

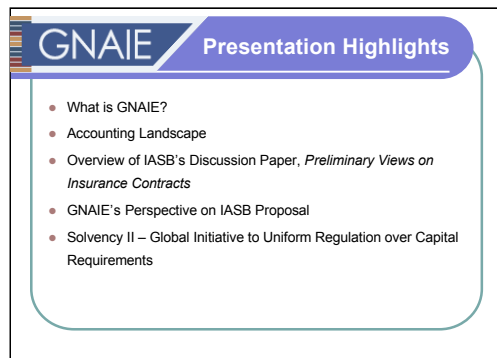
Insurance Day Summit

Paul Medini
EVP and Chief Accounting Officer



Good afternoon. I'm Paul Medini, Chief Accounting Officer of ACE Limited. It is a pleasure to be with you today to discuss the proposed accounting model for insurance contracts recently distributed by the International Accounting Standards Board as well as potential implications to the insurance industry. In addition to discussing my own and ACE's preliminary views, I will address the views of The Group of North American Insurance Enterprises, also referred to as GNAIE, a trade organization that follows new accounting standards affecting the insurance industry which ACE is an active member.

ACE & GNAIE are aligned with the IASB's interest in achieving the highest quality financial reporting standards. It is for that reason that as a company and an industry we have dedicated substantial resources to assist standard setters and others in understanding the views of practitioners. The culmination of the significant efforts during the past few years have resulted in the development of a preliminary proposal from the IASB. We now stand at a critical crossroad which I believe will have significant implications.



Firstly, today's highlights

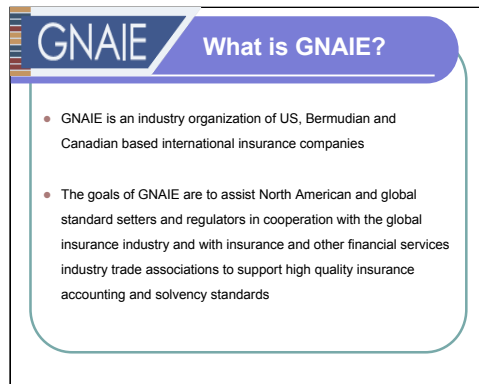
I will begin by providing a brief description of GNAIE and the accounting landscape.

Which brings us on to an an overview of the accounting model proposed in the IASB's Discussion Paper entitled "Preliminary Views on Insurance Contracts."

We will then take a look at the IASB's proposed accounting model and provide GNAIE's perspective on the proposal.

Finally I will address Solvency II initiatives in Europe and their influence on the IASB's insurance project.

I am delighted to have the opportunity to present the views of the North American insurance industry on these important subjects. My presentation will last no longer than 30 minutes allowing time for a healthy debate. Therefore, I would appreciate you hold all questions until the end



GNAIE is an industry organization established in 2003 to work with standard setters and regulators on insurance accounting and solvency. Its Board is comprised of CFOs from 11 of the largest insurers in North America.

Similar trade organizations in other parts of the world include The CFO Forum and a group of Japanese life insurers:

- **The CFO Forum is a European trade organization, the Board consists of 19 of Europe's largest insurance companies. Similar to GNAIE, its Board is comprised of CFOs of its member companies.**

- **The Japanese has formed a group, which includes four of its largest life insurers, to monitor and comment on emerging accounting standards.**


GNAIE meets with these two groups periodically to find areas of common ground and when feasible, develop communications as a tripartite group to assist the IASB and other standard setters in better understanding those issues in which the worldwide insurance industry is united.

In addition to monitoring accounting standards through its Accounting Convergence Committee, GNAIE has a Solvency Committee which examines the proposals for insurance solvency requirements.



As you can see from our list of members, GNAIE has a significant international presence.

The GNAIE non- life members, including AIG, The Hartford, XL and Allstate, endorse the views I am expressing today.

A slide titled "GNAIE Research..." with the GNAIE logo on the left. It contains a bulleted list of three research reports and a footer note.

GNAIE / **GNAIE Research...**

- "Development of Alternative Accounting Methodology for Life Insurance and Similar Products," a research report by Watson Wyatt Worldwide
- Second Watson Wyatt report, "Alternative GAAP Issues," that identifies and analyzes seven key issues surrounding an alternative accounting method
- "The Impact of Fair Value Accounting on Property/Casualty Insurers", a research report by Ernst & Young

Reports are available at www.gnaie.net

Some examples of GNAIE sponsored research are identified here and can be found on GNAIE’s website. In the near future, we expect to issue research on the cost of capital approach for measuring risk margins, which will also be available to the website.



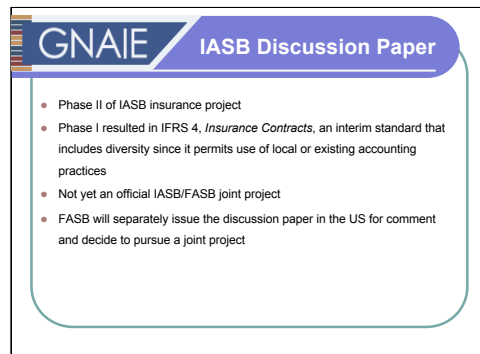
To set the accounting landscape, you need to know the following basics:

•The IASB is responsible for developing international accounting standards through the issuance of International Financial Reporting Standards or IFRS’.

