis of the present value of the estimated future cash flows of the group of insurance contracts based on the rights and obligations of the individual contracts in the group discounted at a current observable discount rate [5].

2.3 Insurance Revenue Recognition

The original standard did not make it mandatory for the recognition of premium income to be materially divested of the unrelated portion of insurance, which made the premium income more “watery”. The new standard requires that insurance companies must split clearly distinguishable investment components and other non-insurance service components of insurance contracts, and for non-separable investment components, their corresponding premiums are also not allowed to be included in insurance service income[6].

2.4 Statement Presentation

The new standard requires insurance companies to present insurance contract liabilities and insurance contract assets separately according to the balance of the insurance contract portfolio, and to present insurance service results and investment income separately in the income statement according to the profit-driving factors, instead of presenting separately the item of “withdrawals of insurance liability reserves”, which was required to be presented in the income statement under the former insurance contract standard. Instead, insurance contract liabilities and insurance contract assets are presented separately according to the balance of the insurance contract portfolio, and insurance service performance and investment income are presented separately in the income statement according to the profit-driving driver.

2.5 Financial Asset

Under the new standard, bonds and stocks can be designated as financial assets in other comprehensive income (abbreviated as “FVOCI”). This means that more insurers will recognize last year's bond float in other comprehensive income, which will push up the consolidated investment return [1].

3 Analysis of the Performance Statement of Bank-based Insurers Under the New Standards

3.1 Net Assets, Net Profit

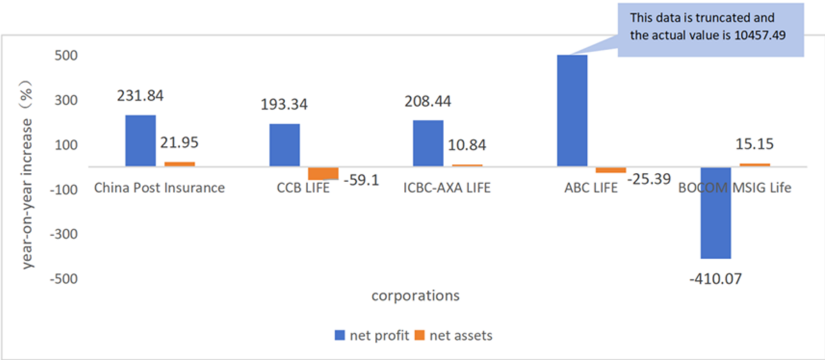

Fig. 1. Year-on-year increase in net profit and net assets in 2024 (Picture credit: Original).

Securities Daily statistics show that in the first three quarters of 2024, nine bank insurance enterprises from 2023 “tens of billions of huge losses” to achieve a net profit of 16.823 billion yuan; total insurance business income of 347.329 billion yuan, an increase of about 18.6% [7]. Of the nine bank-based insurers, CCB Life, ABC Life, China Post Insurance, BOCOM MSIG Life, and ICBC-AXA LIFE all said in their solvency reports that they have adopted new accounting standards this year in accounting for data such as net profit, total assets, and net assets.

As can be seen from Figure 1, among the five bank-based insurers that adopted the new accounting standards, except for BOCOM MSIG Life, which continued to lose money, the other four realized high net profits, especially two of them, CCB LIFE and China Post Insurance, turned their losses into profits. However, in stark contrast to the high net profit, the net assets of some insurers are shrinking rapidly. For example, CCB LIFE's third-quarter report listed a 59.1% year-on-year decrease in net assets.

This is due to the fact that most of the bond assets measured as held-to-maturity investments of insurance companies under the old standard are classified as financial assets in other comprehensive income under the new standard, as shown in Figure 2, and their carrying value is changed from amortized cost to fair value. Although changes in discount rates can be recognized in other comprehensive income under the new standard, they still affect the company's debt level. Meanwhile, under the new standard, the downward movement of the discount rate will lead to a rise in FVOCI of debt assets. The new standard wants both the asset and liability sides to be measured at fair value thus achieving a better match, but since the asset duration of China's life insurance companies is much lower than the liability duration (business duration), this large duration gap will have a serious impact on the net worth of each company in a long-term lower interest rate environment. It is important to emphasize that when the discount rate is reduced, as shown in Figure 3, neither changes in debt FVOCI nor insurance contract reserves enter the income statement, but both affect net assets through other comprehensive income. This treatment may exacerbate the split between net assets and net income [8].

