



# NEWS RELEASE

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## **U.S. INSURERS PRAISE IAIS EFFORT ON INTERNATIONAL ACCOUNTING STANDARDS, BUT OPPOSE MOVE TO DISCOUNT NON-LIFE LOSS RESERVES**

**NEW YORK, May 12** – U.S. insurers expressed support for the efforts of international insurance regulators to define an accounting structure that serves the needs of regulators, users of financial statements and insurers.

Responding to the International Association of Insurance Supervisors (IAIS) comments on proposed international accounting standards being developed by the International Accounting Standards Board (IASB), the Group of North American Insurance Enterprises (GNAIE) said it was encouraged by the mandate of the IAIS to study the possibility of using an IAS compatible model as a basis for prudential regulatory supervision.

“The long-term interests of shareholders and the insurance of insurance regulators are aligned in many important ways,” GNAIE said.

However, the organization of leading U.S. life and property/casualty insurance and reinsurance companies cautioned that “difficulties and undesirable results” would occur if discounting and risk margins are used for non-life reserves. The IASB will consider this issue at its meeting next week.

GNAIE, the only trade association that focuses exclusively on financial reporting and accounting issues, is a provisional Observer Member of the IAIS, pending acceptance at its October Annual Meeting.

In a May 9 letter to the IAIS, the GNAIE noted that it agreed with many of the ideas contained in the regulatory organization’s analysis of the IASB proposals, particularly the need for the IAIS and IASB to work together to derive an accounting structure both can use.



But GNAIE counseled against incorporating discounting of loss reserves of non-life insurers. GNAIE observed that future claims payments are subject to a great deal of uncertainty, especially for long tail liabilities, due to a variety of factors. Evidence of this is the fact that even well managed insurers have to strengthen loss reserves from time to time, it said.

“By discounting, one is adding another element of uncertainty, since it is necessary to forecast future interest rates or assume the interest rate expectations in the current yield curve will be realized, when experience shows that interest rate do change unexpectedly and there can be rapid shifts in the yield curve,” said GNAIE.

Another uncertainty factor is the impact of inflation on insurance claims, especially on long-tail liability insurance contracts, it said. “One can only legitimately discount loss reserves at a nominal rate of interest if the insurer has built future inflation estimates into its loss reserves, since nominal interest rates include the expected general level of future inflation,” GNAIE noted.

The organization said that since claim payments are risky cash outflows, allowance for risk must be made when using discounting methodologies. This can be either in the cash flows or in the discount rate. However, it is critical to specify clearly, what risk is being considered.

GNAIE explained that estimating risk perceptions and the degree of risk aversion of a theoretical buyer of loss reserves would be very difficult, whether one seeks to incorporate risk adjustment in the claims outflows or in the discount rate. “Even if these risk adjustments could be estimated, they would be highly subjective” it said.

GNAIE also pointed out that it is important to understand what the users of financial statements, mainly investors and creditors, actually want. Analysts, investors, and indeed rating agencies, tend to look at the core underwriting business alone and use metrics, such as combined ratios to assess how it is performing, the organization observed.

“They prefer to look at the underwriting and investment results separately. They can easily incorporate the



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current and expected investment returns into undiscounted loss reserves in their own models,” GNAIE said.

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GNAIE said it shares the IAIS belief that complete convergence of the models for public financial reporting and prudential regulatory reporting may not be possible in all cases. It agreed with the IAIS draft paper that “when investors and regulators can easily identify and reconcile differences, the credibility of both public and prudential measurements is reinforced.”

GNAIE further urged the IAIS to press the IASB to make use of the concepts underlying the General Purpose financial statements the IAIS has developed.

“We particularly agree that the IAIS and IASB should work together closely to derive an accounting structure both can use,” said GNAIE.

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