•The FASB or Financial Accounting Standards Board is responsible for developing U.S. accounting standards through the issuance of Statements on Financial Accounting Standards.

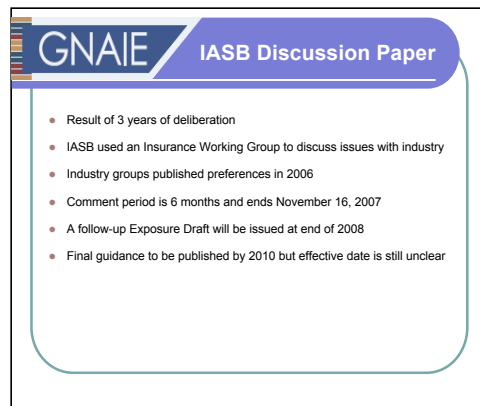
•Several years ago the IASB and FASB announced a goal to work toward the convergence of global accounting standards. As a result, many, but not all, accounting projects are joint ventures between the IASB and FASB.

Given the IASB’s initiatives to improve standards and converge with US GAAP, the SEC announced last month that separate US GAAP reconciliations will no longer be required by companies reporting on International Accounting Standards by 2009.



Over the past several years, the IASB has taken the lead in developing a new accounting model for insurance contracts. The status of the IASB insurance contracts project can be summarized as follows:

- The discussion paper represents a preliminary view for Phase II of IASB insurance project**
- Phase I resulted in an interim standard that includes diversity since it permits use of local or existing accounting practices**
- The insurance contracts project is not yet an official IASB/FASB joint projects**
- It is anticipated that the FASB will separately issue the discussion paper in the US for comment and based on those comments will decide whether or not to pursue a joint project.**



Here we have brief description on the timeline for the development of a final insurance standard:


The comment period for the discussion paper is 6 months and ends November 16, 2007.

A follow-up Exposure Draft will be issued possibly by the end of 2008 but more likely during 2009.

Lastly, final guidance is expected to be published by 2010 but the effective date is still unclear.

The paper is the result of many years of deliberation including intensive discussions since 2004. As part of this process, the IASB used an Insurance Working Group to discuss issues with industry. CFOs from three GNAIE members participated in the working group (AIG, Prudential, and XL) as well as other industry executives and analysts throughout the world.

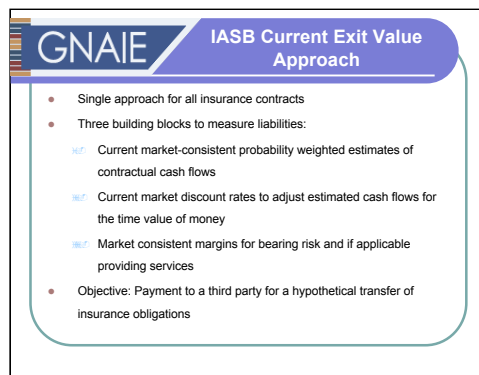
In 2006, GNAIE and the four Japanese life insurers and the CFO Forum published their proposed principles for insurance accounting. GNAIE issued separate Life and Non-Life Principles since it supports separate models for each.



Scope of Discussion Paper ("DP")

- Insurance and reinsurance contracts issued by insurers
- Reinsurance ceded
- Includes participating contracts
- Excludes investment contracts; there are inconsistencies between DP and IAS 39
- Does not address accounting by policyholders (final standard may include)

This slide addresses the scope of the discussion paper. It includes accounting for insurance and reinsurance contracts entered into by insurance enterprises but excludes policyholders' accounting for insurance contracts.



GNAIE IASB Current Exit Value Approach

- Single approach for all insurance contracts
- Three building blocks to measure liabilities:
 - Current market-consistent probability weighted estimates of contractual cash flows
 - Current market discount rates to adjust estimated cash flows for the time value of money
 - Market consistent margins for bearing risk and if applicable providing services
- Objective: Payment to a third party for a hypothetical transfer of insurance obligations

The IASB’s proposed insurance model for Insurance Reserves is referred to as “current exit value.” Key aspects include:

A single approach for all insurance contracts. There was some deliberation for separate models for life and non-life contracts but the Board is strongly supportive of a single model.

There are three building blocks to measure insurance liabilities:

- **First, a current market-consistent probability weighted estimate of contractual cash flows must be developed. For non-life, this component is similar to current GAAP loss reserves which are stated at the expected nominal value of claim payments. However, in order to develop a single best estimate, the IASB’s proposal requires that this calculation be done using a probability weighted average of expected outcomes. This will require companies to incorporate multiple scenarios in its estimate of insurance liabilities.**
- **Second, the liability should be reduced for current market discount rates to adjust estimated cash flows for the time value of money**
- **Third, the liability should be increased to reflect market-consistent margins for bearing risk and if applicable, for providing services, such as claims services**

The objective of the measurement-basis is to estimate the payment to a third party for a hypothetical transfer of insurance obligations. While this is not fair value per se, it is commonly understood to be a proxy for fair value.