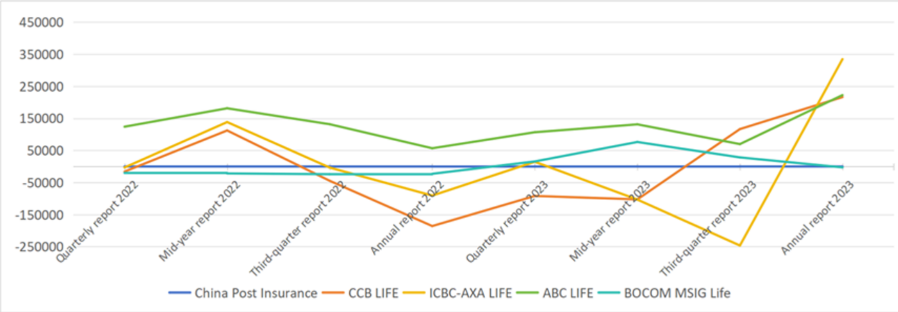

Fig. 2. Change in other comprehensive income (Picture credit: Original).

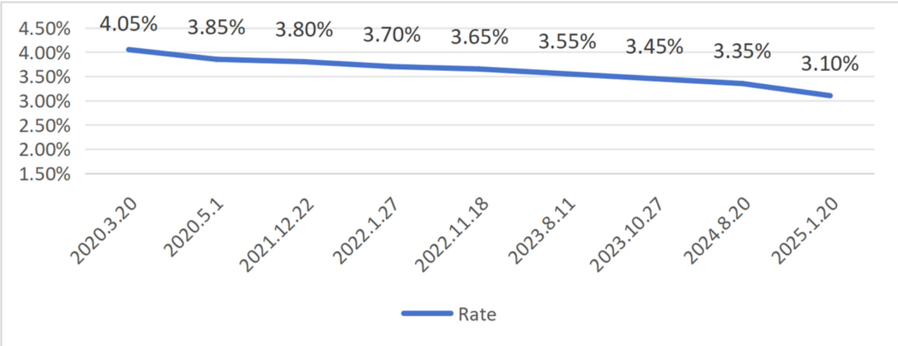

Fig. 3. Interest rate changes (Picture credit: Original)

3.2 Gross Operating Income

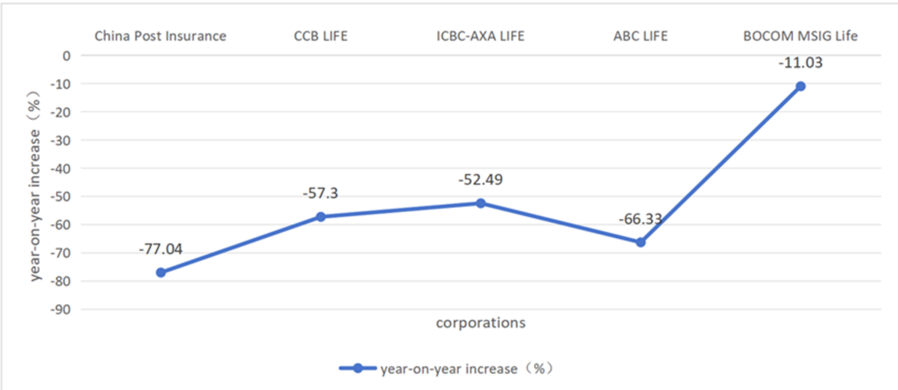

Fig. 4. Year-on-year increase in total operating revenue (Picture credit: Original)

Figure 4 illustrates that in the third quarter reports of the five bank-based insurers that adopted the new accounting standards, all of them showed substantial decreases in total operating income. With the exception of BOCOM MSIG Life, the decreases were all as high as 50% or more, especially for China Post Insurance, which saw a 77% decrease. This is because the former standard stipulates that an insurance contract can only be unbundled if the insurance and non-insurance components are distinguishable and separately measurable; otherwise, in the event that the significant insurance risk test is passed, the contract as a whole should be treated as an insurance contract, with the corresponding premiums credited to insurance service income. Such a provision results in an insurance company recognizing revenue that includes amounts that must be reimbursed to policyholders regardless of whether an insurance event occurs, i.e., an investment component that is in the nature of a policyholder's savings, which is inconsistent with the principle of recognizing revenue under the new revenue standard. Under the new standard, in order to better reflect the “insurance premiums”, revenue recognition is required to exclude non-insurance-related and investment components. The adjustment of the new standard on the revenue recognition of insurance companies has squeezed out the “water”, which can more truly reflect the real income of premiums.

