

# The Financial Reporter

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## OCI OK

By Tom Herget

The use of Other Comprehensive Income (OCI) is receiving its moment in the sun. It is being considered for housing some of the earnings volatility in the International Accounting Standards Board (IASB) current approach to measuring insurance contracts' performance.

The American Academy of Actuaries' Insurance Accounting Task Force<sup>1</sup> recently prepared a white paper to help IASB members understand just what could belong in OCI.<sup>2</sup>

Following are some of the concepts that were raised to help answer this question.

## ACCOUNTING BASICS

Any accounting system has fundamental relationships between assets, liabilities and net worth. No matter what rules or principles exist for an accounting basis, the balance sheet item for net worth is the difference between assets and liabilities.

The income statement is a measure of performance for an accounting period. The change in net worth reflects the excess of income over expenses for the period. The change in net worth that results from this performance is called Comprehensive Income (CI).

CI comprises two components, Profit or Loss (PL) and Other Comprehensive Income (OCI). A search of accounting literature has not revealed principles for assigning elements to either PL or OCI. Items included in OCI are events that rule makers have decided should not be in PL. Some of the events may be characterized as unusual, non-recurring, or items outside the control of management.

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## Chairperson's Corner

By Rob Frasca

**T**he need for financial reporting actuaries to be able to communicate effectively has never been greater.

The 2011 annual reporting period has challenged actuaries to communicate financial results and the risks to future performance from an extremely difficult economic environment. Insurance companies depend on financial reporting actuaries to articulate clearly to management the messages contained within their reported numbers. Without such communication, management outside of financial circles will remain unclear on where the company stands and on the business directions to pursue.

The need to communicate effectively is not just a necessity for internal management purposes. The ability to communicate financial reporting issues and to interpret financial results may be even more critical when dealing with external audiences. As the forces advocating regulatory change intensify, financial reporting actuaries must communicate with regulators to ensure a clear understanding of the implications of regulatory change before it is enacted. Also, in a difficult economic environment, where investors are reluctant to commit capital to ventures that are in any way risky or uncertain, it is imperative that financial reporting actuaries be able to represent effectively the risks and rewards of the industry in a manner in which those with little background in insurance can understand. This communication is critical to attracting the steady flow of capital that the industry desperately needs.

Two recent developments have focused on actuarial communications. The first is the explosion of disclosure requirements associated with various financial measurement regimes. The disclosures required under fair value reporting in US GAAP as well as the requirements contained in IFRS 7 are just two examples that immediately come to mind. Ironically, however, the increasing volume of disclosure requirements, introduced in an attempt to clarify results, may have the unintended consequence of clouding the picture through the overwhelming heft of the information presented. Here is where the financial reporting actuary must cut through the clutter and communicate what all the information means in a clear and relevant manner.

A second development is the adoption of Actuarial Standard of Practice No. 41, "Actuarial Communications." Effective for most actuarial communications made after May 2011, the standard places new requirements on how actuaries present information to their audiences. In addition to requiring more complete disclosure of the sources and methods used to arrive at actuarial conclusions, the ASOP places obligations on actuaries to take responsibility for the data and assumptions that go into their work, even if such information is provided from external sources dictated by the actuaries' clients. Now that this standard is in place, financial reporting actuaries would be well-advised to track the range of practice that emerges.

It has been a long held view that the market capitalizations of insurance enterprises are significantly below those of other enterprises. While this observation may be understandable when interest rates are low, it is one which predates today's difficult economic environment and has dogged the industry for years. Many industry observers point the blame at the opaqueness of insurance accounting and the difficulty in interpreting financial results. This trend shows no indication of decreasing any time soon. The development of more complicated financial measures makes it even more difficult for outsiders to understand the messages contained within the numbers. The current capital measures in the United States along with the complexities of

US statutory and GAAP reporting (think AG 43 and fair value measurement, for example) are difficult enough to interpret. Now, layer on emerging capital measurement techniques, Solvency II and the proposals under IFRS and US GAAP, and the challenges of communicating what the numbers mean seem only to be growing greater.

This is where the financial reporting actuary has the opportunity, indeed the obligation, to shine. Calculating the numbers is difficult to be sure, but the value of the financial reporting actuary is in interpreting and communicating the results to the external audiences who have no interest in, and no patience for, the arcane methodologies used to determine them.

The obligation to communicate effectively does not stop with internal company management, nor within the investment community. It extends beyond the industry into areas where the general public could benefit from an understanding of the financial issues facing the insurance and financial services industry and general economy as a whole. In his address at the Society of Actuaries (SOA) Annual Meeting, SOA President Brad Smith challenged all actuaries to become more visible in commenting on the key issues facing society and in helping people to understand our unique perspective. Financial reporting actuaries are in a position to contribute to the understanding and resolution of some critical issues around the health and viability of the life and health insurance industry in today's difficult economic environment. In order to do this, financial actuaries must focus on clear and accurate communication of the meaning of the numbers that they calculate and to seek out opportunities to discuss financial reporting issues with people outside our usual audiences.

The current economic environment and the emerging financial reporting developments make the interpretation of financial issues facing life insurance companies more difficult than ever. At the same time, the variety of parties needing to understand these same financial issues continues to expand. As financial reporting actuaries, we are uniquely qualified to contribute to the communication of financial aspects of the life and health insurance business and to improve the general understanding of issues facing our industry. We have an obligation to communicate effectively. Are we up to the challenge? ■



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## Model Efficiency Study Results Report Now Posted

The report summarizes the findings of a stochastic modeling efficiency study.

View the report at [SOA.org](http://SOA.org), research, completed research projects, life insurance.

Once a contract has expired, earnings under any accounting basis will be the same. No matter what the IFRS, US GAAP, Estonian or whatever reserving rules are, the change in liabilities will be canceled once the policy obligation is extinguished. All the accruals sum to zero; the only thing left is cash.

At the point where the policy exits the company's inventory, the PL and CI must be equal. Thus, the last OCI entry reverses all the prior OCI entries so they sum to zero.

## AUTHORITATIVE ACCOUNTING LITERATURE

Search results for information related to OCI in three popular accounting systems (US GAAP, IFRS and U.S. statutory) revealed:

**US GAAP:** A Sept. 30, 2010 letter from Ernst & Young, LLP states, "There are no clear underlying principles for the recognition of OCI items or for the reclassification of such items through net income."

**IFRS:** A June 2010 Ernst & Young, LLP industry newsletter reads, "A number of respondents to the exposure draft requested that the IASB also address the issue of the lack of clear underlying principles for the recognition of OCI items (as well as for the reclassification of such items to profit or loss) within IFRS."

**U.S. Statutory:** Instructions for preparing the U.S. statutory statement include a description of its OCI provision: "The purpose of the capital & surplus account is to delineate certain charges and credits not included in operations such as net capital gains and items pertaining to prior years. ..."

The conclusion is that under these three accounting bases, there is no articulation of comprehensive principles for recognizing items in OCI.

## USES OF PROFIT OR LOSS

PL is used by company management, by authorities and by investors.

### *Company Management*

All insurance products are developed using models of future cash flows. The models produce results that display returns to policyholders, employees/agents and to the company itself. The returns to the company itself are the PL. In pricing, the anticipated PL should be set neither too low (not enough return) nor too high (likely uncompetitive and unsalable). The actual PL as it emerges is compared to the expected PL to evaluate the success of the product. Under current accounting standards, it is rare, if at all, that items captured in OCI play a part in the product pricing process, since they are typically non-recurring items.

PL can also play an important role in the determination of executive and employee bonus and incentive compensation. This helps align management actions with shareholder interests. OCI may or may not be a component of incentive plans.

Finally, PL is used to trumpet performance results. Each quarter, in print and through earnings conference calls, PL is the focal point of performance discussions. OCI is usually mentioned and discussed separately in such communications.

### *Regulatory Authorities*

Insurance regulators tend to look at balance sheet adequacy on a current basis before looking at income. However, a string of successive negative CI's would cause alarm.

Insurance taxation bodies have a keen interest in the PL as that serves as the basis for taxable income. In the United States, impacts of management-elected changes are often captured and re-spread into PL or OCI over a specified number of years, according to regulatory policy.

### *Investors*

Generally, the item that attracts investors' attention most is the PL. That seems to be the basis on which management is judged. PL is the numerator of a common benchmark, earnings per share. When a share value is expressed as a multiple of earnings per share, it is the PL that is used as the benchmark although sometimes additional adjustments are made by an analyst.



## RECOGNIZING EVENTS IN EITHER PL OR OCI

One could ask, should OCI even exist? A case can be made that it doesn't really matter how something gets to the bottom line.

If OCI should exist, performance impacts could be allocated to PL or OCI by either a blanket assignment or through principles.

### *Blanket Assignment*

Authoritative literature could merely state what measures do not belong in PL and should run through OCI. This would involve subjective determinations and could be the result of convenience, simplicity or political compromises. Any accounting authority can make such a list; without principles, there would be no way to evaluate its propriety.

### *Principles*

There are many viewpoints as to what can constitute regular or normal earnings (PL) in insurance, especially since there is so much unknown and so much variation around the unknown in insurance products and the investments and capital that support them.

Following are several possible principles. This presentation starts with a clean sheet of paper, incognizant of rule makers' existing preferences or pronouncements. There may be more than one right answer. Any answer may also not be practical. Also, it might be that no single principle is adequate; a combination may be needed. The purpose of this offering is to discuss different viewpoints.

Here are some possibilities and perspectives, offering advantages and disadvantages, on the following

candidates for principles that could be used to distinguish OCI from PL:

1. Warranted vs. unwarranted volatility;
2. Actions within vs. outside of management control;
3. Ordinary (usual) vs. extraordinary (unusual) events;
4. Regular results vs. those due to changes in methodologies or assumptions; and
5. Current year results vs. prior (or future) period adjustments.

*1. Warranted vs. unwarranted volatility:* The challenge is to develop a consensus viewpoint among participants as to what type of volatility would be considered unwarranted. There is a common perspective that volatility imposed by accounting conventions that doesn't reflect the underlying economics of the business can be viewed as unwarranted. This is called accounting mismatch.

