

International Accounting and Progress on a New Insurance Accounting Standard

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Doug Van Dam, FSA, MAAA
Manager, PolySystems, Inc

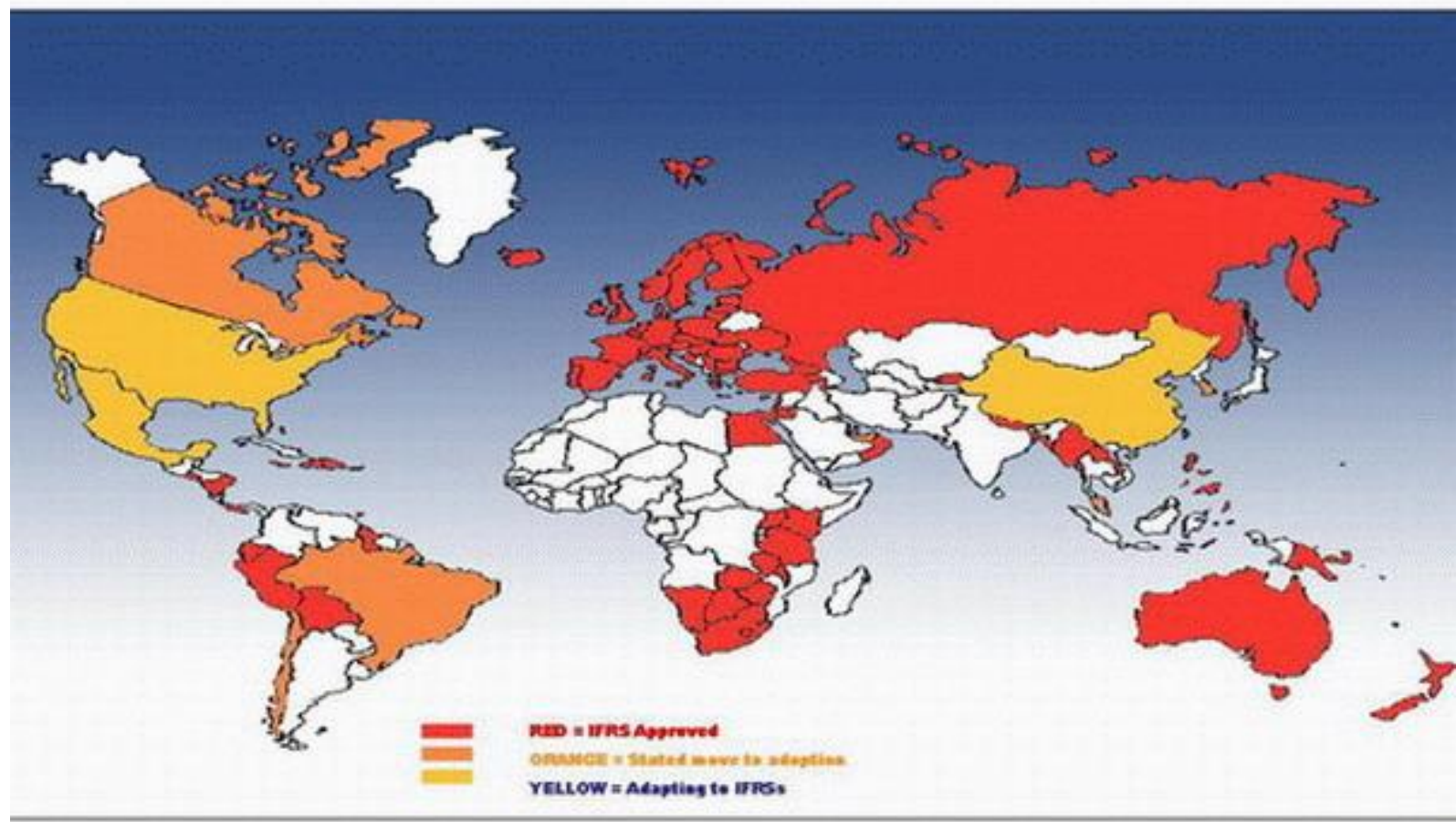
Outline of Speech

- 1) Background (10 minutes)
- 2) Insurance IFRS/New GAAP Basics (20 minutes)
- 3) Discussion Topics (30 minutes)

IASB

- Formed April 1, 2001, assuming standards setting from IASC
- 15 international members (4 from USA)
 - One member is a former Hanover Re CFO
- Actions taken at monthly meetings
- Staff is located in London and most meetings take place in London
- www.IASB.org

IFRS AROUND THE WORLD



IFRS in the US

- SEC has already decided that foreign companies no longer need to reconcile IFRS based financial statements to US GAAP
- SEC has published a roadmap that could lead to a decision to require US companies to report under IFRS
- FASB and IASB have a Memorandum of Understanding to converge IFRS and US GAAP
- FASB is working with IASB on new Insurance Standard

GLOBAL FINANCE

U.S. Nears Accounting Shift

By MICHAEL RAPOPORT

Regulators are edging closer to switching U.S. companies to global accounting rules, as the Securities and Exchange Commission's top accountant suggested Monday he was moving toward recommending a long-discussed compromise approach.

