



Group of North American
Insurance Enterprises

Valuation of Insurance Contracts

Presentation to IAIS Contracts Committee

26 June 2008

(Prepared as of June 11, 2008)

What is GNAIE?

- GNAIE is an industry organization of US, Bermudian and Canadian based insurers and reinsurers.
- The mission of the GNAIE is 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.



GNAIE Member Companies



Travelers



Genworth Financial 



PartnerRe



Insurance Contracts – Measurement Issue

- The following groups attempting to identify a new, universally acceptable, measurement basis for insurance contracts
 - International Association of Insurance Supervisors (“IAIS”)
 - International Accounting Standards Board (“IASB”)
 - Industry Groups – GNAIE and CFO Forum have both developed measurement principles for Life and Non-life insurance
- Goal is a measurement model that is consistent with the economics of the business and understandable to users
 - Consistent for both solvency and general purpose financials
- IASB and IAIS have both attempted to develop principles to support a market/transfer-based measurement
 - Challenge is absence of market observable support for key inputs (e.g., cash flows, risk margins, etc.) as no markets exist for insurance contracts

Measurement Candidates

- IAIS – Market Consistent Value (“MCV”)
 - MCV of insurance liabilities calibrated to value a third party insurer would require to take them over and settle with claimants. In absence of market inputs; use mark-to-model
- IASB – Current Exit Value (“CEV”)
 - CEV is amount the insurer would expect to pay at the reporting date to transfer it’s remaining contractual rights and obligations immediately to another entity
- GNAIE – Contract Fulfillment Value (“CFV”)
 - CFV is amount the insurer expects to pay to settle the obligation with the insured pursuant to the terms of the contract in the normal course. Separate models for life and non-life contracts
- CFO Forum – CFO Forum Principles (“CFOFP”)
 - CFOFP is present value of all future cash flows (reflecting management’s best estimate) with an allowance for inherent risk and uncertainty
- CFO Forum – Market Consistent Embedded Value (“MCEV”)
 - MCEV, which is disclosure based information, represents the present value of shareholders’ interests in the distributable earnings from assets allocated to covered business after allowance for risk. MCEV includes both a capital and risk charge

Measurement Candidates – Key Attribute Comparison

Measurement Attributes	Measurement Candidates				
	MCV	CEV	CFV Life	CFV Non-Life	CFOFP²
One model for life and non-life	Yes	Yes	No	No	Yes
Settlement or transfer based	Transfer	Transfer	Settlement	Settlement	Settlement
Gain at issue allowed	Yes	Yes	No	No	Deferred
Own credit risk reflected	No	Yes	No	No	No
Explicit risk margins	Yes	Yes	Yes	No	Yes
Allows for entity-specific cash flows	Yes	No	Yes	Yes	Yes
Allows for entity specific expenses	Yes	No	Yes	Yes	Yes
Discount rates	Risk free	Risk free	Asset based	N/A	Risk free

¹: Life total margin (risk and profit) calibrated to initial premium to produce no gain at issue

²: CFO Forum also uses Market Consistent Embedded Value for disclosure purposes (mainly for life insurance contracts)

³: GNAIE non-life model does not allow discounting unless cash-flows are fixed and determinable on an individual claim basis

Key Attribute Comparison - Discussion

- One model versus separate models for life and non-life
 - Key distinction between life and non-life?
 - Is management of life and non-life business similar enough to warrant one measurement model?
- Should model be settlement or transfer based?
 - Consistency with how business is managed
 - Absence of a market for insurance contracts
- Gain at issue (i.e., day one gains)
 - Should day one gains be permitted?
 - Have any services been provided or performance obligations fulfilled?
 - Enough information to reliably distinguish between risk and profit?
 - Is “we think we know the future” a sufficient profit recognition threshold?
 - Cross-cutting issue (revenue recognition)
 - Customer consideration or exit value
 - Re-measurement
- Own credit risk reflected in measurement
 - Why are we still debating this?

Key Attribute Comparison - Discussion

- Should there be explicit risk margins?
 - Life insurance
 - Can risk margins be estimated separate from profit?
 - Questions regarding cost-of-capital measures
 - Uniform rate; are all companies capitalized similarly?
 - What are we attempting to isolate in terms of risk?
 - Impact of income taxes
 - Non-life insurance
 - Can risk margins be estimated in a consistent, reliable manner?
 - Are risk margins comparable and verifiable?
 - Are risk margins used to manage the business and hold management accountable for results?
- Should non-life insurance contracts be discounted?
 - Reliability and cost/benefit for short-duration contracts (one year or less)?
 - Timing of cash flows reliably determinable for long-duration contracts?
 - Hold claim reserves at anticipated contract fulfillment amount
 - Discounting cannot be implemented independent of risk margins
- Inability to reliably determine both timing of cash flows and risk margins basis for GNAIE's non-life position

Key Attribute Comparison - Discussion

- **Market-consistent versus entity-specific cash flows**
 - Availability of market-consistent cash flows? Reliability? Verifiability?
 - Differences between life and non-life insurance contracts
- **Market-consistent versus entity-specific expenses**
 - Availability of market-consistent cash flows? Reliability? Verifiability?
 - Differences between life and non-life insurance contracts
- **Discount rate**
 - Risk-free
 - Asset-earned
 - Asset-liability matching

Cross-Cutting Issues

- Revenue Recognition
 - Customer consideration or exit value (Day 1)
 - Re-measurement (Day 2)
 - Period of revenue recognition
- Liabilities Research Project
- Financial Statement Presentation
 - Margin presentation for both life and non-life?
 - Underwriting presentation?
 - Consistency with management view
- Financial Instruments
 - One measurement model
- Conceptual Framework
 - Timing

Focus on Contract Fulfillment Value

- Analysis of CFV versus key measurement objectives:
 - Settlement based measurement; consistent with the cash flows that are expected to occur in the normal course
 - CFV most consistent with how insurance contracts are managed
 - No gain at issue; consistent with fact that no services have been provided and with customer consideration model
 - Margins (risk and profit) calibrated to premium; no gain at issue for life
 - No explicit risk or profit margins (or discounting) for non-life
 - Short-duration – not reliable or cost beneficial to discount and gross up for risk
 - Long-duration – cash flow timing and risk margins not reliably determinable
 - Entity specific cash flows used for both losses and expenses
 - Discount rates
 - Life – asset earned rate (consistent with asset-liability matching)
 - Non-life/Short-duration – not reliable or cost beneficial to discount
 - Non-life/Long-duration – timing of cash flows not reliably determinable
 - Does not reflect own-credit standing

Issues with Alternative Measurements

- MCV (IAIS – Second Liabilities)
 - One model for life and non-life
 - Transfer-based
 - Allows gains at issue
 - Explicit risk margins
 - Unclear that risk can be separately identified from profit
 - Use of risk-free rate for discounting
 - Does not reflect asset-liability matching
- CEV (IASB Phase II Discussion Paper)
 - Same as MCV, **plus**
 - Market average cash flows for expenses
 - Requirement to reflect own-credit standing
- CFOFP
 - Same issues as MCV, **except**
 - No gain at issue
 - Settlement based
 - Greater use of entity specific cash-flows

Conclusions

- CFV is the best measurement alternative
 - Meets most constituent objectives
 - Settlement-based; consistent with how business is managed
 - Understandable to financial statement users
- Separate measurement and reporting models for life and non-life are necessary
 - Measurement; discounting and risk margins for life
 - Presentation; margin presentation for life, underwriting for non-life
- Gains at issue should not be allowed
 - No services provided or performance obligations fulfilled
 - Cannot adequately distinguish profit from risk margin