The Financial Reporter

March 2008 – Issue 72

Foreign Correspondent

by Henry Siegel

There was a time when all that actuaries interested in financial reporting in the United States needed to monitor were developments at the FASB for GAAP and the NAIC for Statutory accounting. Once in a while the AICPA or the SEC would issue something of importance, but even then these were all U.S. entities that could be monitored without too much effort. This is no longer the case; the SEC has turned the applecart upside down.

With its decision in November to allow foreign filers to use International Financial Reporting Standards (IFRS) as their basis for financial reporting without any reconciliation to US GAAP and the impending decision that may permit U.S. filers to use IFRS as an alternative to US GAAP, a different environment will now be in place. It will now be essential for U.S. insurers to monitor closely what happens at the International Accounting Standards Board (IASB) in London.

At the same time, developments are emerging on the solvency front that suggest the U.S. Statutory system may have a limited shelf-life as well. Solvency II in Europe and developments at the International Association of Insurance Supervisors (IAIS) are moving to adopt IFRS liability standards for statutory purposes as well. Furthermore, formulaic risk-based capital (RBC) structures will likely be replaced in Solvency II and in guidance provided by the IAIS by internal company models. Whether the U.S. statutory reporting structure can hold out when almost the entire world is moving in a different direction remains to be seen.

One result of these changes is that U.S. actuaries need to begin to pay much more attention to developments at the IASB and the IAIS than we have in the past. The purpose of this column over the next year will be to present developments on the international front particularly aimed at U.S. actuaries who have not previously been involved in international discussions.

Developments at the IASB

Clearly the most important development in financial reporting in the past year, other than the SEC's ruling, was the issuance of the Discussion Paper *Preliminary Views on Insurance Contracts (the DP)* by the IASB. This paper sets the stage for the IASB's development of an accounting standard specifically for liabilities for insurance contracts. Weighing in at more than 250 pages including appendices, the DP discusses most of the major issues concerning financial reporting for insurance contracts including arguments for each of the various positions included. Painful as it might be, this is required reading for anyone who wants to understand where GAAP accounting is headed. Fortunately, there was an article in the December Financial Reporter by Mark Freedman and Tara Hansen that outlined the major issues included in the paper.

Comments were due Nov. 16, 2007. As of this writing, there are 143 comment letters posted on the IASB's Web site. Clearly, this paper has received considerable attention worldwide. Deadlines being what they are, it's impossible for me to completely report on the contents of all these comment letters. By the time you read this, such expansive information may well be available since the IASB staff plans to report to the Board on the comment letters in February. Nevertheless, I have assembled a sampling

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of comments on certain of the questions raised in the discussion paper that are of particular interest to actuaries. The attached table shows the responses in comparison to the IASB's tentative conclusion for those questions where an answer in a tabular form could be representative of the responses.

Responses to Question 2 are not shown on the table because they were generally too complicated to display in a tabular form. Question 2 deals with the basic building blocks used to measure the liability. Most comments regarding life insurance products accepted the basic three building blocks (estimates of the contractual cash flows, discounting and a risk margin), but there was disagreement on the details. The DP, for instance, called for "explicit, unbiased, market-consistent, probability-weighted average and current estimates of the contractual cash flows." There are a number of comment letters that disagree with the inclusion of "market-consistent" since markets don't exist for insurance contracts. Furthermore, some commentors felt that "probability-weighted" may not always be possible or even preferable for some liabilities such as for IBNR liabilities.

There was also disagreement concerning discounting (which rate to use) and with how risk margins should be addressed. I'm not going to discuss these issues in detail here. They are complicated and, in some cases, nearly philosophical, but the comments made are important reading for anyone who wants to understand the discussion. The point to remember, however, is that there is not widespread agreement with the details of the IASB's preliminary views.

Related Question 5 asked whether Current Exit Value, the overall accounting objective proposed, is the proper measurement attribute for insurance liabilities. Somewhat to my surprise, most of the respondents given in the table said that they disagreed with this approach, indicating that a transfer value is not a relevant objective since there is no market to observe or to calibrate values to. Several preferred to use the present value of the benefits as they are expected to be paid by the current insurer. It's important to note, however, that current exit value is consistent with the values being used in Solvency II and with FAS 157.

Question 3 asked if guidance for calculating the three building blocks contained in the DP was appropriate. The actuarial commentators, as well as several others, thought that the guidance provided was too detailed. These comments indicated that the IASB should stick to stating principles and the industry, particularly actuaries, should be relied upon to provide specific measurement guidance.

This is a particularly important issue for actuaries, as it deals with who decides how we will perform our jobs. We have become more sensitive to assure that the guidance reflects actuarial and business reality, to given the experience gained in the recent efforts to implement SOP 05-1.