One example of unwarranted volatility would be the component of CI created by the fact that assets and liabilities are measured at discount rates that are determined on an inconsistent basis. Another possibility is the fact that one side of the balance sheet may be unlocked (e.g., at fair value) while the other side may be locked-in (e.g., at amortized cost).

### Advantages:

- Accounting mismatch is objective and it is relatively easy to identify.

### Disadvantages:

- It might involve two perpetual independent valuations at reporting time (companies are already doing this with available for sale securities and shadow DAC, shadow VOBA calculations).

*2. Actions within vs. outside management control:* This is also a challenge to define. Conceptually, management is responsible for every action and inaction of its company. Further, the purpose of insurance is to deal with risks (for the most part) outside of the policyholders' control.

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Possible examples of items outside of management's control would be introduction of a new catastrophe model that now dictates more capital is needed. Another candidate would be the use of market interest rates in determining the value of liabilities. A third possibility would be the introduction of legislation that is disruptive to the current business plan. Some people maintain investment results are outside of management's control.

Advantages:

- This helps measure management performance by removing items that are beyond their control.

Disadvantages:

- Management is responsible for everything; why exempt certain items?
- It may be difficult to ascertain what is or is not within management's control.
- There might be a bias in classifying favorable events to be within management's control and unfavorable ones outside of their control, thus inviting manipulation.

*3. Ordinary (usual) vs. extraordinary (unusual) results:* Here again, defining extraordinary will be a challenge. To an individual, the arrival of a hurricane may be a life-changing extraordinary event. But to an insurer, this would be a regular component of day-to-day business. A major catastrophe, for which benefits are payable under the terms of a contract is not an extraordinary, external event. Nor would major medical or technological breakthroughs that dramatically reduce the cost of existing coverage be considered an extraordinary event. For this purpose, a determining criterion might be whether there is a provision for such events in the pricing of the product.

Possible considerations for extraordinary events might be a court case that establishes retroactive liabilities in contracts where no such exposure was anticipated (asbestos). Another possibility is the collapse of a counterparty (a reinsurer or a hedge provider), the value of whose promises is now dramatically diminished. Additional candidates are the transfer of a large loss

portfolio and the acquisition or sale of a block of business or company.

Advantages:

- This helps provide a better trend line of normal operations.
- This may help management make difficult decisions if there is a separate place in CI to report their impacts.

Disadvantages:

- It is difficult, and getting more difficult, to define the dividing line between the ordinary and the extraordinary.
- There may be a tendency to classify adverse events as extraordinary and favorable events as ordinary, thus inviting manipulation.

*4. Regular results vs. those due to changes in methodologies or assumptions:* Insurers will frequently review methodologies in light of emerging developments and environments. Companies will often introduce new models or upgrade existing ones. These can be perceived as presenting a better indication of the future. Use of new methodologies can be viewed as a refinement rather than a correction.

Often, assumptions need to be changed. If an event occurs during the current period that dictates a prior assumption is no longer valid, the assumption should be changed. OCI could be used to report the impact of the assumption change. However, applying outdated, prior assumptions to the current period's inventory is a meaningless, if not incorrect, determination.

Advantages:

- This helps provide a better secular performance trend line.
- It may help management make difficult decisions if there is a separate place in CI to report their impacts.

Disadvantages:

- Since insurers should be changing their evaluation of the future regularly, why classify activities as extraordinary when they are part of normal operations?



- To measure the impact of the assumption change, the company would need to quantify by using old assumptions at a new date or new (but premature) assumptions at the old date. Neither would reflect a valid representation of the balance sheet at that time.

*5. Current year results vs. prior (or future) period adjustments:* Assumptions need to be changed periodically. Sometimes what had appeared to be an aberration is confirmed as a trend. This is a normal situation for the evaluation of mortality and sometimes voluntary terminations. Introduction of a new assumption is appropriate. With the benefit of hindsight, one could say that the change should have been implemented several periods earlier. One use of OCI would be to report the prior period effects in OCI and only the current period in PL.

In the same way, changing an assumption brings into the current year, adjustments to the results of all future years. Using OCI to remove these effects from the current year PL would also improve the usefulness of PL.

Sometimes, a mistake may have been made. Thousands of keystrokes are used to generate an image of a liability or an asset. When these human errors are detected, their impact could be recorded in OCI.

Advantages:

- Items that have prior period impacts can usually be clearly identified as well as quantified.
- This helps provide a better trend line of normal operations.
- This eliminates opportunities for management to manage earnings.

Disadvantages:

- This might become painful for management to constantly address.
- Pointing one's eyes towards a mistake in a prior report might become a source of litigation.
- Changes in estimates could be used to manipulate the emergence of profit through PL; e.g., an insurance liability could be strengthened through OCI in order to improve future PL.

## CONCLUSION

Since OCI concepts are being considered as a solution to reducing volatility in the insurance contracts IFRS, it would be a very appropriate time for the accounting industry to consider articulating the principles behind distinguishing between elements of PL and OCI. If the accounting industry desires to provide lists of what should be included in OCI, professionals can submit possible lists. If the accounting industry prefers to develop principles behind what belongs in OCI vs. PL, the actuarial profession would be willing and able to assist, expanding on (or adding to) the five candidates presented. Personally, this author feels that addressing the warranted versus unwarranted volatility (which reveals the accounting mismatch) offers the most information to the user. It is possible that some combination of the above principles offers the most valuable information to a user. The quantification of the impacts of unusual or extraordinary events could always be made in disclosures and not necessarily be assigned to OCI. ■



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## ENDNOTES

<sup>1</sup> The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

<sup>2</sup> [http://www.actuary.org/pdf/finreport/OCI\\_response\\_111219.pdf](http://www.actuary.org/pdf/finreport/OCI_response_111219.pdf)

# Arbitrage-Free Perspective On Economic Capital Calibration

By David Wang



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A stockbroker comes into the office in the morning, logs on to his computer, and sees two different price quotes for the same stock. Naturally, he puts in buy orders on the lower quote and sell orders on the higher quote. He can make money out of it until the stock is listed with just a single price quote.

This is a simple example of an arbitrage opportunity. In reality, arbitrage opportunities rarely exist and, when they do, market participants (especially hedge funds) jump on them fast and they disappear quickly. Therefore, arbitrage-free is an important assumption in finance. At any time, a given asset should only have a single price. That assumption further leads to risk-neutral valuation techniques. Because there can be only one price on the asset, market participants with different risk tolerance levels will have to reach the same price. Removing the risk premium and assuming risk-neutral thus provides a consistent pricing framework for all investors.

Insurance products are of course non-tradable, and thus do not have an observable market price. However, market-consistent reporting, such as market-consistent embedded value (MCEV), Solvency II, or International Financial Reporting Standards (IFRS), attempts to put a price on insurance products using market-consistent principles.

A company typically determines the market-consistent value of its products using risk-neutral valuation techniques, particularly if those products include embedded guarantees. There can sometimes be debate on how risk-neutral parameters can be calibrated, particularly for long-term liabilities. For the purposes of this essay, we are going to ignore such debate and instead assume that a final price has been agreed on, at least internally by the company, as a fair market price for the products.

Let us further assume that this price is determined in accordance with CFO Forum MCEV principles.<sup>1</sup> If we simplify the MCEV calculations, then the price can be determined as follows:

Formula 1:

$$\begin{aligned} \text{Price} = & \text{Risk-Neutral Net Cash Flows (RNNCF)} \\ & - \text{Cost of Non-Hedgeable Risks (CNHR)} \\ & - \text{Frictional Cost (FC)} \end{aligned}$$

RNNCF calculates the average of the present values of net cash flows related to the insurance products across risk-neutral scenarios. Because risk-neutral valuation is used, it essentially captures all the market risks that can be hedged.

Risk-neutral valuation assumes investment returns that are the same as the discount rates. Thus, the emergence of earnings and the timing of regulatory reserves and capital have no impact on the results. In other words, the increase in reserves and capital is offset by the interest earned on reserves and capital. The only cost of capital captured in the calculation is the cost of non-hedgeable risk capital through CNHR and the taxation/investment expense through FC.

Now let us pause here and think about the arbitrage-free assumption at the beginning. At any time, there can be only one price on any asset. If the company considers the price calculated above as the fair price for its products, then it must hold true that the same price has to be arrived at if the company uses a real-world pricing approach instead of a risk-neutral approach.

This gives us a very good basis to calibrate the appropriate economic capital.

In real-world pricing, the company would replace all risk-neutral economic scenarios and assumptions with those reflecting realistic probabilities. Risk premiums are allowed to be assumed in the projection. If the present values are discounted at the earned rate, the impact of reserves and capital is neutral, just as it is in risk-neutral pricing.

Let us denote real-world net cash flows (RWNCF) to be the average of the present values of net cash flows related to the insurance products across real-world scenarios. Because risk premiums are explicitly allowed in the scenarios, RWNCF benefits from the higher expected return without proper allowance for the higher market risk. Therefore, to reach the same price, RWNCF has to be reduced by a cost of capital that includes both CNHR and the cost of hedgeable market risks, or the cost of the entire economic capital.



Formula 2:

$$\begin{aligned} \text{Price} &= \text{Real World Net Cash Flows (RWNCf)} \\ &\quad - \text{Cost of Total Economic Capital (CTEC)} \\ &\quad - \text{Real World Frictional Cost (RWFC)} \end{aligned}$$

If we combine Formula 1 and Formula 2, we get Equation 3:

$$\begin{aligned} \text{Price} &= \text{RNNCF} - \text{CNHR} - \text{FC} \\ &= \text{RWNCf} - \text{CTEC} - \text{RWFC} \end{aligned}$$

This equation provides a very useful guideline for the company in its economic capital calibration. In particular, it helps the company define the economic capital tail event that corresponds to the degree of risk the company takes on. For example, the European Solvency II sets the tail event to be 1-in-200, and the U.S. C3 Phase II sets the tail event to be a conditional tail event of 90 (CTE90). In reality, companies vary significantly in all respects, including product mix, investment strategy, and experience monitoring, and therefore the degree of risk each company is exposed to should vary significantly too. Having the same tail event is certainly recommended for regulatory capital such as Solvency II and C3 Phase II, but each company should still determine an economic capital that really matches its own risk.

