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INSURERS CITE SHORTCOMINGS OF PAPER ON RISK MARGINS

NEW YORK, Dec. 4 – Insurance and reinsurance companies are challenging some of the findings of a new paper on the measurement of life and non-life insurance liabilities.

The Group of North American Insurance Companies (GNAIE) expressed concerns because the paper, *The Role of Risk Margins in a Fulfillment Accounting Objective*, may influence joint discussions on insurance contracts of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB).

Although not contesting the need for an uncertainty provision in life insurance contracts, GNAIE has serious reservations about the paper's conclusions for measurement of non-life insurance liabilities in the post-claim period.

The basic conclusions of the paper by Sam Gutterman are that an adjustment for uncertainty is appropriate, whether the applicable accounting objective for the liability for insurance contracts is expressed in terms of a contract fulfillment or transfer value.

The paper further asserts that to reflect all aspects of uncertainty in the measurement of the liability, it is necessary to provide an adjustment for uncertainty – a risk margin.

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To influence the development of international accounting and solvency standards to ensure that they result in robust, high quality standards for insurance enterprises.

Regarding the building block approach to measurement, the paper suggests the adjustment be incorporated in building block 3.

In letters to the IASB and FASB from Kevin Spataro, chair of GNAIE'S Accounting Convergence Committee, GNAIE said that for life insurance contracts the adjustment for uncertainty should be included within a composite margin, and that there should be no requirement to quantify a specific risk margin separately within a composite margin.

"While it is possible to define methods for assignment values to risk margins, we believe that these are theoretical calculations that have little practical meaning," the letter said.

Moreover, GNAIE believes "the theoretical calculations would not be independently verifiable (cannot be calibrated to an independently existing value) or comparable among life insurers other than through their inclusion in the premium charged for the risk; thus calling into question the decision-usefulness of the information"

In contrast, the composite margin information would be more concise, verifiable and transparent, and should focus on the total margin available in the reserve rather than on theoretical calculations, according to GNAIE.

GNAIE also took issue with the paper's statement that all insurance pricing methodologies include a provision for uncertainty.

In many countries, including the United States, GNAIE said, the methods life insurers use for pricing and other business processes often do not distinguish a provision for uncertainty from other margins included in premiums because they do not believe that there is a presently reliable and decision-useful way to isolate such a provision.

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While not disputing the need for including a provision for uncertainty in life insurance contracts, GNAIE said its objection is to “a requirement to attempt to quantify an additional provision for uncertainty and volatility separately within the third building block.”

GNAIE said it does have substantial objections to the paper’s conclusions for measurement of non-life insurance liabilities in the post-claim period.

In the letter, GNAIE reiterated its consistent opposition to the three building block approach in measuring non-life contracts in the post-claim period.

GNAIE believes that approach requires the application of subjective judgment in developing probability distributions at a sufficiently granular level to use as inputs in the proposed statistical model that would be used to separately quantify a measure of uncertainty.

“Because the information described is not currently used to manage the business or for any other reason, it cannot be tested or validated sufficiently to ensure it would produce measurements that are reliable, verifiable, comparable, understandable and decision-useful,” GNAIE said.

The letter further noted the absence of a consensus within the global actuarial profession about what methods could or should be used, or if a statistical methodology were to replace the time-tested existing methodology, how that method would be tested and the results validated.

In contrast to IASB’s theoretically-based building block proposal, GNAIE pointed out that existing non-life post-claim reserves are determined by reference to actuarially determined best estimates that implicitly incorporate a measure for uncertainty.

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“Given the lack of consensus on how the three building blocks should be implemented for no-life insurance post-claim liabilities, we believe it would be inappropriate for the proposed accounting standard to require changes in measurement and reporting of non-life insurance contracts in the post-claim phase that would be based on unproven theory,” said GNAIE.

While actuarial methodologies and techniques may be developed and enhanced in the future to enable them to be used for such purposes, as the Gutterman paper states, “We believe that at least at present, there is no basis to change a globally recognized, well understood, and effectively functioning claim reserve measurement methodology.

The goal of GNAIE is to influence international accounting standards to ensure that they result in high quality accounting and solvency standards for insurance companies and, to that end, to increase communications between insurers doing business in North America and international regulators and standard setters. GNAIE works to meet its goals through modeling of proposed accounting standards, analysis, comment and coordination with various end users of financial reports.

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