

## Minutes of the Subcommittee on Actuarial Standards Edinburgh — November 16 and 18, 2006

### November 16 session:

Attendees: Yutaka Amino (Japan), Maria de Nazaré (Portugal), Ralph Blanchard (U.S.), Amy Bouska (U.S.), Guy Castagnoli (Switzerland), Mo Chambers (Canada), Amornthip Chansrichawla (Thailand), Dave Congram (Canada, vice-chair Subcommittee), Mary Downs (U.S.), Stefan Engeländer (Germany), Dave Finnis (Australia), Mark Freedman (U.S.), Sam Gutterman (U.S., chair of Insurance Accounting Committee), Stephen Humphreys (Canada), Burt Jay (U.S.), R. Kannan (India), John Maroney (Australia), Greg Martin (Australia), Bob Miccolis (U.S.), Jim Milholland (U.S.), Yuji Morimoto (Japan), Lutz Öhlenberg (Germany), Richard Roth (U.S.), Francis Ruygt (the Netherlands, co-chair of Subcommittee), Junichi Sakamoto (Japan), Masaaki Shigehara (Japan), Makoto Yasunaka (Japan), Hideyuki Yoshida (Japan), Masaaki Yoshimura (Japan), Jesus Zuñiga (Mexico).

Francis Ruygt chaired the meeting and after introductions the minutes of the [Paris Meeting May 25-27, 2006](#) were approved.

The IASP on Embedded Derivatives was presented for approval. During the discussion the comments of Peter Clark from the staff of the IASB, who was unable to be present were passed along. In his opinion the proposed IASP was still difficult to follow and some phrases were used that were not IASB standard terminology. He thought it would have added to the document if we had been able to present more examples of both embedded derivatives and those that would not qualify as embedded derivatives. He did indicate it was a significant improvement over the previous document. Members of the committee indicated more examples would help and hoped these may be added in another manner in the future. The document was unanimously approved by the subcommittee for approval by the Council.

The IASP on Reinsurance was presented for approval. Peter Clark had no further comments on this document. There was a concern with regard to the wording of the footnote on page 6 that on translation into German that the meaning can be confusing. Amended wording for the footnote was proposed to avoid any potential confusion. The document, with the one editorial change, was unanimously approved by the subcommittee for approval by the Council.

The new working draft on Business Combinations was presented for discussion. In his introduction Jim Milholland indicated that in response to comments, more background on intangible assets and additional commentary on goodwill had been provided. In the absence of sufficient definitive guidance on fair value, examples of common industry practice had been included as education. The question of whether it was applicable to gross-up was addressed and confirmation of the applicability of deferred taxes. A number of additional comments were provided regarding guidance on accounting methods to be used, treatment of reinsurance assets, definition on what is a business combination, the treatment of goodwill, addressing IAS 39

products together with IFRS 4 and IAS 18, impairment of identifiable intangible assets, co-mingling of acquired and ongoing business for impairments and quoting IFRS in certain cases rather than paraphrasing. The following timetable was proposed:

- Reflection of additional comments by December 2006
- Approval of a version for exposure by January 2007
- Exposure to end in May 2007

The Disclosure Standard was reviewed by Sam Gutterman who recommended that the effort should include IFRS 7, which will become applicable in 2007. This was agreed given that we would not be in a position to have a document approved until after it could be of assistance for 2006 year-end. It was noted the current version would be a good springboard for this effort and it was recommended we review actual disclosures in 2005 and 2006 to support the effort. We identified Stefan Engeländer, Ralph Blanchard and Eng Kim Yeoh to participate in the preparation of the document. Others would be welcome to join the effort.

Stefan Engeländer opened the discussion of a possible IASP website. Initial discussion focused around the primary issue of access to this part of the IAA website. Alternatives identified were

1. IAA members;
2. IAA members and specified interested parties; or
3. IAA members and the public.

The subcommittee favored open access by interested parties, provided we would be able to protect against inappropriate messages. Concern was raised between

1. being too successful, resulting in being under pressure to be a source of interpretation for IASB and immediate comments; and
2. putting in significant effort and get no responses.

Another area of concern related to whether the scope should be restricted to the insurance accounting committee or be broadened to all IAA IASPs. It was decided to contact the IAA staff and determine possible website possibilities.