Equation 3 suggests that the appropriate economic capital tail event should be set such that the equation will hold. In other words, real-world pricing will not overstate the price of the products as long as the economic capital considered matches all the risks that the products expose the company to.

One often debated issue in economic capital calculations is whether it should be a runoff approach or a one-year shock approach. An example of a runoff approach is the C3 Phase II calculation where the surpluses are accumulated across stochastic real world scenarios and capital is determined at a certain tail level. An example of a one-year shock approach is the Solvency II where capital is determined based on a base result and the result corresponding to risk factors shocked over a year. Equation 3 suggests that it probably does not matter because there can only be one price and therefore results from different economic capital models should

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... the selection of the economic capital calculation approach becomes more of a modeling decision.

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be the same. Thus, the selection of the economic capital calculation approach becomes more of a modeling decision.

Another debate in actuarial work is whether pricing should be done on a risk-neutral basis or a real-world basis. Equation 3 suggests that both should provide the same answer as long as the correctly calibrated economic capital is recognized in real-world pricing. Typically in the United States, however, real-world pricing only recognizes regulatory capital. Companies need to realize that the resulting price may not fully reflect all the risks to which companies are exposed.

The application of Equation 3 can range from one product, to a product line, to the entire corporation. The corporate level application is probably more meaningful because it allows for diversification across different products and the market capitalization of the company can be directly used as the price instead of having to perform a risk-neutral valuation and a real-world valuation.

In summary, Equation 3 suggests a clean and conclusive way to calibrate the economic capital. However, a lot of the details still need to be studied when we apply Equation 3 in the real world. One of the biggest challenges is perhaps how a company can arrive at the market consistent price for a long-term product with complicated guarantees. We will not discuss it in this essay, but will continue our research and discussions in a separate paper. ■

#### ENDNOTES

<sup>1</sup> Refer to [http://www.cfoforum.nl/embedded\\_value.html](http://www.cfoforum.nl/embedded_value.html) for details.

JUNE 13-15, 2012

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**H** SOA  
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HEALTH MEETING



**Mark your calendar** and plan to attend the 2012 Health Meeting. We're heading to the Big Easy—and planning more topical sessions to provide you with the latest updates on important health issues. Expect top-notch speakers and numerous of networking events—and the opportunity to earn lots of CPD credit. There'll be plenty to see and do in New Orleans while you're there: Chill out in a blues or jazz club; check out the city's well-known architecture; take a riverboat tour or carriage ride; or—head to the outskirts to see sprawling plantations and the incredible wildlife.

*Here's what last year's attendees had to say:*

**"Thought provoking and extremely worthwhile." "Gained great industry insight!"**

**"Excellent content and thoughtful delivery." "Ample opportunities to earn professionalism credit."**

**"Sessions were great! Loved the smaller groups and wide range of topics!"**

<http://HealthSpringMeeting.soa.org>

# This Time is Different!

By Henry Siegel

If you've been reading my columns for a while, you have no doubt recognized that I tend to be consistently optimistic when it comes to the insurance contracts project meeting deadlines. I am constantly disappointed as the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) fail to meet their own deadlines for producing exposure drafts or other papers. But this time is different.

I really expect both boards to have new papers out by the end of June; an exposure draft for the FASB and either an exposure draft or some other type of document for the IASB. There is a real desire to get a standard adopted by the end of 2012 and the number of outstanding issues is declining.

I don't, however, expect the two releases to be same since there are some serious issues the two boards differ on, including:

- Whether to have an explicit risk margin along with a residual margin or only a single margin;
- Whether to unlock the residual (or single) margin for changes in mortality, morbidity and similar non-financial assumptions; and
- The definition and treatment of acquisition expenses.

It's my hope, however, that the boards will come together on these and any other issues so that in the end we will have a single, high quality accounting standard for insurance.

Toward this end, the boards met jointly each month this quarter and there was an Insurance Working Group meeting in October. As a result of these meetings, some progress was made.

## OCTOBER MEETINGS

The IASB and FASB continued their discussions on insurance contracts, considering: fixed fee service contracts, eligibility criteria for the premium allocation approach and presentation in the statement of financial position and comprehensive income. The staff also provided an oral report on recent investor outreach activities.

## Fixed Fee Service Contracts

The boards tentatively decided to exclude from the scope of the insurance contracts standard fixed-fee service contracts that provide service as their primary purpose, and that meet all of the following criteria:

- The contracts are not priced on the basis of an assessment of the risk associated with an individual customer;
- The contracts compensate customers by providing a service, rather than cash payment; and
- The type of risk transferred by the contracts is primarily related to the use (or frequency) of services relative to the overall risk transferred.

## Eligibility Criteria for the Premium Allocation Approach

The boards discussed when insurers should apply the premium allocation approach. No decisions were made. This issue was brought forward to the Insurance Working Group meeting the following week.

## Presentation of the Statement of Financial Position

The boards tentatively decided that:

- a. An insurer should disaggregate the following components, either in the statement of financial position (balance sheet) or in the notes, in a way that reconciles to the amounts included in the statement of financial position:
  - Expected future cash flows;
  - Risk adjustment (for the IASB);
  - Residual margin (for the IASB);
  - The single margin, where relevant (for the FASB); and
  - The effect of discounting.

Nine IASB and six FASB members agreed with this decision, subject to future consideration of whether the cash flows relating to the recovery of acquisition costs should be separately disaggregated.

Note that by showing the effect of discounting separately on the balance sheet, the undiscounted reserve is also shown. This information would



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not be very meaningful for most life contracts but many analysts prefer undiscounted numbers for short-term P&C coverages.

- b. For those contracts measured using the premium allocation approach, the liability for remaining coverage should be presented separately from the liability for incurred claims in the statement of financial position.
- c. For contracts measured using the building block approach, any unconditional right to any premiums or other consideration should be presented in the statement of financial position as a receivable separately from the insurance contract asset or liability and should be accounted for in accordance with existing guidance for receivables. The remaining insurance contracts rights and obligations should be presented on a net basis in the statement of financial position.  
  
I suppose there might be circumstances where there is such an unconditional right, but it is certainly not the most common situation.
- d. For contracts measured using the premium allocation approach, all insurance contract rights and obligations should be presented on a gross basis in the statement of financial position.
- e. Liabilities (or assets) for insurance contracts should be presented separately for contracts measured using the building block approach and those measured using the premium allocation approach.
- f. Portfolios that are in an asset position should not be aggregated with portfolios that are in a liability position in the statement of financial position.

This is a strange position and probably reflects the boards' misunderstanding of how common an asset position really is. Much depends, of course, on how portfolio is defined. The boards discussed this issue in December, although they didn't establish any new guidance. In general, an asset position only exists in the early years of a contract as acquisition costs are being recovered.

### **Presentation of the Statement of Comprehensive Income**

The boards tentatively decided that an insurer should present premiums, claims, benefits, and the gross underwriting margin in the statement of comprehensive income. The boards will consider at a future meeting whether these items should be presented in the statement of comprehensive income separately for contracts measured using the building block approach and the premium allocation approach.

### **OCTOBER INSURANCE WORKING GROUP MEETING**

The Insurance Working Group met during the week following the board meeting. The major topic at this meeting was a proposal by industry to allow changes in liabilities due to changes in discount rate to flow through Other Comprehensive Income rather than earnings. The argument is that discount rates are likely to change frequently. If the valuation basis for liabilities and assets is not the same (i.e., both at current value or both at cost), significant volatility in earnings can result.

Both the HUB Group and the CFO Forum gave presentations endorsing the proposal. Around the table there was general agreement that the proposal had merit although certain details, such as the treatment of options and guarantees needed to be worked out.

Another important issue that was discussed was proposed language for determining when a policy ended. Referred to as the contract boundary issue, the basic concern is that some contracts that are short-term on their face may require renewal of the policy, effectively becoming a long-term contract. Other contracts that appear long-term can actually have their premiums revised annually so they work more like a short-term contract.

Staff had developed working language to deal with these issues. Unfortunately, this language had the possible effect of making Universal Life contracts short term since you can change the crediting rate whenever the contract permits, thereby effectively changing the price. When this was pointed out, it was agreed that

everyone would review the proposed wording and get back with possible problems and fixes.

There were also discussions about the treatment of reinsurance, eligibility for use of the premium allocation approach and presentation of financial results. Those discussions didn't lead to any new results.

## NOVEMBER MEETING

The IASB and FASB continued their discussions on insurance contracts by considering the accounting for explicit account balances within insurance contracts. The boards have thankfully moved off the idea of measuring account balances separately, and are now discussing showing them separately.

The FASB tentatively decided to separate explicit account balances from the insurance contract liability for presentation. Explicit account balances are account balances within a contract that meet both of the following criteria:

- The balance is an accumulation of the monetary amount of transactions between the policyholder and an insurer.
- The balance is credited with an explicit return. A return is explicit if it is determined by applying either of the following to the balance:
  - A contractual formula in which the insurer may have the ability to reset the return rate during the life of the contract; or
  - An allocation determined directly by the performance of specified assets.

For U.S. contracts, this would essentially apply to most fixed and variable universal life and annuity contracts. Traditional whole life, par and non-par contracts would not be subject to this disaggregation.

IASB members indicated their preference to measure explicit account balances as part of the insurance contract and to disaggregate them for presentation or disclosure. IASB members indicated that they would like to explore an approach in which some other deposit components of insurance contracts could be disaggregated in the same way. Although some indicative votes were taken, the IASB made no decisions on these subjects, asking staff to do more work on the issues.

The boards plan to consider at a future meeting:

- Whether there are additional account balances that should be presented separately from the insurance contract liability;
  - How income and expense items related to the explicit account balances should be recognized in the statement of comprehensive income; and
  - Whether to measure separated account balances:
    - Using requirements other than those being developed in the insurance contracts project; or
    - As part of the insurance contract and to disaggregate those account balances for presentation or disclosure.

