10th Global Conference of Actuaries

February 7th and 8th, 2008
Developments in International Financial Reporting for Insurance Companies

IAA President David G. Hartman
Agenda

- International Financial Reporting
- IAA Role
- Insurance
- IAA response to the IASB
  Discussion Paper – Preliminary views on Insurance Contracts
- IAA – Future Activity
International Financial Reporting - Scope

- Financial Statements for Publicly Accountable Enterprises
- Regulatory filing for Financial Institutions
- Pensions
Who are the International Players?

- International Accounting Standards Board (IASB)
- International Actuarial Association (IAA)
- International Organization of Securities Commissions (IOSCO)
- International Association of Insurance Supervisors (IAIS)
- National Standard Setters
International Settlements demands trust in the strength of different national financial institutions.

IFRS is becoming the basis of GAAP in most major jurisdictions outside North America.

IFRS are principles-based standards, as opposed to rules-based standards (e.g. US GAAP).

Many companies, including banks and insurers, already report upstream on this basis.
IFRS – Moving Towards a Global Standard

Fixed deadlines for IFRS implementation
Convergence plans
US-GAAP - Convergence intended
No intent to converge with IFRS

Source KPMG
SEC Chairman Christopher Cox – July 25, 2007

“Having a set of globally accepted accounting standards is critical to the rapidly accelerating global integration of the world capital markets”

- Concept Release for public comment
- Allowing US Issuers prepare on IFRS for SEC purposes

This follows the June 2007 proposal

- Proposal to eliminate the requirement on foreign private issuers using IFRS to reconcile to US GAAP
What is the role of the IAA?

IAA - Objectives

- Develop the role and reputation of the profession
- Promote high standards of professionalism to serve public interest
- Advance the body of knowledge of actuarial science
- Further the personal professional development of actuaries
- Promote mutual esteem and respect amongst actuaries
- Provide discussion forum for actuaries and associations

- Represent the global profession with supranational bodies
IAA Moving toward global representation

Green – Full IAA Member Associations

Yellow Associate Members
IAA International Actuarial Standards of Practice

- Class 1 Compulsory
- Class 2 Voluntary
- Class 3 Recommended Practice
- Class 4 Practice Guidelines:
  - educational in nature
  - not binding
  - Usually start as class 4, can be upgraded later to class 1-3.

Due Process is under review
The challenge of global standards

Uniform international standards

National protection of citizens

Subsidiarity
Why is the Insurance Project a Top Priority?

- Industry historically mutual in form
- Financial reporting largely dictated by national regulators (solvency driven)
  - financial reporting models quite different around the world
- Industry now demutualized; raising capital across borders
- No common regulation / capital formula without a common financial reporting basis
- If the insurers adopt fair value standard, then banks might as well
Insurance Project Timetable

IASC

IASB

Insurance Project

Steering Committee

Advisory Committee

Insurance Working Group

Phase I

DSOP

ED 5

IFRS 4

Split of Project

Discussion Paper

Discussion with FASB

Phase II

Source KPMG
IFRS Phase I --> Phase II

**Assets**
- IAS 39 for Invested Assets

**Liabilities**
- All *Insurance Contracts* and Investment Contracts with Discretionary Participation Features
- Other *Investment Contracts* and All Service Contracts

Phase I
- (2005)

Phase II
- (20??)

Source: E&Y
IAA Insurance Actuarial Practice Guidelines

- IASP 2 Actuarial Practice
- IASP 3 Classification of Contracts
- IASP 4 Measurement
- IASP 5 Current Estimates
- IASP 6 Liability Adequacy Testing
- IASP 7 Discretionary Participation Features
- IASP 8 Changes in Accounting Policies
- IASP 9 Accounting for Reinsurance Contracts
- IASP 10 Embedded Derivatives and Derivatives

Introduced July 25, 2005

Introduced June 11, 2007
Phase II Discussion Paper

- Issued May 2007; comment period November 16, 2007
- Presents tentative decisions to date by IASB
- Has considered input by a number of interest groups, such as IAA, CFO Forum, GNAIE, and IAIS
- Process will lead to final standard, replacing IFRS 4 Insurance Contracts
Phase II Discussion Paper - Objectives

- Insurance to be subject to the same general principles as other financial services firms
- Principles-based approach with additional guidance
- Consistency of treatment between insurance, investment management and banking products
IASB DP – IAA comments
Accounting objective

- Support major thrust requiring relevant and reliable measurement
- Support, to extent relevant and reliable, market-based inputs
- Where relevant and reliable market based inputs are not available, the three building block prospective model for future cash flows could be sound
- Support for useful information to users in the balance sheet, performance measurement statement and disclosure
IASB DP – IAA comments

Recognition

- Two views of the insurance contract
  - Financial Instrument – time contract is agreed
  - Service contract – effective date of the contract

- If Financial Instrument view prevails there will be practical systems challenges

- Contractual changes and reinsurance implications need to be addressed

- Insurance is a hybrid contract
  - Consisting of interlinked bundle of insurance, service and financial components
IASB DP – IAA comments
Measurement

- Should be based on the current economic value of the rights and obligations of the insurance contracts

- Application of up to date measurement and cash flows reflecting rights and obligations agreed

- Divergent views on the transfer notion were noted
  - Market participant view without rule constraints favoured by the majority
  - Settlement notion executed within the current organizational environment by the minority

- Application guidance should be relatively limited, focusing on high level issues, such as
  - Explicit rather than implicit calculations
  - Objectives of risk margins

- Support for no cash value floor
IASB DP – IAA comments
First building block

- When market-based expense inputs are not available nor relevant
  - Use entity-specific assumptions in their absence

- Renewal premiums
  - A measurement rather than recognition issue
  - Need to reflect policyholder behavior uncertainties in margin

- Reflect expected policyholder behavior, whether favorable or unfavorable
IASB DP – IAA comments
Second and Third Building Blocks

- Include risk associated with service with risk margin
- Recognize diversification effect from the point of view of the market participant
- We referred to the risk margin paper that the IAA has had in exposure.
IAA – Risk Margins paper

- Generally consistent with IASB Discussion Paper
- More restricted Risk Margin approaches
- Focus on Reference Entity
- Excellent feedback
IAA – Continued Activity

- IASPs
  - Business Combinations
  - Disclosure
  - Models
  - Pensions

- Exposure Draft - Measurement of Liabilities for Insurance Contracts: Current estimates and risk margins

- Stochastic Modeling Educational Monograph

- Review of Due Process

- Identification of where new IASPs needed for Phase 2