4 Recommendations for Insurers to Respond to the New Guidelines

4.1 Strengthen Risk Management and Asset-liability Matching Management

The new standard requires insurers to recognize revenues and expenses according to a new model driven by actual expenses [9], which will force insurers to focus more on matching assets and liabilities to avoid risks due to market changes. The impact of asset reclassification and interest rate fluctuations on net assets and solvency has increased under the new accounting standards, which makes it more difficult to manage the assets and liabilities of insurers. Insurers need to establish a more comprehensive risk management system, assess and adjust the asset-liability structure in real time through dynamic risk monitoring, reduce the risk of asset-liability mismatch, and safeguard the sound operation of enterprises in the volatile market environment.

4.2 Strategic Transformation and Business Model Alignment

Under the original guidelines, insurers were overly dependent on investment income as a source of profit [10]. The adjustment of the new standard on the revenue recognition principle of insurance companies, which reasonably squeezes out the larger 'water' contained in the premium income, will effectively inhibit the short-term impulse of insurance companies to blindly expand the scale of income, forcing the insurance companies to transform their business [9].

The new standard requires insurers to make sweeping adjustments from their business models to their financial reporting. Insurers may consider reconstructing the structure and pricing strategy of their products and developing high-value, diversified products, such as pension insurance, health insurance and other long-term protection products, to curb short-term investment impulses, to ensure that their business models are in line with the direction of development of the new guidelines, and to promote the transformation of the industry to high-quality development.

4.3 Specialized Personnel Training

The shortage of specialized personnel is one of the obstacles to the implementation of the new standard. The new standard requires significant effort in actuary, risk and accounting and the adoption of new relevant processes and controls [11]. Insurers should develop a team of talents with complex skills through internal training and external cooperation. Insurers can cooperate with universities and professional organizations to establish a talent development mechanism to ensure that professionals with multifaceted skills in actuarial, accounting and information technology can support the implementation of the new standard [10].

4.4 Continuous Monitoring and Periodic Evaluation

The implementation of new standards is an ongoing process and insurers should establish processes to monitor and review the effectiveness of the implementation of new standards. This includes regular assessment of the quality of financial reporting, compliance with regulatory requirements and the effectiveness of internal controls [4]. Through continuous monitoring and assessment, insurers can identify and resolve problems encountered in the implementation process in a timely manner to ensure the accuracy and compliance of financial reporting. Insurers can also refer to the implementation experience of IFRS 17 in relevant international industries and optimize the implementation plan with the characteristics of the local market.

5 Conclusion

This paper analyzes the development of bank-based insurers under the new guidelines in three dimensions. The first is to focus on the major changes in the new standard, including the shift in the classification of financial assets and the revamping of the measurement model for insurance contracts, which have restructured the financial accounting framework.

Second, the paper analyzes the changes in key financial indicators such as net assets, net income, other comprehensive income, and total operating income. The results of the study show that the implementation of the new standard has significantly increased the financial volatility of bank-based insurance companies. The fluctuations in net assets, net profit and other indicators have become more frequent due to factors such as the revolution in the measurement of insurance contracts and changes in the recognition of premium income, which puts higher demands on the operation management and financial reporting of insurance companies. From an operational management perspective, insurers need to re-examine their asset allocation strategies and optimize their product mix; at the financial reporting level, they need to ensure that information disclosure is more timely and accurate to meet regulatory and market demands.

However, there are opportunities in the midst of challenges, and the implementation of the new guidelines provides an opportunity for high-quality development of the industry. By strengthening risk management and asset-liability matching management, insurers are able to better balance returns and risks; advancing strategic transformation and business model adjustment helps to tap new profit growth points; Strengthening the training of professional talents can provide intellectual support for enterprises to cope with the changes in the standards, and establishing a continuous monitoring and regular evaluation mechanism can dynamically optimize the business strategies.

Through the above comprehensive response measures, insurers can better adapt to the requirements of the new guidelines, enhance their core competitiveness, realize sustainable development and seize the first opportunity in the wave of industry changes.

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