The good thing about this discussion is the boards are having it before the final wording is adopted. Discussions of these issues in the past were usually brief and held at the very end of the discussions on the project, without time for industry reactions.

### **Insurance Contracts: Education Session on Residual Margins**

The IASB discussed whether the residual margin established at contract inception should be adjusted (unlocked) to offset changes in estimates and if so, which changes in estimates should adjust the residual margin. This is a very old issue and has been discussed for many years previously. The idea is that the margin would absorb, to the extent it's large enough, changes in items such as mortality and morbidity so that you would have smaller swings in earnings when assumptions are unlocked. The effect would then be amortized into earnings as the residual (single) margin is amortized. This would help accomplish industry's goal to reduce year-to-year volatility in net earnings.

## DECEMBER MEETING

### **Participating Contracts**

This discussion dealt primarily with European-style participating contracts where there is a specific fund underlying the participating element. These can be either unit-linked contracts, which are similar to U.S. variable contracts, or contracts where the shareholders are only entitled to a percentage of earnings on the par fund, often 10 percent.

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The boards tentatively confirmed their earlier decision to require insurers to discount the liability for incurred claims ... when the effects of discounting would be material.

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Both the IASB and the FASB noted that their previous tentative decision meant they would measure the obligation for the performance-linked participation feature in a way that reflects how the underlying assets are measured in the US GAAP/IFRS financial statements. That could be achieved by two methods, which both lead to the same measurement:

- a. Eliminating from the building block approach changes in value not reflected in the measurement of the underlying items; or
- b. Adjusting the insurer's current liability (that is, the contractual obligation incurred to date) to eliminate accounting mismatches that reflect timing differences (between the current liability and the measurement of the underlying items in the US GAAP/IFRS statement of financial position) that are expected to reverse within the boundary of the insurance contract.

The bottom line is, this would result in the liability value generally being equal to the value of the underlying assets.

The boards also tentatively:

- a. Confirmed that options and guarantees embedded in insurance contracts that are not separately accounted for as derivatives when applying the financial instrument requirements, should be measured within the overall insurance contract obligation, using a current, market-consistent, expected value approach; and
- b. Agreed that, when an insurer measures an obligation, which was created by an insurance contract liability, that requires payment depending wholly

or partly on the performance of specified assets and liabilities of the insurer, that measurement should include all such payments that result from that contract, whether paid to current or future policyholders.

The problem with b. is that it makes reference to future policyholders and some object to the concept that you can have a liability today for a policyholder who has not yet purchased a contract. However, without this, the shareholder equity would be potentially overstated on certain European contracts. In such contracts, for example, if you have earnings of 100, only 10 can be paid to shareholders. However, the 90 does not need to be paid out today or to current shareholders. It's necessary to hold the 90 as a liability or the shareholder equity will be greater than 10.

#### **Discounting of the Liability for Claims Incurred**

The boards tentatively confirmed their earlier decision to require insurers to discount the liability for incurred claims (for contracts accounted for using the premium allocation approach) when the effects of discounting would be material. All IASB and FASB members present agreed with this decision. One IASB member and one FASB member were not present.

In addition, for contracts accounted for using the premium allocation approach, the boards tentatively decided not to provide additional guidance on determining when the effect of discounting the liability for incurred claims would be material. However, the boards tentatively decided to provide a practical expedient that would permit insurers not to discount portfolios where the incurred claims are expected to be paid within 12 months of the insured event, unless facts and circumstances indicate that payments will no longer occur within 12 months.

All IASB and FASB members present agreed with this decision. One FASB member was not present.

#### **Onerous Contracts**

The boards tentatively decided that:

- a. An insurance contract is onerous if the expected present value of the future cash outflows from that contract (plus, for the IASB, the risk adjustment) exceeds:



- i. The expected present value of the future cash inflows from that contract (for the pre-coverage period); or
  - ii. The carrying amount of the liability for the remaining coverage (for the premium allocation approach);
- b. Insurers should perform an onerous contract test when facts and circumstances indicate that the contract might be onerous. The boards also tentatively decided that they would provide application guidance about the facts and circumstances that could indicate that a contract is onerous; and
- c. Onerous contracts identified in the pre-coverage period should be measured on a basis that is consistent with the measurement of the liability recognized at the start of the coverage period. Similarly, onerous contracts identified under the premium allocation approach should be measured on a basis


that is consistent with the measurement of the liability for claims incurred.

**SEC Position**

The SEC was expected to announce a position on adopting IFRS by the end of 2011. However, as the year ended no position was announced. Instead, a decision on adopting IFRS will be delayed until 2012. It appears likely that the staff paper released earlier in 2011, which provides for adoption but with a review by FASB before any standard becomes effective, is likely to be the preferred course of action. However, this is far from certain.

In the meanwhile, we need to remember that ...

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



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# NAIC ORSA

By Steeve Jean



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## GUIDANCE MANUAL

The latest draft ORSA Guidance Manual was released on Oct. 14, 2011. An overview of the requirements from a qualitative, quantitative and governance perspective was provided in the December edition of the Financial Reporter. Several trade associations and companies commented on the draft. The main comments and recommendations were:

- Several organizations and companies expressed concerns that the ORSA could lead to additional regulatory solvency requirements and become the new solvency standard. This is primarily based on several references in the Guidance Manual such as “capital adequacy,” “security standard,” “risk capital requirements” and “target level of capital”;
  - There were also concerns about the possibility that regulators could have some input into the selection of the various stress tests, measurement metrics (VaR, etc.) and the parameters underlying the economic scenario generator, therefore influencing the level of risk capital that company might be expected to hold;
  - Concerns were expressed about the lack of a level playing field between insurers or groups if the regulators could potentially use the quantitative results of the ORSA as a basis for regulatory action. Companies that take a more conservative view could be at a disadvantage relative to insurers that take a less conservative approach or because of differences in quantification methods (stress tests, stochastic simulations, factor-based), accounting framework (economic, rating agency, regulatory), time horizon (one year vs. lifetime) and measurement metrics (value at risk, tail value at risk, probability to ruin);
- There was general support for the pilot project in 2012 proposed by the NAIC Global Solvency Issues Working Group, preferably open to all insurers and groups as opposed to a select group, that would provide a field test of the manual and help assess if the ORSA provides meaningful information in relationship to the efforts required to produce it; and
  - Most respondents would like more specificity around the concept of Lead Regulator so that groups would only need to prepare one ORSA Summary Report to be filed with the Lead Regulator which would be acceptable to multiple jurisdictions.

## ORSA SUBMISSIONS AND ORSA MODEL ACT

**The Guidance Manual had initially identified the reporting vehicle as Form B of the NAIC’s Insurance Holding Company System Regulatory Regulation.** Form B is an annual registration statement that must be filed by each legal entity. The industry raised several issues with this approach. The key concerns with using Form B were:

1. The lack of uniformity (not all states use Form B);
2. The potential lack of confidentiality as some states indicated they consider Form B public information;
3. It contradicts the concept of a single ORSA Summary Report to be submitted to the Lead Regulator, as Form B needs to be filed for each legal entity with their state regulator; and
4. It would not allow for flexibility in the filing timeline to reflect company practices with regards to their ERM, business planning and capital evaluation processes.

Industry drafted a stand-alone ORSA Model Act as the manual’s reporting vehicle alternative to the Form B proposal. This act was also submitted for comments. Most of the comments received were consistent with those on the Guidance Manual and focused on:

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There was general support for the pilot project in 2012 proposed by the NAIC Global Solvency Issues Working Group.

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1. Maintaining confidentiality of the ORSA Report and the supporting documentation. In particular, the industry is not comfortable with the idea of the states sharing information with the NAIC as it is not a state regulator and may lack privacy protection;
2. Clarifying the roles and responsibilities of the insurers/groups and of the Lead Regulator in order to make the ORSA Summary Report and the supporting documents available to all relevant regulators in an effective manner; and
3. Firming up the effective date and expectations around the timing of the ORSA Summary Reports. The proposed effective date of Jan. 1, 2015 requires more clarity as to when the first ORSA report would be due and the as-of-date of this report.

## IMPLEMENTATION CONSIDERATIONS

Companies that have robust ERM frameworks and Economic Capital Models will have less difficulty preparing the initial ORSA from a qualitative and quantitative aspect. The most challenging component will likely be the development of a forward looking view of risk capital and the integration with the business planning process. Factor-based techniques based on limited stress-tests and sensitivities might make it difficult to reflect the development of the risk profile over a two- to five-year horizon (as indicated in the Guidance Manual), adequately reflecting changes in economic conditions, product mix, investment strategies, reinsurance, etc.

As part of the prospective solvency assessment, projecting risk capital under different scenarios will also be problematic as the existing models may not be flexible enough to prospectively adjust the risk measures, correlation factors and diversification benefits under significantly stressed scenarios.

Although not specifically required, the potential need to perform reverse stress-testing also presents difficulties as it implies the identification of scenarios that would have a material impact on risk capital after taking into account management actions and fungibility of capital across legal entities.



There is an expectation that the ORSA will be performed at least annually and updated upon occurrence of significant events or changes in the economic or business environment. This will require a robust and flexible ORSA process.

The development of “lite models” might be a potential solution for developing a forward looking risk capital assessment. Lite models are simplified versions of the more robust internal models (or Economic Capital models) and can be calibrated to capture the key characteristics and drivers of risk capital. They can also prove valuable in supporting business decisions through a better understanding of how the business strategy impacts the development of risk capital which is one of the expected benefits of the ORSA.

## LESSONS LEARNED FROM SOLVENCY II

European insurers have been developing an ORSA

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as part of the Solvency II implementation. This has possibly been one of the most challenging aspects of Solvency II due to the lack of clarity around regulators' expectations and the format of the ORSA report, the need to demonstrate how the ORSA is embedded into business decisions (the Use-Test) and having to reconcile the ORSA risk capital to the Solvency II Solvency Capital Requirements determined using internal models.