International authorities are pushing the SEC to move U.S. companies to use the global rules, known as International Financial Reporting Standards, to unify companies world-wide under the same accounting system. American corporations are watching intently for a recommendation from the SEC's staff about whether the commission should do so. Big accounting firms and multinational companies say a move would simplify their accounting and make it easier for them to raise capital around the world, while skeptics



SEC staffer James Kroeker may be closer to backing global accounting.

say it would be too costly and burdensome.

Most companies world-wide now use IFRS, but the U.S. still uses its own set of rules, known as generally accepted accounting principles. IFRS allows companies more flexibility and judgment than GAAP. The global system is centered on applying

guiding principles of accounting rather than following GAAP's set of detailed rules.

The SEC's staff hasn't made a recommendation yet. But on Monday, SEC Chief Accountant James Kroeker discussed the matter in terms that hinted that he and his staff were gravitating toward a middle-ground "en-

dorsement" proposal, under which IFRS would be incorporated into U.S. rules and U.S. rule makers would retain the authority to evaluate future global rules for U.S. use.

Speaking to an IFRS advisory panel in London, Mr. Kroeker said the rules to be used globally "would be the standards of the IASB"—the International Accounting Standards Board, which created IFRS—and that the Financial Accounting Standards Board, the U.S. rule maker, would play "an endorsing role."

Joel Osnoss, Deloitte Touche Tohmatsu Ltd.'s global leader for IFRS, said Mr. Kroeker's remarks "clearly confirm" that he and his staff are heading toward a recommendation that the SEC use IFRS for American companies. Mr. Kroeker said the recommendation will be completed in "something more than a couple and less than many" months.

Congressional Quarterly/Getty Images

FASB

- Formed 1973
- 7 members
- Actions taken at weekly meetings
- Staff is located in Connecticut and most meetings take place in Connecticut (or London)
- SEC delegates standard setting to FASB
- www.FASB.org

Insurance IFRS / New GAAP

Timeline

- IASB
 - Spring 2007 – Phase II Discussion Paper
 - July 2010 – Insurance Standard Exposure Draft
 - ~~June 2011 – IASB Insurance Standard~~
 - December 2012 Re-exposure
 - ? – IASB Insurance Contract Standard
 - ~~2014 or 2015~~? – Insurance Standard Effective
- FASB
 - September 2010 – Insurance Discussion Paper
 - ~~June 2011~~ Dec 2012 – FASB Exposure Draft
 - ? – FASB insurance Standard
 - ~~2014 or 2015~~? – Insurance Standard Effective

IFRS Insurance Project Objectives

- Reduce diversity of accounting practices that currently exist for insurance contracts
- Align insurance accounting with other business sectors, where possible
- Increase users' understanding of insurance financial statements
- Help investors make decisions

Overview of Exposure Draft

- Principles-based approach with additional guidance
- Reflects the economics of insurance contracts
- Based on insurance contracts, not insurance companies

Goals of Exposure Draft

- A measurement model that focuses on the drivers of profitability and uses current estimates of cash flows
- Presentation of information about insurance contracts that reflects the changes in those drivers
- Consistent accounting for embedded options and guarantees in insurance contracts
- Consistency with market inputs, such as interest rates
- A coherent framework for dealing with complex and future insurance contracts

Premium Allocation Approach

- Gross Unearned Premium for short-term (one year) contracts
- Keep P&C pre-claims accounting similar to current P&C accounting

Four Building Blocks

- Current estimate of future cash flows
- Time value of money
- Risk adjustment
- Residual margin

Current Estimate of Future Cash Flows

- Current, use all relevant information
- Unbiased
- Explicit
- Probability weighted
 - Expected value (mean), not “best estimate”
 - Number of scenarios depend on product
- Exclude non-performance risk for insurer but may include non-performance risk for ceded reinsurance

Acquisition Costs

- The ED limits acquisition costs to incremental at a policy level and only for successful sales
- This is more restrictive than other cash flows which are to be based on a portfolio of similar contracts
- The IASB has changed its mind to be less restrictive than the ED, but the FASB has not changed its view

Time Value of Money

- Consistent with current observable market prices
- Exclude factors not present in the insurance liability
 - Independent of assets held unless obligation is a direct function of a set of assets
 - Do not consider non-performance risk of insurer
- Guidance in ED is risk free plus adjustment for illiquidity (bottom up)
- IASB and FASB will now allow top down
- Any discounting would be a change for P&C

Risk Adjustment

- Compensation the insurer requires for bearing the uncertainty inherent in cash flows that arise as the insurer fulfills the insurance contract
- Designed to take into account that insurers/investors have a preference for an expected cash flow of 10 with a standard deviation of 1 versus an expected cash flow of 10 with an standard deviation of 12
- Remeasured at each period
- Not a PAD

Residual Margin

- Residual Margin is the plug so that there is no profit at issue
- Residual Margin is re-measured for changes in future assumptions. Current year experience flows through income statement

Unsettled Items

- Level of aggregation (unit of account)
- Unbundling
 - Non-insurance
 - Account value
 - Embedded derivatives
 - Presentation
- Disclosures
- Transition rules

Unsettled Items - Presentation

- Tentative decision to provide information on premiums, claims, and expenses
- Yet to be settled:
 - What level of disaggregation on face versus notes
 - How to separate deposits from premiums
 - Should some changes in the insurance liability be presented in Other Comprehensive Income
 - How to present acquisition costs

***Discussion Topics –see
handout***