

# Proposals for an IFRS Phase II Insurance Accounting Model



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CFO Forum, GNAIE, & four leading  
Japanese Life Insurance Companies

Presentation to the Board of the IASB



# Agenda

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- Who are we?
- Our role in the economy
- Our objectives for a high quality global standard
- Proposals for IFRS Phase II
- Areas for further discussion
- Conclusion
- Next steps

# Who are we?





## Who are we? (cont'd)

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- The US, EU, and Japan make up 85% of the world's life insurance market and the US and EU make up 80% of the world's non-life insurance market.
- The represented companies have subsidiaries in most parts of the world's insurance market.



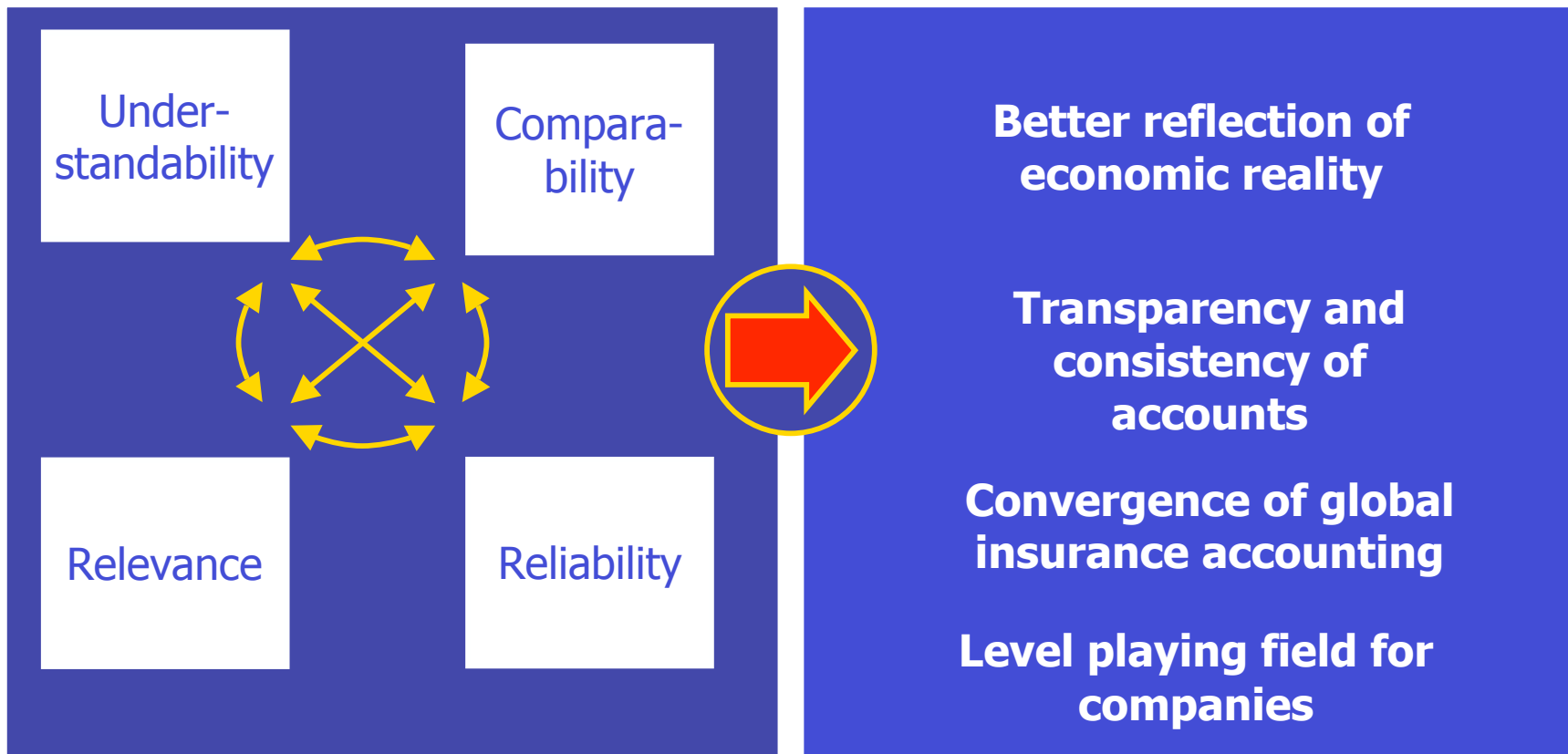
# Our role in the economy

Role of insurance		Impact on larger economy
Risk absorber	Pools risk within a large group, limiting risk for the individual	Enables growth
Risk mitigator	Prevents economic loss	Protects resources
Savings manager	Provides long-term savings and old age provisions	Enables sustainable income into old age
Institutional investor	Significant long-term investor in public and private sectors	Drives and stabilises financial markets
Major employer	Many million people directly and indirectly	Contributes to households income and consumption

# Our objectives for a high quality global accounting standard

The change we are seeking in our financial statements...

...and how it will benefit users and other stakeholders





# Our objectives for a high quality global accounting standard

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- Reflection of business model
- Economic valuation of insurance products
- Profit recognition as the underlying risk is released
- Resolve the asset / liability accounting mismatch
- Global comparability among insurers
- Level playing-field with other industries



# Proposals for IFRS Insurance Contracts Phase II

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# Release From Risk

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- The main service provided by an insurer is the acceptance and management of risk associated with insurance contracts.
- The risk profile of a policy determines the pattern of profit recognition.
- For many short-duration insurance policies, the 'release from risk' approach may be closely approximated by the unearned premium reserve approach.