The adoption of the NAIC ORSA appears to be on a fast track and insurers need to gain a good understanding of the requirements and expectations and how they

will impact their organization. The ORSA will likely impact several aspects including risk management, strategic planning, capital management and regulatory reporting. In defining their implementation approach, insurers should consider the value that can come out of the ORSA, especially from developing a forward-looking view of risk capital. ■



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# The Risk Adjustment—Accounting Perspectives

By Jim Milholland

Actuaries are accustomed to considering how much conservatism is appropriate in their estimates, whether made for pricing or for measurement of liabilities. In the proposals for a new standard on accounting for insurance contracts, this conservatism is referred to by the International Accounting Standards Board (IASB) and the Financial Accounting Standard Board (FASB) of the United States as the risk adjustment. Colloquially it is also known as the risk margin. The title of this article reflects that there are several perspectives on the risk adjustment. At this stage, the IASB and the FASB disagree about the necessity of a risk adjustment. Furthermore, within IFRS there are different (but not necessarily inconsistent) approaches to the consideration of risk in the measurement of liabilities, depending on the nature of the liability and on the specific accounting standard that must be applied. [See the sidebar on pg. 21 for a summary overview of the proposals for accounting for insurance contracts.]

This paper addresses the proposals of the two boards as expressed in the IASB's Exposure Draft *Insurance Contracts* (ED) and the FASB's discussion paper *Preliminary Views on Insurance Contracts* (DP) and as modified by subsequent deliberations of the boards since the publication of the ED and the DP. Note that the boards are very active with the insurance project and their thinking may have evolved since the time the article was written.

## THE IASB'S VIEW

Under the IASB's proposal for insurance contracts, the risk adjustment is one of the building blocks; it is a component of the insurance liabilities. The IASB believes that a risk adjustment is necessary to properly portray the uncertain nature of insurance liabilities.

“The risk adjustment conveys information to users of financial statements about the effects of uncertainty about the amount and timing of the cash flows arising from an insurance contract.” (ED, para. B68)

As explained in the *Basis for Conclusions* to the ED, most notably in para. BC112, the risk adjustment distinguishes uncertain liabilities from those that are

risk-free. The presence of a risk adjustment is more consistent with the measurement of financial instruments. It conveys the reduction in risk in the contracts that occurs with the passage of time and hence provides a more appropriate basis for the release of the liability into revenue than would the use of a single composite margin, the release of which the IASB sees as inherently somewhat arbitrary.

## THE FASB'S VIEW

The FASB's view can be found in the DP, notably in para. 69-71. The FASB believes that the composite margin reflects the amount of risk and uncertainty priced into the contracts and that the determination of an explicit quantification of risk is highly judgmental.

The benefits of a composite margin are:

- Consistency with the proposed standard on revenue recognition;
- The elimination of the need to use subjective methods for measuring the risk adjustment margin; and
- A simple and more understandable approach to account for the difference between the expected inflows and outflows.

### *The IASB's Characterization of the Risk Adjustment*

The IASB has tentatively decided that the risk adjustment should be the compensation that the insurer requires to bear the risk that the ultimate cash outflows could exceed those expected. Hence, the risk adjustment is the value of the risk in the eyes of the insurer, rather than an estimate of the market price of the risk. This characterization of the risk adjustment is consistent with the notion that the measurement attribute for insurance contracts is not a fair value or an exit value. The characterization corresponds with the idea that the expected cash flows that are the first building block are those that the insurer requires to fulfill its obligations under the contracts. The risk that is being quantified relates to the possibility that the fulfillment cash flows may be greater than expected.



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## RISK ADJUSTMENT OR NOT—WHAT DIFFERENCE DOES IT MAKE?

Except when a contract is onerous, as discussed below, the risk adjustment is in effect an allocated part of the total margin in a portfolio of contracts. It serves the purpose of timing the release into income of that part of the total margin. The risk adjustment is re-measured at the valuation date to reflect the current perception of the risk for the remaining cash flows. The release of the risk adjustment into income extends beyond the coverage period to include the claims period.

On the other hand, the boards have indicated that the composite (FASB) or residual (IASB) margin will be released over the period of coverage of the contracts. The composite or residual margin is not re-measured.

The biggest difference in the timing between the two approaches—with or without a risk adjustment—occurs for contracts with long-tailed claims. The bottom-line effect of the difference in the two board proposals is that income would be recognized faster under the FASB approach because the FASB would not

require that claims liabilities include a risk adjustment. This difference is potentially large.

When claims liabilities have no risk adjustment, they are a drag on an entity's return on equity. An insurer must hold capital for the uncertainty associated with the claims, but there is no margin to be released along with the payout of claims to compensate the insurer for the cost of capital. Any margin in the premium would have been released over the coverage period and the insurer would have been compensated prematurely for the cost of capital related to the claims period. The insurer may welcome the benefit to the bottom line when it occurs during the coverage period, but may well have preferred to delay it until the claims period.

The other difference between the approaches of the two boards relates to onerous contracts. When using the building blocks, insurers may sometimes find that at inception the present value of the outflows, plus a risk adjustment in the case of the IASB, exceeds the present value of the inflows. In other words, the contracts are loss-making. In this case, the insurer cannot defer the loss but must recognize it in income immediately. If there is a risk adjustment in this calculation, the size of the loss is greater than if there were no risk adjustment. Members of the IASB are aware that the inclusion of a risk margin in the measurement of the liability for a loss-making contract represents an amount that is expected to reverse itself in the future. Judging from their discussions, one can infer that they find it undesirable to create an expense that is expected to reverse into income in a later period. They are reluctant to remedy this situation because they are wed to the idea that the liability includes a risk adjustment. They also see difficulties with the subsequent measurement of liabilities if there is a modification at inception; it is not clear how an insurer would measure the risk adjustment at subsequent valuation dates if there had been some sort of constraint on the risk adjustment at the date of inception.

The IASB's tentative decision on onerous contracts is understandable, but it leads to a semantic problem. If a portfolio of contracts is onerous, then the risk adjustment is not the amount of compensation that the insurer



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## SIDEBAR: OVERVIEW OF THE IASB'S PROPOSED ACCOUNTING FOR INSURANCE

The proposed guidance for insurance contracts would apply to contracts that meet the definition of insurance. For all practical purposes, the definition is carried over from the existing guidance for insurance (IFRS 4), with a small number of specific types of contracts specifically included or excluded. The board has tentatively decided to add to the current definition that the insurer should consider the time value of money in assessing the significance of the insurance benefit and that there must be a scenario of commercial substance in which the insurer could have a loss. The insurance contract is recognized on the date when the coverage period begins, or sooner if the contract is onerous (i.e., when there's a loss at issue).

The insurance liability for contracts other than certain short duration contracts (as discussed below) is measured according to three building blocks. These are a current unbiased estimate of future cash flows (an estimate of the mean or expected value), an adjustment for the time value of money, and an adjustment for risk. Cash flows are determined for a portfolio of contracts. Cash outflows are benefits, including participating features, and direct expenses, including acquisition costs. Inflows include premiums for the duration of the contract. The contract duration is the period until the contract terminates or until the insurer has the right to reassess the risk and re-price the contract.

The adjustment for the time value of money is the effect of discounting. The discount rate is based on the current market rate for contracts with observable prices that have characteristics that are similar to insurance contracts. The observed rate is adjusted to reflect differences in characteristics between the insurance contracts and the reference instruments. For contracts for which the cash flows depend to some extent on the results of specific investments, the measurement can reflect that dependence.

The risk margin is the compensation the insurer requires to bear the risk that the ultimate cash flows could exceed those expected.

A fourth component of the liability is the margin, which is set at inception to defer any profit at issue. The board proposes to amortize the margin over the period of coverage but is undecided on whether the margin should be adjusted to offset the effects of changes in expected cash flows or of changes in discount rates.

The board seems likely to adopt an allocated premium approach, essentially an unearned premium approach, as an alternative to the building blocks. It would be used for pre-claims liabilities of contracts that are short duration in nature, which are those of approximately one year in duration or less. Claims liabilities would be measured by the building blocks.

The board has decided to require unbundling of embedded derivatives, essentially retaining current IFRS 4 requirements. The board is undecided to what extent it will require separation of service and financial features from insurance contracts.

The main differences of the FASB's proposal from the IASB's are:

- There is no explicit adjustment for risk, the margin is a composite rather than a residual margin. As a consequence, claims liabilities would have no margin; and
- The amount of acquisition costs that could be considered would include only costs associated with successful efforts, which is potentially a significantly lower amount than direct costs at the portfolio level. ■

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## The insurance standard is only one area of guidance where the IASB has had to consider the topic of risk adjustment.

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requires to bear the risk, as patently it has not required the customers to compensate it adequately (otherwise the contracts would not be onerous). Perhaps the risk adjustment should be characterized as the compensation the insurer would like to require, and sometimes does.

### DISCLOSURES

The insurance standard will require insurers to disclose the amount and the movement in the amount of the risk adjustment. Insurers will also disclose the methods and inputs used to calculate the risk adjustment.

The IASB is looking for ways to make the information comparable among insurers. They are seeking a way to help users understand what the risk adjustment says about the relative uncertainty in the estimated cash flows. In the ED the IASB proposed that insurers would disclose the confidence level of the risk adjustment if the use of a confidence level was not the approach taken to determine the risk adjustment. This proposal was very unpopular with insurers, who commented that there would be a duplication of effort. They also stated that if the confidence interval was not seen by the insurer as the most appropriate approach to set the risk adjustment, its relevance as a disclosure was dubious. In subsequent deliberations of the decisions in the ED, the IASB has moved away from asking for disclosure of confidence intervals, but is still pursuing a means of helping users assess the information about risk adjustments.

### GETTING FROM THE WORDS TO THE NUMBER

After the conceptualizing is done, it falls to the actuary to produce a number that represents the compensation that the insurer requires to bear the risk that the ultimate cash flows could exceed those expected. The IASB

intends to provide some application guidance that may be helpful. In its discussions the IASB has talked about the idea that the risk adjustment should make the insurer indifferent between fulfilling the uncertain liability and fulfilling a certain liability of the same value.

