



Group of North American
Insurance Enterprises

**IAIS Insurance Contracts Subcommittee
meeting at the
Financial Services Agency
Tokyo, Japan**

August 25, 2010

Jerry M. de St. Paer

Executive Chairman

www.gnaie.net

jerry.destpaer@yahoo.com

Objectives for a High Quality Standard

The characteristics GNAIE seeks in financial statements...



...and how they benefit users and other stakeholders



IASB Insurance Contracts Discussion Paper

- **GNAIE supports:**
 - Convergence of International Financial Reporting Standards with US GAAP and other country GAAPs
 - A high quality robust international standard for Insurance Contracts accounting
- **Actively engaged IASB on Insurance Contracts project**
 - Several participants on the Insurance Working Group (IWG)
 - Numerous formal & informal comments
- **Commissioned & published research**
 - Modeling portions of proposed accounting standards

IASB Insurance Contracts Discussion Paper

- Insurance requires unique accounting
- GNAIE developed & proposed accounting principles for an IFRS on insurance contracts
- There is substantial worldwide insurance industry agreement on insurance accounting

Objectives for a high quality global accounting standard

- Reflection of business model
- Economic default adjusted valuation of insurance products
- Profit recognition over the coverage period
- Resolve the asset / liability accounting mismatch
- Global comparability among insurers
- Level playing-field with other industries

Not all the answers.....

- Still a long way to go in analyzing the Exposure Draft.
- Will continue our communication and cooperation with stakeholders including regulators and standards setters

Timing of Issuance

- Insurance standard not ready to expose
 - Priority: High quality standards, not speedy adoption
 - Should have been a Discussion Paper
 - IASB continues to be split on major issues.
 - Many untested elements, never used together
 - IASB due process for Exposure Draft requires
 - Near final standard
 - Almost all issues resolved
 - Ready for clear field testing
 - Insufficient time to evaluate and comment

Measurement Basis

- **GNAIE Supports Contract Fulfillment Approach**
 - Like Revenue Recognition Standard
 - Simple, Consistent Measurement
- **Transfer Basis Approach Not Founded in Reality (Fair Value, Exit Value, Current Value, Other Pseudonyms)**
 - IAS 37, Liabilities Standard
 - ED argues that Insurance should be like all other liabilities

Discounting Problems

● Life Insurance

- What should be the basis for determining discount rates for insurance liabilities?
- Discount rate should be based on principle of Economic Default Adjusted Rate (EDAR)
- ED says should be Independent of discount rates used to value assets that back those liabilities.
- This results in severe, model-driven accounting mismatches between reported asset and liability values.
- Ignores the basic business model for life insurance which is based on matching assets and liabilities.
- Open question on the determination of an illiquidity adjustment

Discounting Problems (2)

- **Non-Life Insurance**
 - Should not require discounting and explicit margins for short-term contracts.
 - ED replaces the current basis that's well understood and transparent.
 - ED proposes a basis that would require arbitrary calculations and adjustments, without calibration to market.
 - More difficult to track from period to period.
 - Submission of Comment Letter to IASB

Margins

- Exposure Draft approach
 - Risk and residual margins
 - Requiring calculation of a risk adjustment would have little or no meaning to insurance entities.
 - Users of financial statements will have difficulty comparing between entities.
 - Speculative assumptions on which the calculations would be based.
 - Increased opportunities for profit management
 - Brings in transfer mechanism and maximum amount a third party would be willing to pay

Margins (2)

- ED lists three methods that are permitted for determining risk adjustment.
 - No other methods are acceptable.
 - Questionable whether this limitation will lead to comparability among entities.
 - Speculative judgments that will still be required.
- More questionable that the accounting standard setters have any business or expertise to impose such limitations.
 - If new/better methods are developed in the future, they can't be used until/ unless the standard is changed.
 - The new/better methods will probably have to be in place for several years before they are included.
 - Due process
 - Sufficient credibility.

Margins (3)

- **Composite Margin**
 - Difference between best estimate of cash flows and the premium
 - Easily calculable
 - Consistency and Comparability
 - Well understood internationally

Probability Weighted Cash Flows

- Requirements and guidance that, at a minimum, create a bias toward use of probability-weights and complex statistical over-modeling in estimating cash flows.
- This requirement is untested and would change the basic model toward determination of a liability.

Premium Allocation Method

- **Modified (?) Approach**
 - The premium allocation method (unearned premium approach) for pre-claim liabilities of short duration insurance contracts.
 - It's not clear how this method would relate to measurement of post-claim liabilities.
 - Need to look to the FASB Discussion Paper when it comes out for a more expository approach.

Unbundling

- ED generally doesn't require unbundling.
- But, in some cases it does.
- Life insurance experts are reviewing closely.
- What about policy loans?

Other Standards

- Revenue Recognition
- Financial Instruments
 - Classification and Measurement
 - Amortization and Impairment
 - Hedging
 - Asset and Liability Offsetting
- Fair Value Measurement
- Financial Statement Presentation
- IAS 37, Liabilities
- Conceptual Framework

Other issues

- Field Testing
- Roundtables
- Interaction with prudential supervisors
- Linkage with other standards
- Full due process
- Transition

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