

IFRS Update

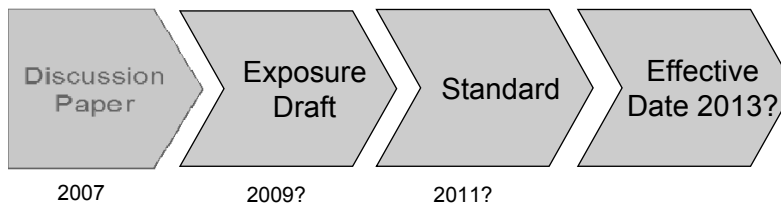
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Society of Actuaries Advanced GAAP Seminar

Agenda

- ▶ Review of IASB's insurance discussion paper ("DP") comment letters
- ▶ Key themes in responses
- ▶ Next steps

Background

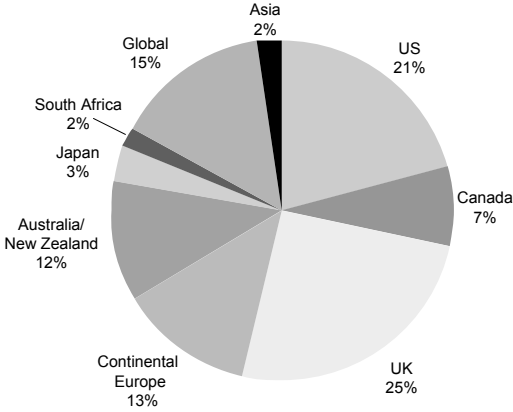
- ▶ The Discussion Paper was published in May 2007 -- 162 responses
- ▶ Regulators, analysts, companies, standard setters, professional associations, accounting firms, actuarial firms, industry groups, individuals
- ▶ Few European companies, apparently deferring to the CFO Forum/CEA letter



Survey objectives

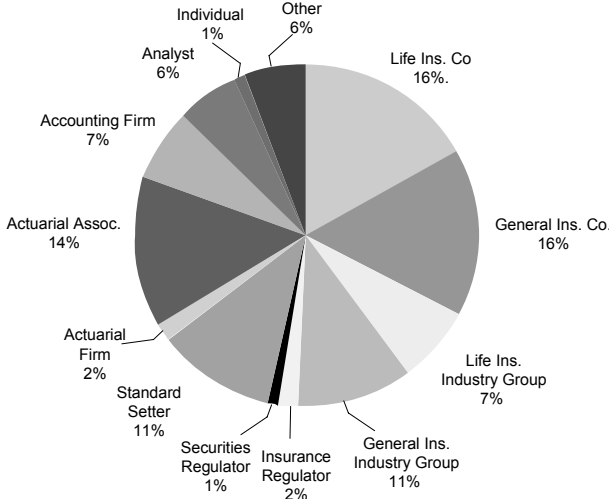
- ▶ The purpose of the review was to:
 - ▶ Summarize respondents' answers to the DP's questions
 - ▶ Summarize respondents' views on certain questions from the DP and other issues not directly asked about in the DP, e.g., 'How should the IASB proceed with the insurance project given its dependency on other IASB projects?'
 - ▶ Attempt to gain an understanding of the various rationales for differing responses
 - ▶ Gauge the level of acceptance of the IASB's preliminary views
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Respondents by region



Note: This slide represents the distribution of the 94 letters included in this survey.

Respondents by type



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General observations

- ▶ Respondents believe accounting for insurance should reflect the economics of the business.
 - ▶ The comment letters show there is little support for Current Exit Value (CEV) without potentially substantial modification.
 - ▶ Many respondents do not agree that the transfer value concept is appropriate for valuing insurance liabilities.
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Key topics from the letters

- ▶ The measurement approach/attribute
 - ▶ The building blocks
 - ▶ Profit at issue
 - ▶ Other questions
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The measurement approach/attribute



Measurement approach

- ▶ The respondents broadly agree with an approach to measurement for life insurance with three components, similar to the building blocks:
 - ▶ A current measurement of future, unbiased estimates of cash flows
 - ▶ Discounting for the time value of money
 - ▶ A margin

