

Building Competencies in Insurance Accounting in an IASB World

Presented by
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Transition from National Based systems to IASB Financial Reporting

- **Current systems are mixtures of rules based and principles based.**
- **The new IASB IFRS will also be a mixture of principles and rules.**
- **Whose principles and whose rules should prevail?**



IASB Principles

- **Standards should fit inside the Framework and the IAS 8 criteria**
 - **But, in Phase 1, the IAS 8 criteria need to be suspended**
 - **And the Framework needs to be modified to reflect the change in emphasis from certainty in historically based accounting to more probabilistic methods in fair value measurement.**



IASB Principles (Cont'd)

- **Fair Value is more relevant than historical cost**
 - But FV is not universally applied in measuring assets
 - And FV has not yet been developed for insurance liabilities
 - And certain historical cost ideas (e.g. demand deposit floor, no profit at issue) persist
- **Fair value requires reflection of “own credit standing”**



IAA Principles

- **Relevant financial information can only be provided based on the best current credible estimates of all significant contingencies.**
- **Relevant financial information can only be provided for a financial intermediary if assets and liabilities are measured consistently.**
- **No one contingency should override any other contingency in future cash flow assessment.**
- **Risk takers demand (and generally receive) a reward for assuming risk.**



Prudential Implications

- **Both IASB and IAA agree good public policy requires fiduciaries to hold more than FV liabilities.**
- **Both IASB and IAA agree such prudence should be reflected in equity.**
- **The IAA feels that prudence should be based on risk based capital principles (such as conditional tail expectation or tail Var).**
- **To be useful to regulators, FV financials must reflect business reality.**



Conflicts of Principles and Rules

- **The IAA's principle that relevant reliable financial reporting must require consistently measured assets and liabilities is not accepted by the IASB in BC 110 despite 3 studies demonstrating such inconsistencies lead to "financial noise" at times overwhelming "business reality" and could lead to the appearances of insolvency.**
- **The IAA's principle that the FV of any financial liability is based on the probability weighted surrender patterns and includes all associated cash flows is in conflict with an IASB rule requiring demand feature floors.**



Conflicts of Principles and Rules

(Cont'd)

- The IAA's principle that all associated cash flows should be reflected in measurement (since they are recognized in observed FV transactions) causes problems for the IASB because its Framework requires control before recognition can be granted.
- The IASB's principle that the FV of financial liabilities should reflect own credit risk cannot be calibrated to market observations for insurance contract risks by the IAA.



Conflicts of Principles and Rules

(Cont'd)

- **The IAA's principle that risk assumption results in a reward for assuming risk, while accepted by the IASB, is difficult to calibrate in the marketplace. Lack of reliability leads to lack of profit at issue recognition by the IASB.**



True and Fair

- **Both the IAA and the IASB accept “true and fair” criteria for financial reporting.**
- **But the measurement of what is “true and fair” differs because of each profession’s principles.**
- **And in phase 1, the hierarchy has been temporarily suspended by the IASB while no suspension of principle has yet been accepted by the IAA.**



One Rooster – Many Hens?

- **Industry and the regulators are “interested observers” who accept the need for progress by an acceptable route.**
- **Illusory results – as they see them - (particularly if unfavorable) can be strongly resisted by all parties.**



Many Roosters?

- **All accept that accountants set the rules for GAAP.**
- **The public interest is not served by misleading financial results.**
- **Reconciling the principles and the needs of the central players has not occurred.**



Illusory Earnings and Equity

- In February, the IAA identified a major problem with phase 1 in that significant illusory earnings and equity could be produced. A paper was prepared for the March IASB Roundtable on IAS 39.
- In June, the IAA extended its analysis to produce a Second Report to discuss at the June IASB meeting. The scheduled June discussion was cancelled.



Illusory Earnings and Equity

(Cont'd)

- In July, the IAA produced an Appendix in which examples were given of a bias in IAS 39 to produce favorable earnings and equity in falling interest markets and unfavorable earnings and equity in rising interest rate markets. We were invited to go to FASB.
- In August, the IAA produced a Memorandum detailing the theoretical flaw in phase 1 that led to the illusory earnings.



Illusory Earnings and Equity

(Cont'd)

- **In September, the IAA went to FASB but was unable to present its reports in a logical manner due to interruptions.**
- **Last week, the IAA went to the IASB to present our reports but the scheduled agenda item was not called, additional papers sent to the staff were not presented and our concerns were rejected after a brief discussion.**



The Problem with Principles

- **The first Guiding principle of the CIA is “to hold the duty of the profession to the public above the needs of the profession and its members”**
- **Rule 1(a2) (Integrity) states “It is the professional responsibility of the member not to be associated with anything which the member knows is false or misleading”**
- **The Insurance Companies Act of Canada incorporates my own wording that “acquiescence” constitutes association.**



The Problem with Principles

(Cont'd)

- **Research in the IAA indicates that phase 1 may produce significant illusory financial earnings/losses and changes in equity that do not represent business reality and that the adverse “financial noise” is worse in a rising interest rate environment. The research this year has passed 1300 hours and \$500,000 in equivalent time charges.**



Principles Based Systems are Judgment Based Systems

- Rules based systems are measurement based systems.
- The fact that adversity can happen does not mean it will happen.
- The line must weigh the merits of “freeing a guilty person” against “convicting an innocent person”.
- e.g. finding money had left the Confederation trust was not (in my opinion) sufficient to write the letter. Coming to the view that Confederation could not be saved was the point at which the letter must be written.
- The ability to sleep well at night is not a bad guide on the threshold.



Thank you very much