David Finnis introduced the draft RFP for Stochastic Modeling. The approaches used before have not been successful. Within the past month we have identified several opportunities to have the preparation of this effort funded. Use of Stochastic Models around the world has not been consistent and has proven an impediment in getting appropriate materials developed. The objective of this study would be both a technically sound but also a practical approach. Discussion included examples of why the research would be useful and some concerns expressed as to the necessity of the tool. The pressure to develop risk margin have placed greater emphasis on these methods. In terms of the RFP a desire to have a continuity approach was mentioned and this was compared to the Australian application of actuarial control cycle. The title of the study was questioned as to whether this was guidance. Discussion included whether the study should be separated between Life and Non life approaches or alternatively separated between Capital approach and technical reserve approaches. Concern was expressed that there was no requirement for some performance criteria in the RFP. The need for an oversight committee to assist in the selection and also the supervision of the successful bidder was recommended. The

names put forward were David Finnis, Sam and Francis. Discussion needs to take place with the other sponsors of this research. The proposed timetable was as follows:

- Two months for finalization of the RFP
- Two months for bidders to propose
- One month for selection
- Six months to complete the task
- Presentation of results at the fall IAA meeting.

Jesus Zuñiga presented a report on the progress of the translation of the currently approved IASPs into Spanish. They are just at the position to publish this for review. They are expecting some comments from other Spanish-speaking associations. These translated versions should be included in the IAA website when completed. We will ask IAA staff for a status on French translations. Progress is being made on the translation to Japanese.

Francis Ruygt reviewed the expected discussion at the Professionalism Committee on Saturday morning. The following are expected to be addressed:

1. Report on the due process we have followed for Embedded Derivatives and Reinsurance IASPs
2. Wording of the opening material included in the IASPs
3. Discussion on the desirable number of classes of Standards
4. Task Force on the application of the IASP's in the various jurisdictions
5. Whether the Glossary should apply to all IASP's or be restricted to Insurance.

The November 18<sup>th</sup> session will report back regarding conclusions of the Professionalism Committee and agenda items 5 through 10.

### **November 18 session:**

Attendees: Yutaka Amino (Japan), Ralph Blanchard (U.S.), Allan Brender (Canada), Guy Castagnoli (Switzerland), Mo Chambers (Canada), Tony Coleman (Australia), Dave Congram (Canada, co-chair of Subcommittee), Rob Curtis (IAIS), Stefan Engeländer (Germany), Rob Esson (U.S., IAIS), Jiri Fialka (Czech Republic), Dave Finnis (Australia), Sam Gutterman (U.S., chair of Insurance Accounting Committee), Stephen Humphreys (Canada), Burt Jay (U.S.), Tom Karp (Australia), Erkki Kautto (Finland), Nikos Koullapis (Cyprus), Kurt Lambrechts (Belgium), Anne Magnussen (Norway), Greg Martin (Australia), Glenn Meyers (U.S.), Bob Miccolis (U.S.), Jim Milholland (U.S.), Yuji Morimoto (Japan), John Poole (India), Thomas Ringsted (Denmark), Francis Ruygt (the Netherlands, co-chair of Subcommittee), Arne Sandström (Sweden), Masaaki Shigehara (Japan), Dieter Silbernagel (Germany), Lisa Simpson (Australia), Charles Vincensini (France), Tuomo Virolainen (Sweden), Makoto Yasunaka (Japan), Hideyuki Yoshida (Japan), Masaaki Yoshimura (Japan), Jesus Zuñiga (Mexico).

Francis Ruygt asked David Congram to report on the results of the meeting with the Professionalism Committee which had been attended by Francis, Sam and David. He reported the following:

1. We had informed the Professionalism Committee that our Committee had endorsed the two outstanding IASPs, Reinsurance and Embedded Derivatives, with the only change being in a footnote to the Reinsurance paper to clarify the intended meaning, identified in the course of translation of the text. The Professionalism Committee then adopted their report, which indicated their conclusion that the Subcommittee has followed due process. They can now go forward to Council for discussion and a vote, which is expected in the next two months.
2. With regard to the draft Business Combinations IASP, based on the comments received a redraft was deemed appropriate, which will require re-exposure. Francis indicated that, while the initial period of exposure has to a minimum of four months in length, any subsequent re-exposure period should reflect the degree of amendment. When it has been prepared, we will review the due process requirements and will then recommend an appropriate exposure period.
3. We discussed opening a section of the IAA website to capture comments on Standards and communicate the status of the development or revision of standards. We thought it would be appropriate to have it cover all IASPs, rather than just those involving accounting issues. This idea was supported by the Committee. We were asked to contact the other Chairs who would be involved and the IAA secretariat on feasibility.
4. We raised the issue of translation and noted that when accessing the IAA website under the French language you are referred back to the English version of the IASPs. We indicated the IAA has not yet been able to get the Standards translated into French, but we have been making progress with the Spanish, given the active leadership of the Mexicans. The Committee re-emphasized the position that we are a bilingual organization (English and French) and that we should pursue the completion of the French translation.
5. We discussed the Glossary, raising our concern that some words that were used in different standards had different meaning (and source) and again indicated that it would be ideal to have all IASPs to utilize a single Glossary. The AAA representative indicated that this was the reason that they had taken the position of not having a single Glossary, but instead have maintained a Compendium to identify where words have different meanings in different Standards. Paul Seymour from the UK Actuarial Standards Board indicated that they had recently discussed this issue; ordinary members had been very explicit that they were going to require convergence in the meaning of words.
6. Helen Rowell, Chair of the Professionalism Committee, raised the question of the use of the definition of Practice Guideline on the cover of the IASPs. She felt that it may be somewhat misleading to some, possibly indicating that it was expected for all actuaries to follow them. However, it was noted that this has been included on all those published to date and was in fact the official IAA definition. The consensus of the Committee that this practice be reviewed immediately after the IASP due process review (Francis is our representative on) was completed, which is currently underway. As part of this review, a survey had been completed on the current application of the IASPs by association

members. It was difficult to assess given the limited number of countries in which IFRS apply at this time. The current proposal appears to be moving to describing them as educational notes and model standards. There was a discussion of other international association practice and their compliance requirements.

Sam Gutterman reported on the other follow-ups that had taken place since the first session of the Subcommittee.

1. He had a discussion with the Secretariat regarding a possible IASP website and determined there were some limitations of the existing software, but these should not interfere with a website, but may limit its flexibility. He will continue to investigate the best way to implement this initiative.
2. There was a discussion of the effort of the Insurance Regulation Committee in respect to developing an Internal Model initiative at the Joint Meeting of the two committees. It was agreed that potential duplication with current IASPs exists and duplication with the Accounting Committee's stochastic methods educational initiative. The Regulation Committee appears to want to keep the development internal until a later stage. There was agreement that we will need to manage this process.
3. A Role of the Actuary task force had been formed, but has only just commenced. It is still formulating its terms of reference and scope of operations. Initial thoughts are to concentrate on the Financial Reporting roles of Regulator, the Auditor and the Actuary as an expert.

We then moved to the final agenda item, which was the approach that we should take to IASPs that will have to be developed to implement Phase 2 of the IASB's Insurance Contracts project. The parent committee will hold a session on Phase 2 issues that will be addressed on the 19th. We have been told that the IASB will leave guidance over actuarial measurement issues and techniques to the IAA. The question is in what areas will we develop such guidance and how we best proceed.

Sam indicated that the elements that are within our scope at this time are the development of applicable current estimates, risk margins and the determination of discount rates. Another aspect of the question is whether to approach this on a generic conceptual basis, or on a more coverage/product specific or technique specific basis. This should be different in nature than the previous material we have assembled because – rather than providing educational guidance regarding the financial reporting standards themselves, we will be providing such guidance in the application of actuarial science, although in the context of the financial reporting standards and any possible constraints that they might impose.

A question raised was to what extent is the IASB looking for supplemental guidance. Will they include our guidance in their guidance hierarchy (the tentative answer is no)? This raises the question of whether our guidance will be perceived as authoritative from an accounting perspective. What the IASB has indicated is that they do not want to establish detailed rules and need to rely on experts where appropriate.

We were reminded that we are assisting the entity prepare its Financial Statements and do not have a reserved or designated role in that work. We have been recognized as insurance experts,

assisting the people who prepare the statements. The scope of our work tends to focus on the development of estimates, and not in the interpretation or application of the accounting standards (except to the extent that they apply to actuarially developed items. Even if we develop Actuarial Standards, the person preparing the entity's financial statements can choose to use other resources to develop their estimates, although they will have to pass an audit and demonstrate they have met IFRS. The IASB has been specific in not including reference to other experts in their IFRSs and have no intention of changing this position.