GNAIE Other Implications of Current Exit Value

- Potential for Day 1 gains and losses
- Acquisition costs are expensed as incurred
- Liability measurement
 - Do not consider entity-specific cash flows (e.g., consider a third party's claims servicing costs as opposed to your own)
 - Transaction price is a check for day 1 liabilities but not determinative
 - No deposit floor


*The Board preliminarily voted for an Exit Value over an Entry Value
Approach by 7 to 6 with one abstention*

So lets take a look at other implications of the current exit value approach.

A controversial aspect of the model is that the IASB allows the possibility of having an accounting gain, or loss, on Day 1. Under the proposal, a gain can arise when the calculation of exit value is below the price of the contract. Current GAAP does not allow day 1 gains.

Another potentially large change relative to GAAP is that acquisition costs are to be expensed as incurred.

It is important to note that the tentative decision with respect to the exit value model was reached by the IASB Board with the slimmest of margins -- 7 votes for exit value, 6 votes opposed that favored an entry value approach, and 1 abstention. As I will describe shortly, GNAIE has similar concerns as those Board members voting against current exit value.

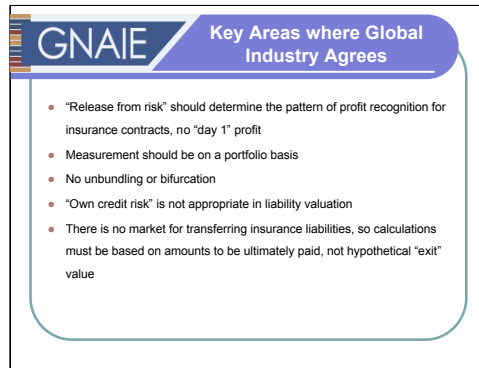


Other Aspects of the Proposed Model

- Unit of Account – portfolio of contracts
- Unbundling – yes, if cash flows are not interdependent or interdependent with non-arbitrary split
- Own Credit Risk – include but impact is low due to regulatory funds protecting claimants
- Policyholder Participation – include dividends if have legal and constructive obligation to pay
- Revenue Recognition
 - No view on definition of premium
 - Earnings=Changes in assets and liabilities
- Reinsurance
- Policyholder Behavior– Extent of premiums to include within accounting model

I do want to highlight that there are other aspects of the IASb’s proposed insurance model that the IASB’s has not concluded on the definition of revenues in the discussion paper, which can see here.

In fact, there is little consideration of the income statement. Earnings is simply the fall out from changes in assets and liabilities. Therefore, the income statement may look very different under this proposal relative to current U.S. GAAP.

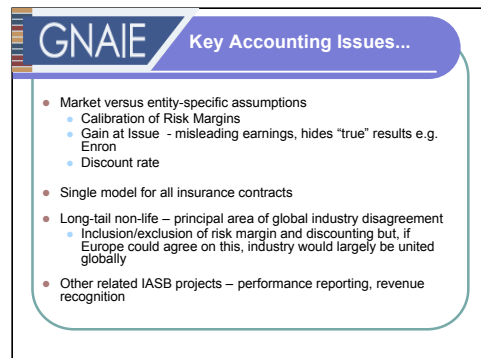


The slide features the GNAIE logo on the left and the title 'Key Areas where Global Industry Agrees' in a blue header box on the right. Below the header, a list of five bullet points is enclosed in a rounded rectangular frame.

- "Release from risk" should determine the pattern of profit recognition for insurance contracts, no "day 1" profit
- Measurement should be on a portfolio basis
- No unbundling or bifurcation
- "Own credit risk" is not appropriate in liability valuation
- There is no market for transferring insurance liabilities, so calculations must be based on amounts to be ultimately paid, not hypothetical "exit" value

Earlier this month, the technical accounting committees of the three industry groups (the CFO Forum, GNAIE and the Japanese life insurance companies) met in London, to discuss the IASB's Insurance Contracts Discussion Paper with the objective of beginning to forge our global industry position. Much of this discussion is still in process and we will continue working hard together to further develop our thinking on the Discussion Paper proposals.

Here is a summary of some of the key discussion points that took place during this Tripartite technical meeting for which there has been general agreement, although the Europeans are potentially re-evaluating their views with respect to profit recognition.



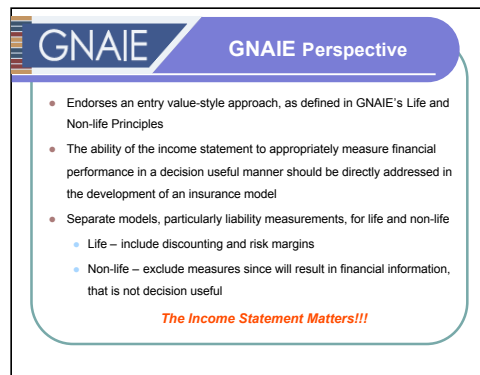
Among the three industry groups there is not a general consensus on these topics.