Of the items in the table, of particular importance is the response to Question 7, the treatment of favorable policyholder behavior and Question 16 concerning participating policy dividends. In both cases, the IASB had tentatively limited the extent that expected future cash flows could be considered in the measurement of the liability. Nearly every responder disagreed with this approach. There is nearly unanimous agreement that all future cash flows should be included in the measurement.

The major difference in responses to Question 7 is whether the principle applied should simply be to reflect all future cash flows related to the contract or to restrict those considered to those with commercial substance. In fact, these approaches are essentially the same, as the commercial substance requirement simply attempts to eliminate cash flows that one would not include in any event, such as renewals for short-term policies such as group life business. The likely result under both approaches would be the same.

Similarly, there was near unanimous opposition to the unbundling proposal that was the subject of Question 14. In some cases, responders were willing to accept unbundling when there was clearly no relationship between the elements of a contract, but the Board's proposal had little support in its entirety.

The key immediate question for now is how the IASB will respond to the comment letters. Will they hold their positions in the face of serious opposition or will they modify those positions to provide a set of principles more consistent with the views expressed. This remains to be seen.

The International Actuarial Association

In late October, the International Actuarial Association (IAA) held its semi-annual meeting in Dublin. Approximately 250 individuals attended including about 50 from the United States. At the meeting, most of the time was spent in committee meetings discussing important issues such as their comment letter to the IASB, development of international actuarial standards and how the organization will be run in the future.

The IAA is very different from the organizations we are familiar with in the United States and Canada. The members of the IAA are not individuals but actuarial associations, 57 Full Members, 23 Associate Members and three Institutional Members. The United States has five association members: the SOA, the CAS, the AAA, the CCA and ASSPA. Each committee potentially has a member from each association, generating relatively large committees. Nevertheless, most committee meetings are open and observers are welcome to express their views.

In the past, the IAA has been relatively overlooked by U.S. practitioners. As we move to international regulation of accounting and to a lesser extent solvency, however, this will no longer be acceptable. The IASB will be looking to the IAA to prepare standards for actuaries who prepare IFRS statements and the International Association of Insurance Supervisors, a member of which is the NAIC, will be looking to it for assistance in setting solvency standards.

The American Academy of Actuaries has been given the task of coordinating the IAA efforts in the United States. Nevertheless, since most meetings of the IAA are held across one or the other ocean, participating in person is often expensive and participation by phone can be at inconvenient hours. What the role of the IAA will be in the future and how it will operate most effectively are important issues that deserve particular attention. All actuaries should start to pay close attention to material posted on the IAA's Web site www.actuaries.org.

Upcoming Events

The FASB will decide formally whether to join the IASB's insurance project in the third quarter of 2008. Prior to this there may be educational sessions for FASB and the IASB may take up topics, time permitting.

The next IAA meeting is in June in Quebec City. Discussion there will probably include a revised paper on its paper that is in the process of being re-exposed, entitled, *Measurement of Liabilities for Insurance Contracts: Current Estimates and Risk Margins,* as well as drafts of standards on several accounting topics. $

Responses to Questions in IASB Discussion Paper

Responder	Q4	Q5	Q7	Q13	Q14	Q16	Q18
IASB Tentative Conclusion	c	Yes	a	Yes-as drafted	Yes	Only if Obligation	None Taken
AAA	b -> a	No	b	No	No	All	Revenue
IAA	c -> b	Mixed	c	No	xx	All	Revenue
DAV	b	No	b	No	No	All	Revenue
IAJ	xx	No		No		All	
UK	d	No	b	No	N/O	As Drafted	Revenue
S&P	c	xx	b	No	Yes	xx	xx
Fitch	c	Yes - Fair Value	a	No	No	xx	xx
PWC	c	No	c	No	Yes	All	Deposit
E&Y	Depends	No	c	No	No	All	Mostly Revenue
KPMG	b	No	Not a close to c	No	No	All	Revenue
D&T	c	No	xx	Not Always	Yes	All	xx
Tripartite Umbrella3	a	No	b	No	No	All	Revenue
UK ASB	b	No	b	No	Maybe	All	Revenue Usually
AICPA/AcSEC	b	Yes	xx	xx	Probably No	xx	xx

xx = No opinion expressed

Brief Description of the Questions Summarized

Q4 - Should Premiums be used to calibrate margins?
- a) Yes
- b) Rebuttable Presumption
- c) No more than anything else

Q5 - Is Current Exit Value the Proper Measurement Objective for liabilities?

Q7 - Should renewal premiums only be counted if they are required to keep the policy in force?
- a) Yes
- b) All cash flows should be recognized
- c) Only cash flows with commercial substance

Q13 - If an insurance contract contains deposit or service compoents, should the insurer umbundle them?

Q14 - Should the measurement of an insurance liability reflect changes in the liabilities' credit standing?

Q16 - Should policyholder dividends only be used if they are required by law or constitute an obligation?

Q18 - Should Premiums be treated as revenue or deposits?