Update on International Accounting Standards

Presentation to
NCOIL International Insurance Issues Committee

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Introduction

- Today's goals
  - 1. What's happened since the last NCOIL meeting
  - 2. What GNAIE and others have been doing
  - 3. What's coming up before NCOIL meets again
  - 4. Questions

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Recent Developments

- March 1, 2008: NCOIL Panel on International Accounting Standards (Jerry de St. Paer, Wayne Upton, Commissioner Thomas Hampton)
- Since then, “convergence” has become “replacement” and “if” has become “when”

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Recent Developments

- FASB Financial Accounting Standards Advisory Committee (FASAC)
- Norwalk, CT, March 18, 2008
- Official advisory board to FASB
- Discussed future of U.S. GAAP
- Favored "Big Bang" **switch** to IFRS rather than current policy of "convergence"

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Recent Developments

- IASB Insurance Working Group
- London, April 1-2, 2008
- Insurance industry experts provided advice to IASB concerning the insurance accounting model described in its paper
- IASB response: recognized more work to do – many issues with “current exit value” valuation approach

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Recent Developments

- Joint IASB – FASB Meeting
- London, April 21-22, 2008
- Discussed revisions to their technical plan
- Focus: Facilitate remaining “major capital markets” (i.e., U.S.A.) adopting IFRS as of January 1, 2013
- Requires “quiet period” for new standards starting mid-year 2011

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Recent Developments

- FASB Insurance Forum
- Norwalk, CT, May 6, 2008
- Discussed insurance accounting, U.S. GAAP, and IFRS
- FASB member asked why FASB should join IASB Insurance Contracts project "since we may not be around by the end of the project"

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Recent Developments

- Revised IASB Technical Plan
- London, June 20, 2008
- New Insurance Contracts IFRS now targeted for 2011; allows more time for consideration than prior schedule
- Other major projects (e.g., Financial Statement Presentation and Revenue Recognition) also targeted for 2011

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Recent Developments

- U.S. Securities and Exchange Commission (SEC)
- Working with other national and international securities regulators to develop regulatory oversight body for IASB prior to committing to U.S. switch to IFRS
- SEC Fair Value Roundtable two days ago (Wednesday of this week)

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Recent Developments

- National Association of Insurance Commissioners (NAIC)
- San Francisco, June 2, 2008
- Adopts “Solvency Modernization Work Plan”
- Will analyze international solvency and accounting standards and propose enhancements to U.S. standards

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Recent Developments - Summary

- IFRS very likely (not yet certain) to replace U.S. GAAP in next five years
- IASB Insurance Contracts standard very likely to become global general purpose and insurance regulatory accounting standard
- More critical than ever to get IFRS for insurance contracts right

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GNAIE/Industry Developments

- April 28, 2008: GNAIE releases five Discussion Papers following up on key issues discussed at IASB IWG meeting
- June 25, 2008: GNAIE releases another Discussion Paper
- GNAIE continues to develop Discussion Papers to make substantial intellectual contributions to ongoing accounting standards development

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GNAIE/Industry Developments

- Two papers: “Settlement Value” for life insurance and for non-life insurance
- GNAIE developed and supports the “Contract Fulfillment Value” measurement attribute that represents paying policyholder benefits as they come due
- GNAIE opposes the “current exit value” method based on hypothetical “transfers” of obligations to policyholders

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GNAIE/Industry Developments

- Paper: “Field Testing”
- Preliminary IASB concepts, such as “current exit value”, unlike any measurement concept used anywhere
- Such fundamental changes must be tested before being implemented
- We suggest specific tests and efficient ways of accomplishing them

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GNAIE/Industry Developments

- Two Papers: “Day One Profit” and “Risk Margins”
- Profits should only be recognized as insurer is released from risk, not on “day one” as “current exit value” may allow
- Similarly, risk margins (where they are explicit) should be released as the insurer is released from risk

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GNAIE/Industry Developments

- Paper: “Earned / Asset Based Discount Rate for Life Insurance Contracts”
- Life insurance contract liabilities should be discounted at an “earned rate” rather than a “risk-free” rate, consistent with the way insurers price and manage such contracts
- “Risk-free” rates presume a need for liquidity inconsistent with reality and will cause volatile and inappropriate accounting of income

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GNAIE/Industry Developments

- June 20, 2008: Letter to FASB signed by eight industry associations
- Urges FASB to join with IASB “to develop a high quality, understandable, enforceable global insurance accounting standard”
- Provides theoretical and practical reasons why FASB joining the project will improve the final outcome

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GNAIE/Industry Developments - Summary

- GNAIE has provided six Discussion Papers on critical accounting issues to advance the thinking on a high quality IFRS for insurance contracts
- Critical concepts include “contract fulfillment value” and “no day one gains”
- Industry urges FASB to get involved to produce a better IFRS for insurance contracts

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Upcoming Developments - 1

- FASB decision on whether or not to participate in joint project with IASB on insurance contracts accounting
- Decision due in third quarter 2008
- “Yes” makes sense because insurance requires dealing with the important cross-cutting issues
- “No” means a lost opportunity for U.S. influence on the new insurance IFRS

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Upcoming Developments - 2

- SEC proposal due soon on when to allow which U.S. filers the option to use IFRS instead of U.S. GAAP
- By November, expect SEC “Blueprint” for the process of conversion to IFRS from U.S. GAAP
- Many issues remain for IFRS in the U.S., including tax treatment, accountant and auditor training, and IASB governance

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Upcoming Developments - 3

- IASB Insurance Contracts project – two key steps
- September 2008: IASB Staff provides IASB members educational session on choices for measurement attributes for insurance contract
- November 2008: IASB IWG provides additional insurance expert input into IASB deliberations on insurance contract accounting issues

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Upcoming Developments - Summary

- FASB – In or out of IASB insurance contracts project?
- SEC – What is the “blueprint” for U.S. adoption of IFRS?
- IASB – How will IASB Staff establish the framework of the next critical discussions of insurance contracts accounting?

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Conclusions

- IFRS is coming to replace U.S. GAAP
- We're making a difference on insurance accounting, but there's a lot of work ahead and help from FASB would be great!
- Key ideas: "Contract Fulfillment Value" and "No Day One Gains"
- What happens for general purpose accounting will drive insurance regulatory accounting

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NCOIL Implications

- When IFRS replaces U.S. GAAP, changes underlying structure and basis for state insurance regulatory accounting standards
- Possible need for legislation regarding insurance regulatory accounting and solvency requirements

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Any Questions?

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GNAIE Member Companies

Travelers

Genworth Financial

PartnerRe

What is GNAIE?

- **GNAIE is an industry organization of US, Bermudian and Canadian based insurers and reinsurers.**
- Our Mission: to assist North American and global standard setters and regulators in cooperation with the global insurance industry and with insurance and other financial services industry trade associations:
  - To support high quality insurance accounting standards that are useful, understandable, comparable and reliable; that preserve the insurance industry's level-playing field access to global capital markets; and that provide good disclosure to the insurance industry's diverse constituencies;
  - To support high quality insurance solvency standards that provide useful and effective statutory solvency measures to protect the interests of policyholders and other stakeholders while encouraging competitive insurance markets; and
  - To enhance cooperation, education and communication regarding insurance accounting and solvency among the insurance industry's standards setters, regulators, and diverse constituencies.

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