Asia e-Alert

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Vietnam – Proposed amendments to Circular 50

Introduction

In July 2018, the Ministry of Finance (MOF) in Vietnam released proposed amendments to a number of articles associated with its existing Circular 50 regulation (No. 50/2017 / TT-BTC dated 15/5/2017) that guides the implementation of Insurance Business Law (Decree No. 73/2016 / ND-CP dated 01/7/2016).

In this e-Alert, we give an overview of the proposed amendments to Circular 50.

Valuation interest rate

The most anticipated change to Circular 50 pertains to MOF's decision to amend the maximum technical interest rate that is used for the valuation of liabilities. The Vietnamese bond market has seen its lowest yields over the past decade, with the 10-year government yield dropping close to 4% in mid-2018 from a high of about 12% in 2012. The recent low interest rate environment has led to the need for many life insurers to hold higher reserves and solvency capital requirements, which has put pressure on balance sheets and resulted in several companies making capital injections.

The MOF has proposed amending the calculation of the maximum technical interest rate mentioned under Item a, Point 3.1, Clause 3, Article 18 of Circular 50 as follows:

- **Proposed new basis (A):** 80% of the average yield of 10-year or longer-term Government bonds issued in the last 24 months
- **Current basis (B):** 70% of the average yield of 10-year or longer-term Government bonds issued in the last six months

All policies issued after 1 October 2018 will need to use the new approach A.

For policies issued before and in-force as at 1 October 2018, insurers were asked to comment on which option they preferred in terms of the adoption of this new approach.

Option 1 is an immediate application of the new approach, whereas Option 2 is a "phased-in" approach over 5 years such that:

- **In 2018:** Maximum technical interest rate = 20% A+ 80% B
- **In 2019:** Maximum technical interest rate = 40% A+ 60% B
- **In 2020:** Maximum technical interest rate = 60% A+ 40% B
- **In 2021:** Maximum technical interest rate = 80% A+ 20% B
- **From 2022:** Maximum technical interest rate = 100% A

A higher maximum technical interest rate will provide some balance sheet relief to insurers. The new approach will also take the average of historic bond yields over a longer period of time (24 months rather than six months), thereby reducing balance sheet volatility in a fluctuating interest rate environment.

Treatment of sale and repurchase transaction

Under the new amendment to Circular 50 Point 2.3, Clause 2, Article 20, assets excluded from total accounting value will include "assets equal to the profit (if any) from the sale and repurchase transaction". Previously, insurers were allowed to retain this adjustment on the asset side of their balance sheet. As assets are recorded on a book value basis in Vietnam, this effectively means that insurers will no longer be able to recognise marked-to-market adjustments on their asset portfolio through sale and repurchase transactions. Interestingly, we note that sales and repurchase transactions have become more common under recent economic conditions with insurers having to realise marked-to-market gains to meet the increase in liabilities resulting from the decline in interest rates.

Use of cash or deposit to fund deficits in policyholders' fund

Circular 50 Clause 1, Article 27 states that the insurers have the responsibility to fulfil deficits in the policyholders' fund (if any) from the shareholders' fund. In the proposed amendment, MOF provided clarification that the asset vehicles used to fulfil these deficits are to be either in cash or deposits coming from the shareholders' fund.

Conclusion

There has been considerable industry discussion in Vietnam in the past year over the impact of sharply falling bond yields, particularly the implications on the capital position of life insurers under the existing reserving framework. The amendment to Circular 50 has been eagerly awaited by many market observers. In a recent decreasing interest rate environment, the higher maximum technical interest rates are expected to provide some balance sheet relief for insurers (and hence lower reserves and solvency capital) in the near term. The new approach takes the average of historic bond yields over a longer period of time (24 months rather than six months), thereby also reducing balance sheet volatility in a fluctuating interest rate environment. However, we understand that some market players were hoping to see more drastic changes to the existing reserving requirements given the challenges posed by the severely depressed yield curve observed in the recent years.

The amendment to the treatment of accounting assets will only affect insurers which had entered into a sale and repurchase transaction to recognise marked-to-market gains. For these insurers, the proposed revision to this regulation will not be well received as they will not be able to utilise the market value adjustments from the sale and repurchase option to minimise the asset liability mismatching gap due to the difference in accounting treatment in assets (on a book value basis) versus liabilities (on a market value basis). That said, the revisions to valuation interest rates will soften the impact. Moreover, the use of cash or deposits to fund deficits in the policyholders' fund will result in a need for the shareholders' fund to hold sufficient liquidity under stressed conditions.

If you have any questions on this e-Alert or would like to discuss this further, please contact any one of our consultants below.

CONTACT

Michael Daly
michael.daly@milliman.com

Wen Yee Lee
wenyee.lee@milliman.com

Clement Bonnet
clement.bonnet@milliman.com

Pingni Eng
pingni.eng@milliman.com