With respect to the first bullet, GNAIE questions the usefulness of financial information that excludes entity-specific assumptions given that insurance liabilities are generally held-to-maturity. Generally, there is wide opposition to the concept of day 1 gains.

GNAIE endorses separate models for life and non-life contracts whereas the CFO Forum supports the IASB's single model approach. Thus, the principal area of disagreement is the inclusion of risk margins and discounting within insurance liabilities for non-life contracts – the CFO Forum agrees with the IASB approach whereas GNAIE does not.

GNAIE is also concerned that other fundamental IASB projects are in process that are very pertinent to the development of an insurance model. These include performance reporting which addresses the presentation of the income statement, revenue recognition that addresses how companies should recognize revenues – both top-line sales and bottom-line earnings, and a review of the conceptual framework that provides a fundamental basis to define assets, liabilities, equity, revenues, and expenses.

I will expand on GNAIE perspective of these issues over the next several slides.



The slide features a blue header with the GNAIE logo on the left and the text 'GNAIE Perspective' on the right. Below the header is a white rounded rectangle containing a bulleted list of points. At the bottom of this rectangle, the text 'The Income Statement Matters!!!' is written in red.

- Endorses an entry value-style approach, as defined in GNAIE's Life and Non-life Principles
- The ability of the income statement to appropriately measure financial performance in a decision useful manner should be directly addressed in the development of an insurance model
- Separate models, particularly liability measurements, for life and non-life
 - Life – include discounting and risk margins
 - Non-life – exclude measures since will result in financial information, that is not decision useful

The Income Statement Matters!!!

Now that we have discussed GNAIE’s concerns; here is what GNAIE believes:

For both life and non-life contracts, GNAIE believes that the transaction price is the most reliable measure at initial recognition as opposed to the value derived from an unobservable assumption-driven model. No two companies’ actuarial models of such a “non existent market” will produce the same result.

Further, GNAIE believes that the ability of the income statement to appropriately measure financial performance in a decision useful manner should be directly addressed in the development of an insurance model. To date, the IASB has not spent any quality time deliberating the usefulness of resulting income statements for users to make informed decisions.

Given inherent differences between life and non-life contracts, GNAIE believes discounting and risk margins should be excluded from a non-life accounting model. However, with respect to life insurance contracts, GNAIE believes discounting and risk margins should be included in the model using an approach more consistent with settlement value and not an exit value approach.

GNAIE Key Issues with Exit Value Approach

- An "exit" value approach is based on the price required to transfer the liability to a third party (not settle with the insured or beneficiary)
- Are there observable and reliable secondary markets for insurance liabilities?
 - There are NO reliable market-based cash flow patterns, discount factors, or risk margins
 - Most reinsurance transactions are not legal replacements of one insurer for the other
 - Most, if not all, policy liabilities end up being settled with the insured rather than transferred
 - Every portfolio of non-life insurance risks is unique

No two companies' "calibrated models" of what the "market" is will be the same!

At the cornerstone of the IASB's exit value approach is a theoretical assumption that a financial model can be used to reliably replicate a secondary market that they acknowledge does not exist for insurance contracts. This, however, is a purely hypothetical notion. Insurance contracts are sold and purchased by our policyholders with the intention of both parties that they will be settled, not transferred. Instead, our business model is one in which the policyholder is paying for our stand-ready promise to settle claims under the policy in the event an insured loss occurs. As an insurer, we intend to hold the contract to maturity and settle claims, not sell it into a non-observable secondary market.

Given the absence of an observable secondary market, the only way to value these liabilities would be with a "model" that is calibrated to an unobservable market. We are concerned that the IASB's proposed 'current value' measurement approach for insurance contracts is predicated on too many "theoretical non-existent market assumptions". The fact is, there are NO reliable market-based or market consistent cash flow patterns, discount factors or risk margins that can be input into a model for non-life contracts.

While many in the theoretical world believe reinsurance transactions represent a market for our products. In the practical world, reinsurance cannot be used to calibrate to market assumptions since:

- **The vast majority of legal contracts are not legal replacements as the transferor or ceding company retains the primary obligation to pay claims.**
- **There are too few transactions to support a market and underlying pricing assumptions cannot be known by independent third parties.**
- **For long-tail casualty business, each policyholder risk is unique and portfolio is unique. This is evidenced by the inability of the capital markets to securitize these risks.**

GNAIE Differences between Life and Non-Life to Justify Separate Models		
	Life	Non-Life
Period of coverage	Extended (unknown duration)	Short (fixed duration)
Probability of insured event occurring	Certain (unless policy lapses)	Unknown (can be multiple claims in a single period or none)
Amount of loss if insured event occurs	Fixed (generally equals face amount of policy)	Unknown (subject to per policy and per claim limits; wide range of losses for many long-tail lines)
Timing of loss payments	Very predictable (mortality and lapse rate assumptions can be reliably estimated for a portfolio of policies)	Often unpredictable (no reliable method for predicting payment dates for many long-tail lines)

This table summarizes how we distinguish between life and non-life liabilities. I won't dwell on the differences but have noted them on this slide for your reference. The bottom line is that non life contracts are significantly different from life contracts in several important ways.