Take for example the choice between a certain liability of 100 and an uncertain liability with an expected value of 100 that has a range of possibilities from 85 to 115. Because it is risk adverse, the insurer would not be inclined to take a chance of a gain or loss on the uncertain liability of 100 if it could instead have a certain liability of 100. At some larger amount of certain liability, say 110, it would be quite happy to have the uncertain liability. The prospect of a gain of up to 25 would be attractive, notwithstanding that there is a possibility of a loss of up to five (assuming of course that the probability distribution is not skewed towards the loss). But at what amount of risk adjustment would the insurer be indifferent between the two possibilities? In this example, the answer lies somewhere between zero and 10. The question is one that each insurer must answer for itself. It must rationalize its position and articulate its policy in a manner that can be associated with the quantity.

The insurer is not limited in the choice of techniques for calculating the risk adjustment, (as had been originally proposed in the ED). Even without limits, it is a challenge to the actuary to find the calculation technique and the calibration of the risk models that provides a number that can be said to represent the point of indifference. The final answer is likely to be more subjective than will be apparent. For this reason the disclosures around the risk adjustment will be important.

### RISK ADJUSTMENT IN OTHER IFRS STANDARDS

The insurance standard is only one area of guidance where the IASB has had to consider the topic of risk adjustment. Other areas that are relevant to insurers are financial instruments, revenue recognition, and general liabilities.

The measurement of financial instruments is either by fair value or by the effective yield method, more com-

monly known as amortized cost. A fair value measure includes a risk adjustment because market participants price risk into the value of the instrument. If the measurement of a financial instrument is an observed price, the risk adjustment is not separately identified, but it is presumably in the price. If the financial instrument is measured by a model, the risk adjustment is a component of the model and the risk adjustment is based on consideration of market factors.

The price of a financial instrument measured by amortized cost reflects the market assessment of risk and the risk is in turn reflected in the effective interest rate. Subsequent measurement retains this rate. The risk adjustment is not re-measured unless the instrument is impaired.

The emerging standard on revenue recognition will apply to contracts for which consideration is given in exchange for goods or services. Contracts that are addressed elsewhere, such as insurance contracts, are not in the scope. The approach to revenue recognition is an allocation of the consideration to the period in which the goods or services are delivered. The allocation process starts by recognizing an initial liability, the performance obligation, which is measured as the value of the consideration. At subsequent dates, the liability is the amount of the performance obligation that has not yet been released into revenue. When a contract is onerous, the entity must add an amount to the performance obligation to cover the expected loss. A contract is onerous when the amount of the performance obligation is not sufficient to provide for the cost of settling the contract. The IASB decided that the liability for an onerous contract does not include a risk adjustment, notwithstanding the possibility that the expected loss may be uncertain. This is one clear point of difference between the insurance standard and other guidance.

Although currently inactive, the IASB has a project on modifications to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets (IAS 37)*. IAS 37 provides general guidance on the recognition and measurement of liabilities that are not specifically addressed elsewhere, such as liabilities arising from lawsuits. In January 2010 the IASB issued an exposure draft, *Measurement of Liabilities in IAS 37*, presenting

its view on how general liabilities should be measured. In this exposure draft the IASB concludes that the measurement should be the amount that the entity would rationally pay at the end of the reporting period to be relieved of the obligation. This is an exit value, akin to a fair value, and includes a risk adjustment. Interestingly six board members disagreed with the choice of the measurement attribute and in particular with the decision to include a risk adjustment. They gave an alternative view in the ED. They disagreed with the idea that a liability should be measured as an exit value. Their objection to the risk adjustment was largely related to the fact that the risk adjustment would create an expense in the period in which it was recognized that would likely reverse and generate income in later periods. They stated that they believe this effect on the timing of income would be inappropriate.

## CONCLUSION

In summary it can be seen that the rationale for inclusion or exclusion of a risk adjustment is largely a function of the measurement objective. The selection by the board of the measurement objective can be contentious, between the boards or even among board members. The difference in the views of the FASB and the IASB reveals a divide in their respective understanding of the measurement objective for insurance contracts and of the value of the information provided by the presence of an explicit risk adjustment. If, in the end, the insurance standard requires a risk adjustment, it will be challenging for insurers and for the actuaries, who must do the heavy-lifting, to determine the number that meets the measurement objective. ■

# Differences Between FASB and IASB Could Lead to Two Accounting Models for Insurance

by Leonard Reback and William Hines



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The Financial Accounting Standards Board (FASB), which promulgates accounting standards under US GAAP, and the International Accounting Standards Board (IASB), which promulgates accounting standards for many countries outside the United States, have been working for several years on a joint project on accounting for insurance contracts. The boards agree on many aspects of the proposed accounting model. However, as of December 2011, there are a number of key areas where they do not. This article summarizes the boards' views on the key areas where they disagree.

## MARGINS

Probably the area of disagreement between IASB and FASB that has been debated the longest is the number and characterization of margins that should be included in the measurement of the liability. The IASB has consistently taken the position that there should be a risk adjustment or risk margin added to the expected present value of future cash flows to reflect the price or cost of the uncertainty present in the underlying cash flows. This risk adjustment would be calculated based on some indicator of the variability of future cash flows. The risk adjustment would be recalculated each reporting period based on the uncertainty remaining in the future cash flows. If, at inception, the expected present value of future cash flows plus the risk margin was less than the initial premium, a residual margin would be added to the initial liability as a plug to avoid a gain at issue. Thus, the IASB position is that there should be two margins on top of the expected present value of future cash flows—the risk adjustment and the remaining residual margin.

FASB has consistently taken the view that, while in theory a risk adjustment could provide useful information, in practice there is no objective way to reliably calibrate such an item. Therefore, FASB's position is of the view that there should only be one margin which eliminates any gain at issue. This margin has been called the composite margin or single margin.

One consequence of the boards' differing views on margins impacts claim liabilities on short duration contracts, particular long-tailed claims such as group

disability income and long-term care, and many property and casualty contracts. Both boards agree that the residual or single margin should be amortized over the coverage period. Thus, during the claims period, the IASB view would result in a claim liability that includes a risk adjustment but no residual margin. However, the FASB view would result in a claim liability that is just the expected present value of future cash flows, with no margin at all.

During the course of 2011, an additional difference between the boards has emerged with respect to margins. That difference is in the way the residual or single margin amortizes over time. FASB's position is that the single margin is not re-measured or recalibrated and cannot increase. The margin should be amortized as it satisfies its performance obligation which they equate to the insurer being released from exposure to risk. The FASB believes that release from risk is evidenced by a reduction in the variability of the underlying cash flows. Thus the composite margin would be released in proportion to the reduction in variability of cash flows of the underlying contracts.

The IASB's position on release of the residual margin is very different. Under the IASB position, the residual margin would be unlocked to offset changes in the expected present value of future cash flows resulting from a change in cash flow assumptions, as long as the residual margin remained non-negative. As of December 2011, they were also considering whether the residual margin could be unlocked to offset changes in the expected present value of future cash flows resulting from a change in discount rates or to offset changes in the risk adjustment.

Depending on how the IASB's position on unlocking margins is implemented, it could reduce the potential volatility in the liability measurement and in resulting income. This is especially the case if applied to changes in non-financial cash flow assumptions. However, if applied to financial cash flow assumptions or to discount rates, the IASB approach may increase volatility. That is because the residual margin could only be unlocked to the extent the margin is non-negative. If a change in discount rates or financial variables caused



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the margin to reduce to zero, there would be no further unlocking of the margin. Basically, when the margin is positive the liability measurement would be indifferent to changes in interest rates, but when the margin is zero the liability would fluctuate with interest rates. This could increase earnings volatility, because asset values would likely be affected by the same financial forces as the liability. But the assets would either be at amortized cost (effectively a locked-in discount rate) at all times or at fair value (fluctuating with changes in interest rates) at all times. There may not be an asset measurement approach that would be consistent with the liability measurement under all scenarios.

A final difference between the boards on margins is whether the residual or single margin should accrue interest. Accruing interest on the margin would defer profits, perhaps materially and in some cases the margin with accrued interest could far exceed the present value of expected cash flows.

## ACQUISITION COSTS

Another key difference between the boards' positions is the treatment of acquisition costs. Both boards agree that certain acquisition costs should be included in the liability measurement, netting those costs against the residual or single margin, avoiding a loss to the extent of such costs. Essentially, the permissible acquisition costs would be offset against the future revenue included within the liability. The boards have different views as to the extent of acquisition costs that would be permissible.

The FASB's view is that the permissible acquisition costs should be limited to costs directly attributable to successful sales efforts, similar to EITF 09-G/ASU 2010-26. The IASB has taken a more expansive view of permissible acquisition costs, on the theory that some unsuccessful sales efforts are necessary to acquire a portfolio of insurance contracts. Therefore, the IASB would include costs directly attributable to both successful and unsuccessful sales efforts in the liability measurement.

## PARTICIPATION FEATURES

As of December 2011, the boards had not re-deliberat-

ed the treatment of participation features in insurance contracts for which the insurer has discretion over the amount paid. Such features are common in many U.S. life insurance contracts, such as non-variable universal life contracts, where the insurer has discretion over the credited rate and charges, and dividend-paying participating whole life contracts issued by mutual companies, where the insurer has discretion over the timing and amount of divisible surplus paid out in the form of policyholder dividends. The boards have re-deliberated the treatment of contracts with participation features where the insurer does not have discretion. Such contracts are common in many European countries, and this treatment may also be applicable to such U.S. contracts as variable life and annuities or closed block whole life contracts.

The boards believe that their views result in identical measurement of the participation feature. However, the boards disagree on the method to achieve the result. The IASB position is that to the extent that the liability cash flows depend on specific asset returns, the liability value should equal the reported asset value. That asset value may be other than a current value; for example, real estate assets and many financial assets backing such insurance contracts might be reported at amortized cost. The FASB position is that contracts with non-discretionary participation features should be measured using the building blocks, similar to any other insurance contract. However, to the extent there are timing differences between the measurement of the assets and liabilities, such as would occur if the assets are held at amortized cost, these should be adjusted for. In addition, to the extent that some changes in value of the assets backing the non-discretionary participation feature are reported in other comprehensive income rather than net income, the change in liability resulting from participation in the performance of those assets should be treated consistently.

