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A Quarter Where "Nothing" Happened

by Henry Siegel

I finished my column for the March issue of the *Financial Reporter* and was concerned that I wouldn't be able to write a column for this issue because not much had been scheduled for the first quarter on the insurance project. I needn't have worried; stuff came up—small stuff like the future of FASB. But more on that later.

January

It was a slow start. There was a Financial Instruments Working Group (FIWG) meeting on January 18. A key question discussed was whether insurance is a financial instrument. If yes, is it a derivative? Some think so! The argument then proceeds: If that's all insurance is, why do we need special accounting for it? Since there are no insurance representatives on FIWG, the discussion of this issue was inconclusive. But the comparison came up again at the February IASB meeting.

The FIWG meeting also covered a discussion paper that the IASB issued later, in March, on how to simplify accounting for financial instruments. The paper is called *Reducing Complexity in Reporting Financial Instruments*, and runs 96 pages (including appendices).

Basically, it says that there are people who find the current accounting for financial instruments too complicated. There are options to use held to maturity, available for sale, trading (or fair value through the income statement) and a number of additional special methods such as for insurance contracts.

The IASB has concluded that a long-term solution is to hold everything at fair value. The logic for this can be simplified as follows: there are some things that clearly need to be held at fair value—derivatives and common stock are two that few would argue with. If that's the case, and you want a single measurement attribute to reduce complexity, then fair value is where you need to go. In the months to come, as we discuss insurance accounting, it's useful to keep this predilection in mind in thinking about the Board's positions. On the other hand, the Board is not unanimous on this position so commenting on whether a fair value approach makes sense now is very timely.

February

All this was prologue to February's IASB meeting. At this meeting, Peter Clark, the project leader for the insurance project, presented his analysis of the comments on the IASB's *Discussion Paper on Insurance Contracts* (the DP). (All the discussion papers for the meeting can be found on the IASB Web site, *http://www.iasb.org/Meetings/IASB+Board+Meeting+19+February+2008.htm*.) If you read my comments from last month, you already know what he said and I won't repeat it all here. Suffice it to say that the comments were not very supportive of most of the DP's tentative conclusions.

A lively discussion ensued at the board meeting. Clark presented three papers for discussion. The first was a project planning paper. It contained a plan for discussing the various issues contained in the DP at upcoming board meetings. The plan called for completing the task in eight "meetings" but some board members observed that some of those meetings would need to be several weeks long in order to reach conclusions.

The most interesting part of the project schedule is that it did not state clearly that the IASB would wait for FASB to join in the project before re-deliberating the issues. This was surprising since almost everyone I have spoken to has assumed all along that the two boards would work together on the next phase of the project. Clark later stated that it was not unprecedented for one board to move ahead on

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a proposal and the other board would then catch up. There would be more on the FASB to follow later in the quarter.

The paper also noted that it didn't provide any time for field testing of proposals. This was also a surprise since almost everyone who commented on the DP called for careful testing of ideas. It was clear that the IASB staff did not want to do any testing, viewing it as unnecessary. Whether anything will eventually be done remains to be seen. In the meanwhile, the SOA research project on the effects of the DP should be seen as the first example of such testing.

The second paper discussed was the concept of the "contract as a whole." Several commentators on the DP stated that the insurance contract should be evaluated as a whole rather than broken up into pieces with certain premiums being recognized or certain parts being valued separately. In part, these comments were alternatives to the Board's proposal to only recognize renewal premium when it was required for insurability and to only recognize dividend payments when they were a legal obligation. After a brief discussion, the staff agreed to study the idea further.

The third paper dealt with the measurement attribute of "settlement value." Again, many of the commentators had suggested replacing current exit value with settlement value as the measurement attribute for insurance contracts. This proposal dealt with perceived flaws in the DP, particularly the requirement to use market-driven assumptions where none exist. I'll have more on this paper in a moment.

March

The most interesting meeting this month was of the Financial Accounting Standards Advisory Council (FASAC). This group provides advice to FASB on a broad range of activities.