From a conceptual and idealistic standpoint the attraction of the IASB's conceptual framework of a "current value" i.e. fair value approach is appealing. We understand that and, nevertheless disagree with the practical application to insurance contracts.

Because life contracts can be measured and valued in large part on the basis of observable and empirically determined data, for example, standard industry mortality and morbidity tables, in some instances a 'current value' model may have merit.

GNAIE / **GNAIE's Proposal for Non-Life Insurance Liabilities**

- Two Components:
 - Pre-Claims Liability – calibrates to price (less acquisition costs) during policy coverage period
 - Post-Claims Liability – estimate of nominal future loss payments (considering probability-weighted averages vs. a single best estimate)
- Key Concerns with IASB Proposal
 - The valuation of non-life liabilities are extremely complex and subjective as evidenced by historical development of loss reserves
 - Compounding of current GAAP judgments with new judgments for risk margins and discounting will render resulting financial information unclear and difficult to use as a basis to assess financial performance

For non-life contracts, we believe the liability should be comprised of two components as follows:

- **The pre-claims liability should be equal to the transaction price on “day 1” and reduced as the insurer is released from risk under the contract. This is consistent with an entry value-type approach; and**
- **The post-claims liability should be measured using best estimates of actual expected cash outlays using either a single best estimate or probability-weighted average.**

In addition to basic concerns regarding the current exit value approach, GNAIE has specific concerns regarding the decision usefulness of income statements for non-life insurers that would result from the IASB’s proposal.

First, one should consider that the valuation of non-life liabilities are already extremely complex and subjective. This is inherent to our business given the myriad of external factors that could affect the ultimate settlement of losses. This fact is evidenced by the significant historical development of loss reserves. There are 2 accident years in the last 10 accident years where the development of the industry’s long-tail casualty risks has exceeded 25% of original estimates. This number is huge and highlights the significant judgment that already exists in the current accounting model.

Once we add new judgments for risk margins and discounting to the existing judgments, there will be a compounding of judgments that will render resulting financial information unclear and difficult to use as a basis to assess financial performance.

The slide features the GNAE logo on the left and the title "IASB Financial Reporting Attributes -- Consistency, Reliability, Relevance and Comparability" on the right. The main content is a bulleted list:

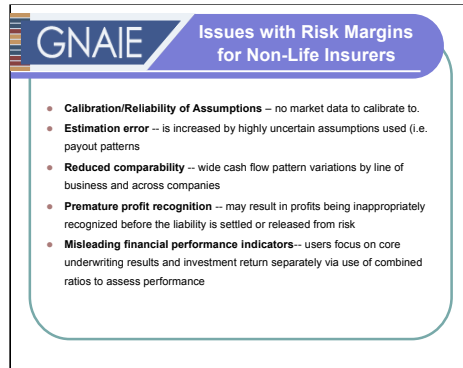
- DP requires that the new accounting model meets these attributes
- However; the IASB defines these attributes broadly and thus, their effect on the new model is unclear
- Performance reporting questions asked in the discussion paper
- Other projects with significant relevance to an insurance model, but little progress has been made to date
 - Revenue Recognition
 - Financial Instruments
 - Conceptual Framework
 - Liability/Equity

Accordingly, we question whether the proposed “current value approach” would produce relevant, comparable or reliable information to help users with economic decision-making. From an insurer’s standpoint, this is evidenced by the fact that non-life insurers have not used this measurement to assess financial performance historically.

From a users standpoint, most are not interested in a highly complex unverifiable model that is difficult to understand. Instead, users focus separately on core underwriting results and investment income, which allows a proper focus on risk selection and pricing, both key performance metrics. If we were to attempt to “current value” our insurance liabilities, users have already indicated that they would need sufficient information to ‘reconcile back’ to the current accounting model.

Users are primarily interested in when and how much liabilities will settle for. We don’t believe it is relevant how much we would ‘hypothetically’ pay someone to take on our liabilities when it is our intent to settle the liabilities.

We have an environment in the US which focuses on narrow and/or literal interpretations of accounting standards which is not the direction of the IASB’s principles-based accounting approach. There is no recognition by the IASB of the problem that companies would face in implementing a new principles-based standard that would have to be supported by a significant amount of judgments; all of which would be subject to scrutiny and second guessing by regulators and auditors. Therefore, auditing and actuarial complexity will create even more incomparability and inefficiency.