One other difference between the boards with respect to participation features involves the treatment of investment contracts with discretionary participation features. The FASB believes that investment contracts that don't meet the definition of an insurance contract should be accounted for as financial instruments. The

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The boards have tentatively agreed to unbundle explicit account balances that are credited with an explicit return that is based on the account balance.”

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IASB has not developed an amortized cost measurement model for contracts with discretionary participation features, and thus believes that such contracts should be accounted for using the insurance contracts model, even if the contracts do not meet the definition of insurance.

### PREMIUM ALLOCATION APPROACH

The boards have generally supported the use of a different measurement approach when accounting for the pre-claims period of certain contracts; ones that are typically short duration. However, the boards have a fundamentally different view of the nature of this alternative measurement model which they currently refer to as the premium allocation approach (PAA). The IASB views the PAA as a simplification of the building block approach and thus looks to the building block model for consistency and precedents. The FASB views the PAA as a completely different model and thus is less concerned about the precedents set in the building block approach.

### UNBUNDLING

The final area of difference we want to highlight is the concept of unbundling explicit account balances. The boards have tentatively agreed to unbundle explicit account balances that are credited with an explicit return that is based on the account balance. The rationale is the criteria developed in the revenue recognition project for identifying separate performance obligations.

The IASB prefers to measure the entire insurance contract using the building block approach and disaggregate the account balance for presentation purposes only. The FASB has not expressed such a preference

and thus may be leaning towards separate measurement of the account balance under certain conditions and measuring the rest of the insurance contract using the building block approach.

The boards plan to explore whether other types of account balances could be separated in a similar way.

### CONCLUSION

As can be seen from the issues laid out in this article, there are areas of significant differences between the boards and areas where the differences are not that great. However, given the long standing nature of some of these differences it seems likely that some will persist into the final standards of each organization, a single converged standard may not be achievable. ■





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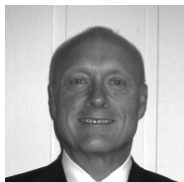
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# Acronyms for Actuaries

By Tom Herget, Chris Kogut and Anna Wetterhus



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**A**ctuaries interact with a dizzying array of programs and institutions from around the world -- and the many acronyms they use as shorthand -- every day. But there are just too many acronyms for anyone to keep straight, and new ones are being added all the time. Members of the American Academy of Actuaries' Solvency Committee have put together an acronym reference chart. This handy guide can be folded up to fit in your wallet and quickly reviewed so you can fearlessly enter an elevator.

This chart can be downloaded from the Society of Actuaries' website at [www.soa.org/fr-acronyms](http://www.soa.org/fr-acronyms).

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## ACRONYMS LIST

ACRONYM (WEBSITE) HEADQUARTERS	FULL NAME	PURPOSE	COMMENTS
<b>AAA (www.actuary.org)</b> Washington	American Academy of Actuaries	The Academy serves as the voice of U.S. actuaries on public policy and professionalism issues, representing the U.S. actuarial profession at the state, federal and international levels.	The Academy was created in 1965 and has 17,000 members.
<b>AAISC</b>	Accounting and Auditing Issues Subcommittee	The AAISC is responsible for the IAIS's external accounting and auditing relationships; monitors accounting developments regarding supervision of insurers; must respond on behalf of IAIS when appropriate.	The AAISC is part of the IAIS; it was formed on January 1, 2011.
<b>ABI (www.abi.org.uk)</b> London	Association of British Insurers	The ABI is the lobbying organization for the insurance industry in the UK, representing the general insurance, investment, and long-term savings industry.	Formed in 1985, the ABI is made up of over 300 members and represents 90% of the premiums in the UK.
<b>ACL (www.naic.org/documents/committees_e_capad_RBCoverview.pdf)</b>	Authorized Control Level	One of the five outcomes to the NAIC Risk-Based Capital (RBC) calculation which is determined by comparing a company's Total Adjusted Capital (TAC) to an RBC calculated amount. An RBC ratio of 70%-100% triggers ACL, where the regulator may take control of the insurer.	The five outcomes of the RBC calculation are: (1) No action; (2) Company Action Level; (3) Regulatory Action Level; (4) Authorized Control Level; (5) Mandatory Control Level.
<b>ACLI (www.acli.com)</b> Washington	American Council of Life Insurers	The ACLI is a trade association representing over 300 legal reserve life insurer and fraternal benefit society member companies operating in the U.S.	Member companies represent more than 90% of assets and premiums of the U.S. life insurance and annuities industries.
<b>ACOPA (www.asppa.org)</b> Arlington, Virginia	ASPPA College of Pension Actuaries	ACOPA is the primary source of professional organizational support for pension actuaries, and is charged with carrying out ASPPA's responsibilities as one of the recognized U.S.-based actuarial organizations.	ACOPA was formed in 2008 when ASPPA and the College of Pension Actuaries combined to form a semi-autonomous operating unit within ASPPA.
<b>ADR</b>	Alternative Dispute Resolution	ADR is a method for resolving legal disputes through formal trial instead of full litigation. The most common technique is arbitration proceedings.	ADR benefits insurance and banking industries in addition to protecting consumers. It can help to maintain long-term relationships between firms and mitigate expenses from a long full litigation.
<b>AIA (www.aiadc.org)</b> Washington	American Insurance Association	The AIA is a Property Casualty insurance trade organization representing approximately 300 insurers that operate in the United States.	The present day AIA was created in 1964 when the old AIA merged with the National Board and the Association of Casualty and Surety Companies (formed in 1866).
<b>AICPA (www.aicpa.org)</b> Washington	American Institute of Certified Public Accountants	The AICPA is the world's largest association representing the accounting profession. AICPA members represent many areas of practice, including business and industry, public practice, government, education and consulting. The AICPA sets ethical standards for the profession and U.S. auditing standards for audits of private companies, non-profit organizations, and federal, state and local governments.	Founded in 1887, the AICPA has nearly 377,000 members in 128 countries.
<b>ALIA</b>	Affordable Life Insurance Alliance	ALIA is a life insurance industry trade organization that promotes policy on behalf of its members. It primarily addresses the NAIC.	ALIA was formed in 2003 by several companies who focused on competitive term and secondary guarantee UL products. The major concern has been the valuation of liabilities on a US regulatory basis.
<b>ALM</b>	Asset Liability Management	ALM is the practice of managing risks that arise due to mismatches between assets and liabilities.	
<b>AML (www.cftc.gov/IndustryOversight/AntiMoneyLaundering/)</b> Washington	Anti-Money Laundering	The USA PATRIOT Act amended the Bank Secrecy Act to require all financial institutions to establish AML Programs (BSA provides the definition of a financial institution).	AML Programs must include the development of internal policies, procedures, and controls, designation of a compliance officer, ongoing employee AML training, and an independent audit function to test programs.

ACRONYM (WEBSITE) HEADQUARTERS	FULL NAME	PURPOSE	COMMENTS
<b>APRA</b> ( <a href="http://www.apra.gov.au">www.apra.gov.au</a> ) Sydney	Australian Prudential Regulation Authority	Oversees banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, friendly societies and most members of the superannuation industry. APRA is funded largely by the industries that it supervises.	Established in 1998, the APRA supervises institutions holding over \$4 trillion in assets. APRA's mission is to establish and enforce prudential standards and practices designed to ensure that financial promises made by member institutions are met within a stable, efficient, and competitive financial system.
<b>ASB</b> ( <a href="http://www.actuarial-standardsboard.org">www.actuarial-standardsboard.org</a> ) Washington	Actuarial Standards Board	The ASB establishes and improves standards of actuarial practice - the Actuarial Standards of Practice (ASOPs). The goal is to set standards for appropriate practice in the US.	Members of the ASB are appointed by the Council of US Presidents (CUSP) composed of the presidents and presidents-elect of the AAA, the ASPPA, the CAS, the CCA and the SOA.
<b>ASOP</b>	Actuarial Standards of Practice	The Council on Professionalism of the AAA has developed ASOPs to provide actuaries with nonauthoritative guidance as to which standards might apply to them as they perform various assignments in their roles as actuaries.	The guidelines are updated periodically; the actuary is responsible to keep current with changes to the ASOPs and to ensure that professional services rendered by the actuary satisfy the current version of each applicable ASOP.
<b>ASPPA</b> ( <a href="http://www.asppa.org">www.asppa.org</a> ) Arlington, Virginia	American Society of Pension Professionals & Actuaries	ASPPA is the national organization for career retirement plan professionals. Its purpose is to educate retirement plan and benefits professionals and to preserve and enhance the private pension system.	Founded in 1966, ASPPA currently has 7,500 members.
<b>BAFIN</b> ( <a href="http://www.bafin.de">www.bafin.de</a> ) Bonn and Frankfurt	Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)	BAFIN's main goal is to ensure the proper functioning, stability and integrity of the German financial system. Monitored by the Federal Ministry of Finance, it's composed of three main organizational units: Banking Supervision, Insurance Supervision, and Securities Supervision/Asset Management.	Established in 2002, BAFIN has been able to conduct the cohesive supervision of banks and financial services providers, insurance undertakings and securities trading. BAFIN is separate from the Federal Budget, as it is mainly funded by the institutions and undertakings it supervises.
<b>Basel I</b>	Standards for determining capital for globally active banks	Capital measurement system developed by the BCBS which implements a credit risk management framework for banks; establishes a set of minimum capital requirements for banks.	Implemented in 1988, also known as the 1988 Basel Accord, enforced by law in the Group of Ten countries in 1992.
<b>Basel II</b>	Standards for determining capital for globally active banks	Basel I revised; more comprehensive credit risk management framework developed by the BCBS; provides better tools than Basel I to help capture more advanced risk. Basel II contains three pillars: minimum capital requirements, supervisory review, and market discipline.	Revised Basel I framework implemented in 2004; BSBC intended for Basel II to be a living framework.
<b>Basel III</b>	Standards for determining capital for globally active banks	Refines Basel II in reaction to the GFC. It raises the amount and quality of capital; it harmonizes liquidity standards. There is a relatively long phase-in period.	Must be transposed into local legislation. Same overall methodology as Basel II (risk-weighted assets). There are new requirements as to leverage, liquidity, extreme events and additional charges for SIFI's.
<b>BCBS</b> ( <a href="http://www.bis.org/bcbs">www.bis.org/bcbs</a> ) Basel	Basel Committee on Banking Supervision	The BCBS formulates supervisory standards / guidelines and encourages convergence of global banking supervisory standards and approaches. BCBS, IAIS, and IOSCO, forming the Joint Forum of international financial regulators, work together to develop guidance, principals, and best practices that are of common interest to all three groups.	Formed in 1974, the Committee's members come from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.
<b>BIS</b> ( <a href="http://www.bis.org">www.bis.org</a> ) Basel	Bank for International Settlements	The mission of the BIS is to serve central banks in their pursuit of monetary and financial stability, to foster international cooperation in those areas and to act as a bank for central banks.	The BIS has 56 member central banks which are the source of the BIS's directors and shareholders. It was established in 1930.
<b>BMA</b> ( <a href="http://www.bma.bm">www.bma.bm</a> ) Hamilton, Bermuda	The Bermuda Monetary Authority	BMA is the integrated regulator of the financial services sector in Bermuda. In addition to regulating Bermuda financial institutions, the BMA issues national currency, manages exchange control transactions, assists other Bermudian authorities with the detection and prevention of financial crime, and advises the government and public on financial matters.	It was established under the Bermuda Monetary Authority Act of 1969.