At the meeting there was considerable discussion of the sub-prime crisis. Eventually discussion moved to how convergence between US GAAP and IFRS would work. An SEC representative reported that in February the chairman of the SEC, Christopher Cox, had directed staff to develop a plan on how to transition U.S. entities to IFRS. This could be done either as an option, as proposed in a paper issued by the SEC in February, or as a requirement as of a specific date (the Big Bang method). The Big Bang method would be similar to the approach taken by Europe in 2005 when all public companies were required to report on IFRS. Before setting a date for the Big Bang, the SEC will need to decide if certain progress on convergence between IFRS and US GAAP is required first.

The bottom line is that FASB is going to largely disappear within the next five years unless a major change of direction takes place. Of course, no one knows whether the Presidential Election will cause a change in the SEC's direction, but by the time it happens, there may be no turning back.

The final event of the first quarter actually took place April 1 and 2. This was a meeting of the IASB's Insurance Working Group. For a report on the discussions at that meeting, see the Breaking News section. However, the discussion papers for the meeting are of interest.

One of the discussion papers concerned the same settlement value issue that was discussed at the February board meeting. Again, the goal here is to see if there is a better phrase for describing the value of the liability than the current exit value measurement attribute that is in the DP, FAS 157 and Solvency II. The concern expressed by those who commented was that current exit value was impossible to calibrate to the real market when there are no real transfers of policies between companies. Reinsurance and acquisitions don't really apply since they are all one-off negotiations and, further, they typically will use expense assumptions that are not typical of a going concern.

A key concern, however, is that the term "settlement value" may refer, for some people, to a deal in which the liability is specially settled, such as for a lawsuit, and not settled in the normal course of business, which is the intent of the commentators. Accordingly, a new term may be needed to describe this measurement attribute.

The IAA has also just, at this writing, published its *Second Exposure Draft on Measurement of Liabilities for Insurance Contracts: Current Estimates and Risk Margins*. This paper may provide important input into the process for setting risk margins for insurance liabilities. The Academy will again be commenting on this paper.

The IAA also published two preliminary exposure drafts of potential IAA standards regarding International Financial Reporting Standards: Business Combinations and Disclosure of Information about

Insurance Risk. Neither, at first reading, appears controversial. It is expected they will be approved at the upcoming IAA Council and Committee meeting June 11–14 in Quebec City.

The upcoming quarter promises to be even more interesting. Not only will the Insurance Working Group be meeting, but in May there will be the FASB Insurance Forum. This is an annual meeting between representatives of the industry and FASB. Our hope is that we will get a better understanding at that meeting of what FASB's plan for the insurance project is likely to be.

As noted above, the IAA will have its twice-annual committee meetings in Quebec City in June, and there will also be a number of informational meetings on international accounting and solvency sponsored by accounting and consulting firms as well as the Geneva Association.

So stay tuned. Remember…

Insurance accounting is too important to be left to the accountants!

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Breaking News—Insurance Working Group

The Insurance Working Group (IWG) meeting on April 1–2 was most notable for the comments made by the IASB members. In particular, Sir David Tweedie, chair of the IASB, stated that two things won't happen. One—there will be no deferred profit liability on the balance sheet. (This was the CFO Forum's proposal). Two—no situation where changes in liability won't go into income. (This can cause a problem where assets are held at available for sale.) He also stated that since a day 1 profit isn't allowed in IAS 39, it would be permitted in insurance accounting only if you have information from other transactions that would justify it. Of course, Sir David is speaking only for himself; nevertheless his comments do have considerable weight.

Otherwise, there was considerable discussion on the concept of a settlement value as proposed by various commentators on the DP as well as on the general topic of risk margins. The FASB staff representative, Jeffrey Cropsey, was asked if FASB would be joining the project, but he was unable to give an answer since FASB hasn't discussed it yet.

Three new members of the IWG from the user community—William Witt (FCAS) of Morgan Stanley; Maurizio Lualdi of Capital Research Global Investors; and Andrew Crean of Citigroup Global Markets—made presentations on their respective views of insurance accounting. For those interested in communicating better with their analysts, I recommend their presentations (found on the IASB Web site) for reading.

Another IWG meeting was scheduled for September 9–10. $