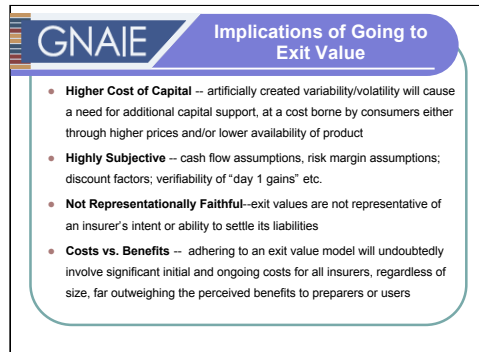


The slide features a blue header with the GNAIE logo on the left and the title 'Issues with Risk Margins for Non-Life Insurers' on the right. Below the header is a white rounded rectangle containing a bulleted list of five issues.

GNAIE Issues with Risk Margins for Non-Life Insurers

- **Calibration/Reliability of Assumptions** – no market data to calibrate to.
- **Estimation error** – is increased by highly uncertain assumptions used (i.e. payout patterns)
- **Reduced comparability** – wide cash flow pattern variations by line of business and across companies
- **Premature profit recognition** – may result in profits being inappropriately recognized before the liability is settled or released from risk
- **Misleading financial performance indicators** – users focus on core underwriting results and investment return separately via use of combined ratios to assess performance

At ACE, our concerns with the exit value model is most evident in the valuation of risk margins. Despite the continuing efforts of many, there appears to be no consensus on the appropriate approach for risk margins and means to promote consistency of underlying assumptions and factors. Many are working with the cost of capital approach to develop some level of comparability; however, the inherent subjectivity of calculating a risk margin without observable market evidence, makes it difficult, if not impossible, to achieve an acceptable level of comparability.



GNAIE Implications of Going to Exit Value

- **Higher Cost of Capital** -- artificially created variability/volatility will cause a need for additional capital support, at a cost borne by consumers either through higher prices and/or lower availability of product
- **Highly Subjective** -- cash flow assumptions, risk margin assumptions; discount factors; verifiability of "day 1 gains" etc.
- **Not Representationally Faithful**--exit values are not representative of an insurer's intent or ability to settle its liabilities
- **Costs vs. Benefits** -- adhering to an exit value model will undoubtedly involve significant initial and ongoing costs for all insurers, regardless of size, far outweighing the perceived benefits to preparers or users

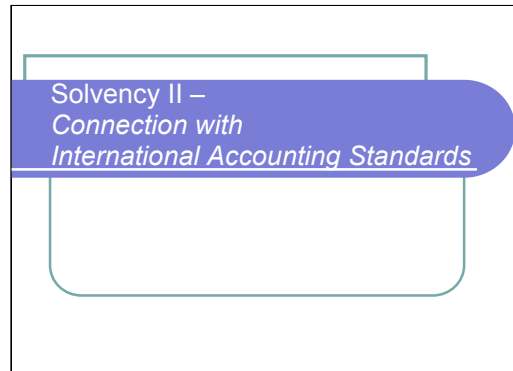
To conclude my remarks on the exit value approach, there are four implications of applying an exit value approach to non-life contracts that I want to highlight.

First, the added variability of earnings is apt to result in a higher cost of capital. Additional variability/volatility will cause a need for additional capital support, at a cost borne by consumers either through higher prices and/or lower availability of product.


Second, the financial statements, and particularly earnings would be driven by numerous highly subjective assumptions. -- numerous risk margin assumptions; discount factors; verifiability of "day 1 gains" etc.

Third, the exit value model does not appropriately represent our business as they are are not representative of an insurer's intent or ability to settle its liabilities.

Costs vs. Benefits -- adhering to an exit value model will undoubtedly involve significant initial and ongoing costs for all insurers, regardless of size, far outweighing the perceived benefits to preparers or users.



Next, I have a few comments on Solvency II initiatives in Europe and the connection with the IASB's insurance contracts project.



GNAIE Why does the North American insurance industry care about Solvency II?

- GNAIE members are significant participants in European and world-wide insurance markets, so we care about Solvency II
- US efforts to converge US GAAP with international accounting standards and the emerging use of economic capital management in the insurance industry and by rating agencies increase the influence of European solvency concepts
- Accounting being influenced by Solvency II

Solvency II is an initiative in Europe to develop new regulatory capital requirements based on risks inherent in the business.

There is a direct impact of Solvency II on GNAIE members. Many GNAIE members have significant operations in the EU and in other countries. Several of our members are currently participating in a Quantitative Impact Study, referred to as QIS 3, that provides insurers a template to calculate the capital that would be required under Solvency II and identify practical implementation issues.

Indirectly, the US accounting, capital markets and insurance standard setters and regulators have committed to various efforts towards convergence of international standards for solvency. The NAIC representing the 50 state insurance commissioners is an active participant in the work project of the Insurance Association of Insurance Supervisors or IAIS to develop harmonized principles and standards for insurer solvency globally. Solvency II is likely to be viewed as “best practices” in terms of more sophisticated approaches to insurer solvency requirements, and is having a great deal of influence on the deliberations at the international level.

There is a direct relationship between

- Solvency II and
- The IASB’s Discussion Paper.

Therefore, the North American Insurance industry definitely has an interest in what is happening with respect to Solvency II, as we are significantly affected by these proposals both directly and indirectly.

