

## IASB Insurance Contracts Exposure Draft

### GNAIE Comments to IASWG on August 15, 2010

1. GNAIE supports a robust high-quality global standard for insurance accounting
  - a. We've been working with the IASB from the beginning and believe:
    - i. The accounting model should reflect the business model and be used and useful to the company
    - ii. Profit should be recognized as insurer is released from risk
    - iii. Comparability and consistency are key attributes
    - iv. The model should reflect the drivers of profitability
  - b. The proposed model seems more Life product focused and, therefore, we believe there is a need for a two model approach to measure life vs. non-life liabilities.
  - c. We're not sure the current ED rises to the level of a high quality standard – neither product nor process reflects high quality standard setting
    - i. Completely new and untested model never used before anywhere
    - ii. Several major unanswered questions - margins, discount rate, probability weighted cash flows; Board conclusions largely split – no clear majority views
    - iii. Field testing not completed
    - iv. Work seems to have been driven by an artificial deadline – 6/30/2011.
  - d. Concerns with “Big Black Box” of current models, which is driving the need for a replacement standard, don't apply to non-life business which is more transparent.
    - i. Unfortunately, the ED seems to make “the Big Black Box” bigger and blacker
2. Measurement Model
  - a. GNAIE supports the decision to use contract fulfillment value vs. Exit value/transfer value
  - b. Building Block approach is more appropriate for life but is not appropriate for non-life
  - c. Risk margin definition attempts to bring back in a transfer value notion to that part of the measurement
3. Unbiased Probability Weighted Cash Flows
  - a. Concerns with the expectations for using probability weighting and complex statistical modeling using all available scenarios. Potential significant departure for non-life
  - b. Concerns with the ability and effectiveness of modeling of non-life claim
  - c. Not cost justified
4. Discounting – Life Insurance
  - a. GNAIE favors an asset earned rate or something like the Canadian ALM method to better match assets to liabilities.
  - b. If discount rate is not related to the supporting assets it won't reflect the business model and could lead to significant volatility of earnings

- c. Risk-free rate will produce higher reserve levels, lower profitability in the early years and produce a loss at inception for some important products that will ultimately be profitable, thus producing misleading information to financial statement users. This is particularly true for products like immediate retirement annuities and long-term care that are important for meeting the needs of our aging population
  - d. May create the need for higher capital levels or products being withdrawn from the market.
  - e. Open question on how to determine “illiquidity adjustment”.
5. Discounting – Non-life Insurance
- a. Discounting is not cost justified for short duration, short tail non-life claims
  - b. Use of discounting and risk margins for claim reserves will not produce decision useful information. Obfuscation of results will occur.
  - c. Current non-life model has proven to be effective and should be retained
6. Margins
- a. Close IASB vote between Risk/Residual vs. Composite Margins
  - b. Risk Margin as defined brings in a transfer pricing model
  - c. GNAIE supports the composite margin approach for life as it is difficult to calculate the risk margin piece and it would imply a level of precision that is not real
  - d. Not sure how the 3 acceptable methods (cost of capital, VaR, CTE) would work for P&C claim reserves that may lack credible probability distributions
  - e. Use of discounting and risk margins for P&C claim reserves will not produce decision useful information
  - f. Residual Margin represents deferred profit which may or may not develop. May lead to the improper use of that information or improper profit management
  - g. May hinder comparability between companies
  - h. Composite margin for life products would be easy to calculate, consistent and comparable, and well understood.
7. Modified approach for non-life UPR
- a. Use of a UPR approach for pre-claim reserve
  - b. Claims would be recognized as incurred but measured based on the building blocks
  - c. Requires PV of future premium cash flows
  - d. Interest is to be accreted each period on collected UPR
  - e. Incremental acquisition costs netted against UPR
  - f. Requires a Liability Adequacy Test which needs PV of future claim cash flows
  - g. So, in essence, this approach incorporates significant aspects of the Building Block approach
  - h. The details (which were not discussed in open sessions) do not support this as a simplified approach that is similar to current UPR.

## 8. Two Model Approach needed

- a. Modified approach complicates UPR in pre-claims period and requires building block approach for post-claims period - doesn't go far enough to simplify methodology
- b. P&C business is different than Life insurance – products are different
- c. The profit drivers are different between Life and Non-life
- d. P&C underwriting component metrics are very important
- e. Loss development triangles are very valuable and need gross reserves to be meaningful
- f. Overall, the building block approach will not be better understood than the existing non-life model used today.

## 9. Presentation

- a. Life - Net Margin model does not provide useful information on the face of the statement
  - i. It requires information that can only be determined using analysis rather than transaction accounting
  - ii. Users must refer to the notes and disclosures to find important information as to the drivers of profitability
- b. Several questions still open on use of OCI vs. P&L for changes in components of liability
  - i. Inconsistencies with Financial Instruments standards possible
- c. Separate non-life presentation is a little more in line with current model

## 10. FASB Activities

- a. GNAIE is pleased to see they will issue a Discussion Paper that recognizes work is not yet done.
- b. Additional work being done on the potential for a non-life model
- c. FASB will compare the IASB ED to current GAAP

## 11. Other Issues

- a. Unbundling –
  - i. Seems to be a lot of work for very little value
  - ii. Definitions are unclear
- b. Reinsurance –
  - i. Reinsurance was not adequately deliberated by the IASB
  - ii. Margin for credit worthiness of reinsurer destroys mirror image Acctg.
  - iii. Mismatch for P&C reinsurance as direct business (based on modified approach ) with claims recorded when incurred but reinsurance is based on Building Block approach and all estimated cash flows recorded at inception of reinsurance contracts causing both timing and measurement to be different
  - iv. Results in recording ceded premium and losses for policies not yet written nor recorded on the books
- c. Contract boundaries – recognizing liability at contract inception vs. coverage inception could be problematic