



International Accounting Convergence

*Are we heading in the right direction ?
- A life perspective*

**Standard and Poors
16 October 2007**

Richard Carbone

Chief Financial Officer, Prudential

Who are the Members?



Global Standards Goal

Globally high quality, robust accepted accounting standards that are

- reliable and understandable
- promote fair presentation, consistency, transparency and comparability in general purpose financial statements
- decision-useful to analysts, shareholders, policyholders, regulators and others

GNAIE Proposed Principles

- **Life (with the four largest Japanese life insurance companies)**
 - new concept
 - see www.gnaie.net
- **Non-life**
 - Simpler version of current U.S. GAAP
 - Already a world standard
 - Might need some clarifying language

General Reactions to the DP

- Is not representative of the way insurers manage the business
- Is not representative of the way users evaluate and analyze insurance business
- Does not measure or reflect economic reality
- Is potentially misleading
- Is an invitation to manipulation
- Will increase cost of capital
- Will create artificial volatility in the Income Statement
- And creates an unlevel playing field internationally

Key DP Life Concerns

- Current DP proposals do not reflect the economic reality of the insurance business
 - Significant gains at issue
 - Entity specific data and assumptions largely ignored
 - Puts improper limits on
 - Beneficial policyholder behavior
 - Renewal premiums
 - Policyholder participation
 - Discount rates

So why does a gain at issue arise?

- **Possible Answers -- Not:**
 - Different ratings
 - Different markets
 - Niche markets
- **The Real Culprits**
 - Understated cost of capital
 - Use of 'market average experience'
 - ignores insurer's actual experience!

DP places Improper Limits on Liability Measurement

- Even trying to use current exit value as an accounting goal, DP doesn't execute it correctly
 - Limits use of premium after the initial premium
 - Limits non-guaranteed benefits on UL policies
 - Limits policyholder dividends
 - Limits certain expenses
- All these conflict with GNAIE principles
- Confuses recognition with measurement

What do we support for Life?

- Entity-specific, best estimates of all expected future cash flows
 - Without artificial restrictions
- Discount rates that reflect the spread an insurer expects to earn
- Margins based on premium agreed upon with the policyholder
 - Only market transaction
 - No accounting gain at issue

Solvency / Accounting relationship

- Regulators in Europe, the United States, and globally are considering new approaches to solvency regulation
- EU regulators are specifically concerned to link Solvency II to the IASB Insurance Contracts Phase II insurance project
- What could be the impact of this link?

What is happening in the US today?

- Regulatory and accounting based on different methodologies, for different purposes
- Currently active revisions in:
 - Risk Based Capital
 - US GAAP
 - NAIC Principles Based Approach
 - FASB Invitation to Comment on DP
- **Which don't all fit together because have different purposes!**

What is happening in Europe today?

- Drive for regulatory and accounting consistency
 - Both Solvency II and IFRS DP proposals are based on the 'current exit value' approach
- Strong drive to enhance EU competitiveness
- Currently active revisions in:
 - European Embedded Value,
 - Solvency II Proposals,
 - IFRS and
 - Now the Phase II Discussion Paper
 - **All intended to fit together somehow !**

Will this put the US at a competitive disadvantage?

- **Possibly Yes**
- **Why?**

Will this put the US at a competitive disadvantage (cont)?

	European Insurer	US Insurer
Solvency and Accounting	Similar methodologies	Different methodologies / different purposes
Reported Cost of Capital Rate	Likely to be artificially low	Higher
Reported IFRS / Solvency II Technical Provisions	Likely to be artificially low	Higher
Solvency II Diversification Credit	Diversification credit permitted for EU insurers worldwide business	Diversification credit not permitted for US insurers third country business
Organizational restructuring costs	Not applicable given domiciled in EU.	Higher costs due to, proposed Solvency II Holding Company requirement for third countries EU business
Financial information	More integrated financial information presented for external users	Separate financial and regulatory information presented for external users

Will this put the US at a competitive disadvantage (cont)?

- Lower EU capital requirements could result in different ratings in Europe vs US for similar business
 - Rating requirements for similar business, driven by different measurement bases, should be rated consistently assuming same quality of management and earnings.
 - Proposed Solvency II third country diversification rules discriminate against US insurers
 - Regulation must recognize diversification and risk mitigation regardless of geographical domicile!

Final thoughts on Convergence

- We are in favor of convergence that takes place in a stepwise fashion that
 - Minimizes market disruption
 - Maximizes the efficiency of the transition; and,
 - Maximizes the quality of the ultimate global standard, and
 - Maintains a competitive balance!