GNAIE Solvency II – The Cart is pulling the Horse (IFRS)

Solvency II Rules Define the Insurance Liability and Incorporates into Capital Requirements

Best Estimate Liability
 + Market Value Margin Based on Cost of Capital Approach
 + Standard Capital Requirement

Assets to Support Liabilities plus Required Capital

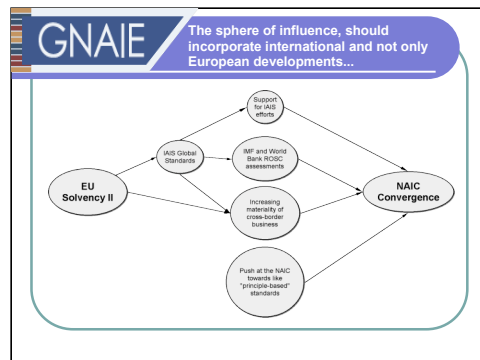
Therefore, Solvency II is influencing the IFRS liability measurement; however, the accounting liability should only be based on accounting and not solvency objectives.

Solvency II is a building blocks approach to develop capital requirements in that it defines the accounting liability and estimates an incremental capital requirement. The financial liability consists of: i) a best estimate liability that is the discounted value of expected loss payments; and ii) a market value or risk margin. Thus, Solvency II had effectively defined a financial liability for regulatory purposes prior to the issuance of the Discussion Paper and has had a substantial influence on both the IASB process and developing the views of the European community.

The standard capital requirement is intended to cover other operational risks as well as add an additional provision for claims based on a distressed scenario.

GNAIE fails to understand why so much effort has been spent in trying to tie the IASB’s measurement-basis of insurance liabilities, particularly risk margins, with the calculation of solvency capital requirement under Solvency II. This issue might have been avoided if European regulators (CEIOPS) had adopted a ‘total capital requirements approach’ to solvency as some observers have already suggested as opposed to the building blocks approach depicted by the slide.

Based on preliminary results of QIS 3, we understand that European regulators and industry are concerned by a possible higher level of liabilities for accounting than for solvency due to a different interpretation regarding profit margins under the IASB’s proposal vs. solvency.



GNAIE has a few observations regarding the current landscape for developing global capital requirements.

Primarily, it seems that the European insurance supervisors' activity is driven by internal European developments at the moment, without much concern about international implications.

Also, the US industry still has problems with a significant part of the proposed Solvency II methodology. Whereas Solvency II will be a mandatory regime in Europe, the International Association of Insurance Supervisors or IAIS sets voluntary principles. North American insurers are not convinced that:

- 1. the mark-to-market balance sheet approach to the calculation of solvency requirements contemplated under Solvency II is workable in some segments of our markets,**
- 2. Solvency II is fully compatible with principles-based reserving methods endorsed by the US regulators, or**
- 3. Solvency II is compatible with the perspective of large North American insurers in determining their internal economic capital requirements.**

We could well anticipate difficulties if the US and other regulators are, at some time in the future, asked to sign up to many of the principles of Solvency II. In GNAIE's view the only way to avoid disharmony breaking out in the future, which could slow down if not halt the move to uniform solvency standards globally (i.e. a level playing field), is for the Solvency II project to give explicit recognition to some of the concerns being raised at the broader international level on the shape of international solvency standards.

GNAIE Solvency vs Accounting - Different horses, Different courses...	
Solvency	Accounting
Objective: Determine required capital in excess of financial liabilities to cover losses under distressed scenarios	Objective: Measure "best estimate" of assets and liabilities at the balance sheet date. The difference is equity.
Focus is on total balance sheet (liabilities + equity) measured against risks	Separate focus on assets, liabilities, and equities
For regulators to focus on monitoring financial capacity to satisfy policyholder obligations – consumer protection	For investors to focus on performance, operating results and current financial position – capital market information
Regulators focus mainly on unexpected losses	Shareholders focus on maximising value in relation to risk
<ul style="list-style-type: none"> • Measurement of required capital needs is inherently different relative to measurement of reported insurance liabilities. • While it is important that the definition of liabilities for accounting and solvency purposes be consistent and reconcilable – <i>it is not necessary that they be the same</i>. The split between risk provisions included in liabilities and those in capital requirements is not important for solvency purposes ("total capital requirement" concept). • Therefore, consistency between solvency and accounting is not required! 	

Solvency II developments will have wide consequences, such as impacting the development of international insurance accounting.

GNAIE believes that the basic premise of Solvency II proceeding lock step with the development of international accounting for insurance contracts is mistaken. Solvency and accounting differ in many important ways, and we believe in the principle of “different horses for different courses”. Let me explain why.