# Initial measurement

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- As a consequence:
  - On initial measurement, there should be no gains or accounting losses.
  - Economic losses should be reflected both on initial and subsequent measurement.



# Liability Measurement

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- The liability should be based on the present value of all future cash flows with allowance for inherent risk and uncertainty\*
- The cash flows should reflect management's best estimate of the future
- The best estimate should be equal to the mean estimate (probability weighted average)\*
- Portfolio approach

\*This is not the position of GNAIE in respect of non-life insurance liabilities. Please see slide 23 for further discussion.



# Separate Customer Intangible Asset

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- An insurance customer intangible asset should be recognised to reflect the initial investment made to acquire the customer relationship.
- The best proxy for the value of the customer intangible asset at inception should be the initial acquisition cost arising from the contract.
- Initial acquisition costs represent all costs associated with procuring the insurance contract, including direct and indirect marketing and sales costs, and related overheads.



# Assumptions

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- Assumptions underlying the measurement of insurance liabilities and intangible assets should be periodically reviewed and updated as appropriate.
- This review should consider relevant market information and management's best estimate of the future.
- Non-financial assumptions should be entity-specific.
- Financial assumptions should be based upon market information where available and reliable



# Unit of Account

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- Measurement should be based on a portfolio basis.
- A portfolio is a group of contracts that are managed together when assessing risk and could constitute one or many contracts.
- Portfolios should be defined and measured on a consistent basis in successive reporting periods.



# Policyholder Behaviour

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- It is important that policyholder behaviour, including all expected recurring premiums and lapses, should be reflected in the measurement of liabilities, in order to reflect economic reality.
- Because policyholder behaviour is taken into account, no deposit floor is appropriate.
- The cash flows included in the estimate of the insurance liability should only include cash flows associated with current insurance contracts and any existing ongoing obligation to service policyholders.
- This should not include expected renewals that are not included within current insurance contracts.
- Where contracts include renewal options or guarantees that provide rights under which the policyholder can obtain a further contract on favourable terms, then the value of these guarantees and options should be included in the evaluation of the insurance liability arising under the existing contracts.



# Options and Guarantees

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- Liabilities should include the value of options and guarantees.
- Options and guarantees should be included in the measurement of the liability reflecting both their time value and intrinsic value.



# Unbundling

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- The insurance business is not designed or run on an unbundled basis.
- Customers see our products as one product.
- There is no market to independently calibrate interdependent contract components.
- Unbundling of the underlying financial and non-financial components of insurance contracts is not necessary since we value all components of the contract in aggregate, including options and guarantees.
- Unbundling of component features of contracts:
  - Requires subjective judgments
  - Increases complexity and operational risks
  - Fails to recognise interdependent relationships of components



# Own Credit Risk

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- The credit standing of an insurance contract should not be considered in the valuation of insurance liabilities.
- The assumptions and methodology used in the valuation of insurance liabilities should take no account of the credit standing of the insurance contract.



# Asset and Liability Consistency

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- Entities should measure assets and liabilities on a consistent basis to reflect the way companies manage risk.\*
- Where the value of the insurance liability is linked, contractually or through other legal or regulatory terms, to the value of associated assets, the value of the insurance liabilities is calculated with reference to the market value of the assets at the valuation date.

\*This is not the position of GNAIE in respect of non-life insurance liabilities. Please see slide 23 for further discussion.



# Participating contracts

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- These principles apply equally to participating contracts.
- Liabilities should include the best estimate of future policyholder benefits (dividends, bonuses, etc.)
  - The best estimate of future policyholder benefits should be based on the other assumptions used to estimate liabilities.
  - Amounts that are expected to be paid to policyholders should therefore not be included in equity.



# Value based reporting

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- Value-based measures may be disclosed as supplementary information. The basis of the value-based measure should be disclosed.



Areas for further discussion

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# Areas for further discussion within the industry

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- Life / Non-life approaches
  - Single set of principles or two models (life and non-life)
  - Measurement of non-life insurance liabilities
    - Discounting – other than for fixed, known and determinable claims reserves
    - Modeling cash flows
    - Asset / liability measurement
- Discount rate
- Impact and frequency of changes in assumptions and risk margins
- Reconciliation to Solvency II



# Conclusion

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# Conclusion

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## We have consensus that:

- Profit should be recognised on a release from risk basis.
- There should be no gain or accounting loss at issue, but economic losses at issue should be recognised.
- Liabilities for life insurance should be measured on the present value of future cash flows with allowance for risk and uncertainty.
- There should be a separate customer intangible asset to reflect the initial investment made to acquire the customer relationships.
- Assumptions should be periodically reviewed and updated as appropriate.
- Measurement should be based on a portfolio basis.
- Policyholder behaviour should be reflected in the measurement of liabilities.



# Conclusion (cont'd)

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We have consensus that:

- Liabilities should include the value of all options and guarantees.
- Insurance policies should not be unbundled.
- The credit standing of an insurance contract should not be considered in the valuation of insurance liabilities.
- Entities should measure assets and liabilities on a consistent basis.
- Liabilities for participating contracts should include the best estimate of all future policyholder benefits, including dividends, bonuses, etc.
- Value based reporting should be permitted as a disclosure item.



## Conclusion (cont'd)

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- We have all invested a significant amount of resources to develop our principles.
- We all believe in developing a comprehensive standard for insurance accounting.
- Although some areas of debate remain, the industry is largely on the same page.
- We appreciate the complexity of these issues and look forward to continuing to collaborate with the IASB in the future.