 - ▶ Many respondents favor a single model for all insurance products, but there was also a significant number of non-life focused respondents who support a separate model for non-life insurance.
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Definition – Current Exit Value (CEV)

- ▶ CEV is defined in paragraph 93 of the DP:
 - ▶ *“In the Board’s preliminary view, a measurement using the three building blocks represents faithfully an attribute of an insurance liability, and an informative and concise name for that measurement attribute is ‘current exit value’. Current exit value can be defined as the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity.”*

 - ▶ CEV is characterized by the following building blocks:
 - ▶ Expected cash flows that are estimated using market-based assumptions to the greatest extent possible, considering all available data both internal and external, and excluding entity-specific cash flows
 - ▶ Current market rates for discounting
 - ▶ Market-based risk (and service) margins, estimated by assessing how much market participants would demand as compensation for bearing risk (and for providing services)
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Definition – Value in Settlement (ViS)

- ▶ ViS or similar terminology is used in this presentation to mean:
 - ▶ A measurement that reflects that contracts are not likely to be transferred, but paid or settled by the company in the future
 - ▶ ViS is characterized by the following building blocks:
 - ▶ Expected cash flows anticipated in the normal course of managing and settling contracts over time that are estimated using entity-specific assumptions
 - ▶ Time value of money
 - ▶ Margins
 - ▶ Respondents who favored ViS did not necessarily agree on approaches to margins and discounting.
 - ▶ This definition differs from the concept of settlement being used in the IASB's Fair Value Measurement project. With ViS, the emphasis is on ultimate settlement; it is assumed that the liability continues to exist after the measurement date.
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Support for ViS

- ▶ A majority of the letters favor a measurement model with characteristics of what is described in this presentation as ViS, principally the use of entity-specific expected cash flows.
 - ▶ Support for this kind of model came from:

Australia Accounting Association	Towers Perrin
Big 4 accounting firms	UK ASB
Board for Actuarial Standards	UK Accounting Association
CFO Forum/ CEA	UK Actuarial Profession
German ASB	
GNAIE	
Certain U.S.-based trade bodies	
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Support for CEV

- ▶ A minority of letters indicate that they support CEV, as defined herein; although many qualified their responses because there are few market-observable transactions.

 - ▶ CEV support came from:

Canadian Institute of Actuaries Assoc.	Japanese General Insurance
CEIOPS	Korean ASB
Fitch Ratings	Hong Kong Institute of CPAs
ISDA	New Zealand Institute of CAs
Insurance Accounting Task	
Force of the Canadian Institute of Chartered Accountants (IATF)	
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CEV points from the respondents

- ▶ Supporters express conceptual agreement with CEV noting comparability among insurers and consistency with fair value measurement of other financial instruments as reasons for supporting CEV.

 - ▶ Some respondents that indicate support for CEV also support the use of entity-specific assumptions. In fact, the majority of respondents support use of entity-specific cash flows, regardless of whether they favor CEV or another measurement attribute.
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CEV points from the respondents - continued

- ▶ Some respondents observed that an exit price may be based on the expectation that the transferee will settle the contracts, making little distinction conceptually or practically, between CEV or ViS.
 - ▶ Various concerns were expressed by the respondents on the use of assumptions from “hypothetical” transfers, such as:
 - ▶ How is a hypothetical purchaser defined? Guidance is needed in order to properly establish cash flow and margin assumptions.
 - ▶ Can CEV, which imposes limitations on cash flows, truly represent what a hypothetical purchaser would consider?
 - ▶ Hypothetical market assumptions are not favored over entity-specific assumptions due to the lack of actual market-observable transactions on which to base the hypothetical assumptions.
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The building blocks



Building blocks

- ▶ Respondents:
 - ▶ Generally favor use of entity-specific cash flows
 - ▶ Do not all agree with a requirement for using probability-weighted cash flows, except as needed to recognize optionality in contracts
 - ▶ Strongly disagree with constraints on cash flows or on reflecting policyholder behavior
 - ▶ Have differing views on calibrating margins to premiums and request clarification on the objectives and intent of margins
 - ▶ Have differing views on discount rates, generally supporting either market rates or earned rates
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Cash flows