An aspect for us to consider in preparing guidance that purports to be market based is that circumstances, markets and techniques are continually changing. We will need to be sensitive as to how we avoid the guidance we provide from becoming dated. A question discussed is whether we develop general principles or standards or how practice or technique specific we get. The general view expressed was that our standards should be short and generic, supplemented by practice specific examples.

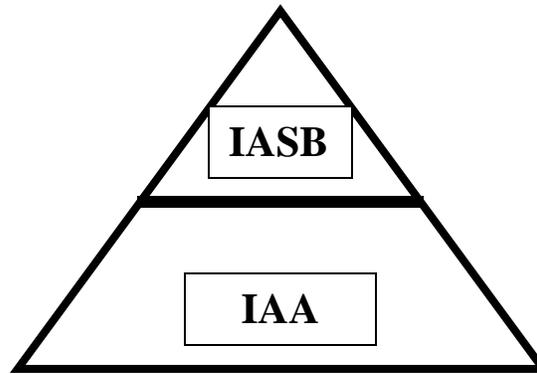
A significant perspective of the IAIS is to the assessment of capital adequacy. They prefer that the approach taken to liabilities / technical provisions be the same as that of the IASB and therefore would like to use the methodology used to recognize and measure general purpose accounting liabilities. However, to the extent that they disagree with the approach taken by the IASB, the IAIS has indicated that they will likely require a reconciliation if differences arise. At this point it would appear that the IAIS will accept IASB liabilities if at all possible, providing they are acceptable to a local regulator. If they are actuarially consistent then we can avoid two sets of accounts.

We have to continue to emphasize the ability of the profession to provide sound advice and practice in our activities and standards, as well as in the practice of the individual actuary in the field. We will have to work hard to maintain our credibility. Some members of the IAIS have questioned whether we will be able to meet the time lines to which we have agreed. This speaks to the effectiveness of how we are organized, our objectivity, and how we develop our material.

Clearly the challenge and the opportunity exist to develop the application of our techniques (although this does not always require original work and might simply be an identification of relevant literature) and gain credibility for the profession. Examples were given in the ways that individual countries have pursued this effort. Where a vacuum has arisen, it has often been filled by the publication of materials (by individual actuaries, actuarial committees, or firms) that those involved look to as the best guidance available, which then becomes generally accepted, rather than having any legal force.

We then came back to the question of what should be within the scope of IAA material that we develop. Some suggested that we make sure that we walk effectively before we run. We should keep initial guidance short, possibly seven or eight pages on a topic at most. A principle-based approach focusing on concepts and general considerations might be our focus, followed up by guidance notes (possibly a compendium of current practice) and practical examples. A question was raised as to whether we might be stepping outside the scope of our mandate (or the extent of our volunteer resources).

The following model was drawn:



It was generally agreed that we should resist the possibility that the IASB will become more prescriptive within the scope of our (current and potential) expertise. If we are able to effectively apply our expertise, we will push the line higher. Just below the line should be our principles and further down our practice examples. We need to think carefully what we ask the IASB for guidance. What we generally need from IASB is the general context and financial reporting objectives in terms of the overall financial reporting model. We have to recognize that anything below the line is not authoritative in an accounting sense. It was thought by some that the IASB has been pushing the line down, either because a vacuum exists or they have been dissatisfied with the range of current practice. However, we have generally observed that they have expressed the desire that the more application guidance that the IAA can complete the better, as long as it is consistent with their Conceptual Framework and their financial reporting standards. We have received the same message from the IAIS.

The question was raised as to whether we have been identifying the correct customer. The insurance industry has been challenging us by going to the IASB and expressing concerns about calibration, the difficulty in accurately estimating claims liabilities, the need for additional rules in order to avoid manipulation of earnings. In many cases it has been the industry that has raised questions concerning the credibility of the actuary. This was particularly evident with IAS 39. The mixed attribute measurement model has developed as a result of compromises, the interest of various industries and prior practice.

Other potential customers identified that we should consider are the regulators, investment analysts and auditors. The audit consulting firms now employ a large number of actuaries. Investment analysts are perceived to be unduly influenced by the information available, as opposed to suggesting constructive alternatives so far.

Most felt that our standards do not need to address areas in which a reliable observable market exists. It is in the non-market area that will remain our focus. We need to stay within our expertise and our positions should generally be acceptable to our stakeholders.

We want to be able to develop a draft approach to our phase II IASPs that would be available for review prior to the next meeting of the subcommittee in conjunction with the IAA meetings in April in Mexico City.

Respectfully submitted,  
David Congram