The objective of solvency requirements and accounting differ. The objective of solvency is to determine total capital needs to cover losses under distressed scenarios. The key is the adequacy of liabilities and capital to pay claims under various scenarios. In contrast, accounting must focus separately on the measurement of assets, liabilities, and equities at the balance sheet date. Furthermore, solvency and accounting standard setters have different constituencies. The primary constituents for regulators are policyholders. Regulators focus on monitoring financial capacity to satisfy policyholder obligations and maintaining consumer protection. The primary constituents for accounting standard setters are stockholders and bond holders, creating and protecting a marketplace for insurers to operate in efficiently by appropriately capturing an entity’s performance, operating results and current financial position.

Although preparing different financial information for solvency and accounting reporting purposes may be somewhat burdensome, we don’t believe the burden justifies choosing an inappropriate methodology for either. We believe we should select and employ the methodology that best serves the purpose of each requirement!

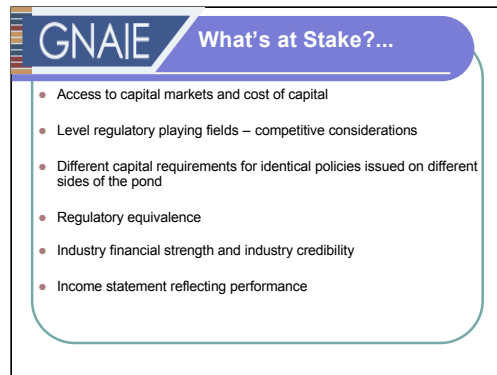
GNAIE Data / field testing – a significant challenge ...

Field testing is a must to reduce the risk of a failure

- How does Solvency II compare to standards in the US and elsewhere?
- Will there be market disruptions caused by insurers being forced out inappropriately?
- Or does a well-designed system allow insurance consumers to benefit from existing insurers and allow new EU and non-EU insurers to compete on a level playing field?
- Market consistent - methodology challenge for non-tradable risks, which to date has not been properly calibrated or modelled

Given that the insurance industry is so pervasive and vitally important worldwide in terms of the individuals we protects, our employees, as well as the impact it has in terms of being such a large investor in public and private debt, we believe that any proposed fundamental change to the insurance accounting model should only be triggered after sufficient field testing and evaluation of whether the proposed model achieves its stated principles.

Frankly, we believe that it is more important to get Solvency II and International Accounting Standards right than it is to meet arbitrary deadlines. Solvency II and IFRS are the most significant attempts to create a modernized insurance regulatory and accounting framework.



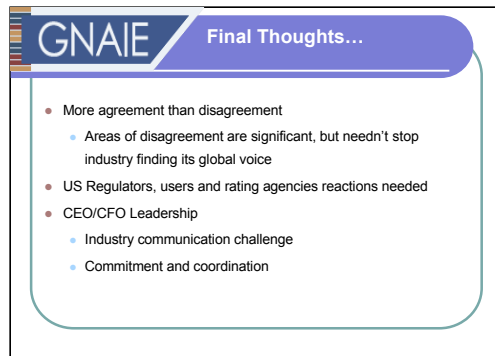
The slide features the GNAIE logo on the left and the title 'What's at Stake?...' in a blue rounded rectangle on the right. Below the title is a list of six bullet points, each preceded by a small red circle. The list items are: 'Access to capital markets and cost of capital', 'Level regulatory playing fields – competitive considerations', 'Different capital requirements for identical policies issued on different sides of the pond', 'Regulatory equivalence', 'Industry financial strength and industry credibility', and 'Income statement reflecting performance'.

- Access to capital markets and cost of capital
- Level regulatory playing fields – competitive considerations
- Different capital requirements for identical policies issued on different sides of the pond
- Regulatory equivalence
- Industry financial strength and industry credibility
- Income statement reflecting performance

One can only conclude from what is known about Solvency II and IASB Discussion Paper right now that it leaves a number of fundamental questions unanswered when it comes to its dynamics on the international scene. Namely,

Care should be taken that Solvency II does not constitute an un-level playing field for non-EU country-insurers in several ways. It is crucial that the benefits of Solvency II must also be available to non-EU based companies.

We are concerned that the artificial volatility created along with potentially weakened reserves that may result could adversely affect insurers' cost of capital, our industry's financial strength and credibility, and the income statement may not be an appropriate measure of an insurer's actual performance.

A presentation slide with a blue header containing the GNAIE logo and the text "Final Thoughts...". The main content area is white with a rounded bottom and contains a bulleted list of key issues.

- More agreement than disagreement
 - Areas of disagreement are significant, but needn't stop industry finding its global voice
- US Regulators, users and rating agencies reactions needed
- CEO/CFO Leadership
 - Industry communication challenge
 - Commitment and coordination

So, in summary, here are the key issues remaining. They may seem daunting, but consider that the global insurance industry is working on this with all the insurance regulators in the world and getting input from all the accountants and actuaries in the world. In this context, it seems like an extremely manageable set of issues.

And the effort is well worth it. The decisions reached in the next few years will affect the fundamental basis of financial regulation for the next generation.

GNAIE was formed for the sole purpose of providing North American input into the process of working with standard setters and regulators as they develop these rules. We are committed to working with our industry colleagues worldwide to accomplish this task.

Thank you for your attention.