- ▶ Nearly 90% of respondents support using all expected future cash flows that are realistically expected or have commercial substance.
 - ▶ Most respondents believe that constraints on inclusion of future cash flows do not reflect the economics of the business relationship with the policyholder.
 - ▶ Most suggest that beneficial policyholder behavior should reduce the insurance liability.
 - ▶ Some (including significant support from Canada, as well as support from actuarial groups, standard setters, industry associations, etc.) disagree with the requirement that projected cash flows necessarily be probability-weighted.
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Cash flows - continued

- ▶ Most respondents disagree with the use of the 'guaranteed insurability' test as the boundary definition for inclusion of future premiums.
 - ▶ Most respondents favor including expected payments of future dividends, interest credits on investment contracts, and dividends on participating contracts, but some did not see the need for consistency with the concept of legal or constructive obligations as established in IAS 37.
 - ▶ Respondents generally agree that cash flows should include expenses (such as administrative costs) but recommend the use of entity-specific information.
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Margins & discount rates

- ▶ Most respondents ask for clarification regarding the purpose or objective of risk margins.
 - ▶ Nearly all respondents express uncertainty about the intent of, or need for, service margins and their relationship to risk margins.
 - ▶ Respondents generally agreed with the principle of discounting, with the exception of certain non-life entities and non-life industry groups.
 - ▶ Those who agreed with the principle of discounting nonetheless had a number of comments on the ambiguity in the guidance.
 - ▶ Those who supported discounting generally favored the use of market yields; however, certain respondents, concentrated in North American life insurers, believe discount rates should reflect insurers expected investment portfolio yields.
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Calibration and profit or loss at issue



Calibration of margins

- ▶ Approximately half of respondents do not believe that premiums should have greater status than other evidence when calibrating margins. Insurers from Canada, Australia and Europe hold this view as well as the rating agencies, several accounting firms, and a few regulators.
- ▶ Approximately 20% want to calibrate margins to premium. Respondents from the U.S. and non-life insurers were heavily represented in this category.
- ▶ Approximately 10% want calibration to premium as the rebuttable presumption.
- ▶ Some respondents do not give an answer, stating that the topic could not be addressed until the measurement attribute had been settled.

Relating calibration to profit at issue

Approach	Profit at Issue
Calibrate margin to premiums	No profit
Premium as best evidence	Most often no profit
Premium is no better than other evidence	Most in this category believe that a profit at inception should not be recognized immediately

Other questions



Other questions

- ▶ Respondents generally:
 - ▶ Do not agree with unbundling
 - ▶ Do not agree with reflecting credit characteristics of liabilities
 - ▶ Want to avoid accounting mismatches
 - ▶ Want consistent accounting treatment for investment contracts
 - ▶ Consider the topics of presentation and disclosure and of measurement as critical to each other
 - ▶ Believe acquisition costs should be expensed when incurred
 - ▶ Over half of respondents favor showing premiums as revenue in the income statement.
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Questions not summarized

- ▶ Recognition
 - ▶ Unit of account
 - ▶ Tax
 - ▶ Inconsistencies with IAS 39 / IAS 18
 - ▶ Reinsurance assets
 - ▶ Business combinations and portfolio transfers
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Support for the project

- ▶ Almost all respondents support the development of a uniform insurance standard, often referring to it as “much-needed”.
 - ▶ Approximately one-third of the respondents comment upon the order of the IASB’s projects – i.e., whether the insurance project should be completed before or after the revenue recognition, liabilities, conceptual framework, and financial presentation projects.
 - ▶ Some express concern about the relationship to other industries.
 - ▶ The majority of the respondents, who comment upon the order of projects, support advancing other projects first (spread over companies, standard setters, accounting firms, industry groups, and rating agencies).
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Support for the project - continued

- ▶ Some support accelerating the Insurance Project and/or not slowing down for convergence with U.S. GAAP (spread over companies, three of four big accounting firms, actuarial groups, a standard setter).
 - ▶ Other respondents suggest a strong interlink between projects that should be coordinated as the Insurance Project proceeds to ensure that conflicts are avoided.
 - ▶ Note – Revenue Recognition project is moving forward with Customer Considerations model
 - ▶ Virtually all respondents call for field testing.
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