ACRONYM (WEBSITE) HEADQUARTERS	FULL NAME	PURPOSE	COMMENTS
CAL ( <a href="http://www.naic.org/documents/committees_e_capad_RBCoverview.pdf">www.naic.org/ documents/committees_e_ capad_RBCoverview.pdf</a> )	Company Action Level	One of the five outcomes to the NAIC Risk-Based Capital (RBC) calculation which is determined by comparing a company's Total Adjusted Capital (TAC) to an RBC calculated amount. An RBC ratio of 150%-200% triggers CAL, where an insurer must file financial information and a business plan.	The five outcomes of the RBC calculation are: (1) No action; (2) Company Action Level; (3) Regulatory Action Level; (4) Authorized Control Level; (5) Mandatory Control Level.
CALM ( <a href="http://www.actuaries.ca/SOP_Doc/Complete/SOP_e_Complete.pdf">www.actuaries.ca/SOP_Doc/Complete/ SOP_e_Complete.pdf</a> )	Canadian Asset Liability Method	One of two methods (CALM and the actuarial present value method) used in Canada to take into account the time value of money for valuing life insurance liabilities. When using CALM, the amount of policy liabilities is the amount of a firm's supporting assets which reduce to zero at the last liability cash flow in the forecast of cash flows from the assets and liabilities.	Defined in the Canadian Institute of Actuaries Standards of Practice. CALM is a "roll forward" method that can be applied to any situation, where as the actuarial present value method is a "pull back" method.
CAS ( <a href="http://www.casact.org">www.casact.org</a> ) Washington	Casualty Actuarial Society	The purposes of the CAS are to advance the body of knowledge of actuarial science applied to property, casualty and similar risk exposures; to establish and maintain standards of qualification for membership; to promote and maintain high standards of conduct and competence for the members; and to increase the awareness of actuarial science.	Formed in 1914, the CAS has 5,500 members.
CCA ( <a href="http://www.ccactuaries.org">www.ccactuaries.org</a> ) Long Grove, Illinois	Conference of Consulting Actuaries	The CCA mission is to advance the practice of actuarial consulting by serving the professional needs of consulting actuaries and by promoting member's' views within the profession.	Founded in 1950, the CCA has over 1,200 members in the US and Canada providing services in the life, health, casualty and pension fields.
CEA ( <a href="http://www.cea.eu">www.cea.eu</a> ) Brussels	Comité Européen des Assurances	A public policy federation for 5,000 insurance and reinsurance companies in 33 European countries. CEA represents undertakings that account for around 95% of total European premium income.	In English, the European Insurance and Reinsurance Federation; founded in 1953; composed of 27 European Union member states as well as six non-EU countries (Croatia, Iceland, Liechtenstein, Norway, Switzerland and Turkey).
CEIOPS ( <a href="http://www.ceiops.org">www.ceiops.org</a> ) Frankfurt	Committee of European Insurance and Occupational Pensions Supervisors	CEIOPS advised the EC on insurance, reinsurance and pension matters.	This body comprised regulators and is based in Frankfurt. It was rechristened EIOPA during 2010 and technically no longer exists.
CFO Forum ( <a href="http://www.cfoforum.nl/">www.cfoforum.nl/</a> )	European Insurance Chief Financial Officer Forum	The CFO Forum holds high level discussions, led by CFOs of major European listed and non-listed insurance companies. It aims to influence the development of both financial and value based reporting and related regulatory developments for insurance enterprises on behalf of its members.	The CFO Forum was created in 2002.
CGFS ( <a href="http://www.bis.org/cgfs/">http://www.bis.org/ cgfs/</a> )	Committee on the Global Financial System	Monitors international banking markets.	Tries to identify potential sources of stress to the global financial environment in order to try to promote necessary improvements in such markets.
CIA ( <a href="http://www.actuaries.ca">www.actuaries.ca</a> ) Ottawa	Canadian Institute of Actuaries	As the Canadian organization of the actuarial profession, the CIA serves both the public interest and the actuarial profession by establishing and maintaining professional guidance, relevant research, quality education, and validations of eligibility; maintaining a code of conduct and a disciplinary process of the highest standard; and making meaningful and timely contributions to public policy.	The CIA was established by an Act of the federal parliament in 1965 and has over 3,900 member Fellows.
CIRC ( <a href="http://www.circ.gov.cn/web/site45/">http://www.circ.gov.cn/web/site45/</a> ) Beijing	China Insurance Regulatory Commission	CIRC regulates the Chinese insurance industry.	CIRC was established in 1998. The size of CIRC was expanded by the State Council in 2002 (upgraded from a semi-ministerial institution to a ministerial institution).
CISSA	Commercial Insurers Solvency Self Assessment	Bermuda's ORSA.	
CLHIA ( <a href="http://www.clhia.ca">www.clhia.ca</a> ) Toronto, Montreal, Ottawa	Canadian Life and Health Insurance Association	Trade association that represents the collective interests of its member life and health insurers.	Established in 1894; represents 99% of the life and health insurance policies in force in Canada.

ACRONYM (WEBSITE) HEADQUARTERS	FULL NAME	PURPOSE	COMMENTS
ComFrame	Common Framework for the Supervision of Internationally Active Insurance Groups	ComFrame develops processes for supervising IAIGs, establishes a comprehensive framework to address group activities and risks; sets grounds for supervisory cooperation; fosters global convergence of measures and approaches.	ComFrame is being developed by IAIS in response to the FSB.
CONAC ( <a href="http://www.conac.org.mx">www.conac.org.mx</a> ) Mexico City	Colegio Nacional de Actuarios	CONAC is a professional membership, government-advising, and independent organization for all the actuaries licensed to practice in Mexico, regardless of their speciality.	Mexican authorities recognize the CONAC as the official representative of the actuarial profession. CONAC is an advisor to the government in matters such as social security, regulation of the insurance system, and management of contingent liabilities.
CRA	Credit Rating Agency	A CRA assigns credit ratings to financial institutions who have debt obligations.	In 2006, SEC passed the Credit Rating Agency Reform Act which tightened CRA regulation. CRA regulation was enhanced by the DFA, causing the SEC to adopt various new rules.
CRO Forum ( <a href="http://www.thecroforum.org">www.thecroforum.org</a> )	Chief Risk Officer Forum	The CRO Forum is a professional group that focuses on developing and promoting industry best practices in risk management; formed to work on key relevant risk management issues within the insurance industry. The Forum intends to represent large insurance company views aimed at the alignment of regulatory requirements with sophisticated / best practice risk management; acknowledgement of group synergies, especially diversification benefits; and simplification of regulatory interaction.	Formed in 2004 and represented by Chief Risk Officers of the various members, the CRO Forum tends to work on topics of a more technical nature (valuation, risk measurement, and risk management).
CTE	Conditional Tail Expectation	CTE is the probability weighted loss above a specified probability level; it can also be defined as the average of all Value at Risk values for probability above a specified level.	CTE is a common measure risk for insurance companies.
DCAT	Dynamic Capital Adequacy Testing	DCAT must be completed by an appointed actuary of any federally-registered insurance firm in Canada; a DCAT examines the effects of numerous possible scenarios regarding the firm's projected capital position. DCATs identify possible threats to the economic future of the firm, plans to minimize probability of threat, and plans to mitigate effects of threat if they occur.	CTA is required by the CIA as a standard practice.
DFA ( <a href="http://sec.gov/spotlight/dodd-frank.shtml">http://sec.gov/spotlight/dodd-frank.shtml</a> )	Dodd-Frank Wall Street Reform and Consumer Protection Act	DFA is US legislation passed in 2010 expanding the role of the federal government in overseeing capital markets. The DFA expanded the authority of existing agencies and mandated the creation of new agencies, such as the Consumer Financial Protection Bureau, to strengthen the regulation of financial markets.	DFA includes over 90 provisions that require SEC rulemaking and dozens more that give SEC authority for discretionary rulemaking.
DFA	Dynamic Financial Analysis	DFA is a simulation approach that looks at an insurance enterprise's risks holistically as opposed to traditional actuarial analysis which analyzes risks individually. Specifically, DFA reveals the dependencies of hazards and their impacts on the insurance company's financial well being such as business mix, reinsurance, asset allocation, profitability, solvency, and compliance.	
DFSA ( <a href="http://www.dfsa.ae">www.dfsa.ae</a> ) Dubai	Dubai Financial Services Authority	The independent regulator of all financial and ancillary services conducted through the DIFC, a purpose-built free-zone in Dubai.	Established in 2004, has a variety of functions, including policy and rulemaking, authorization, recognition, supervision, enforcement, and international cooperation.
DOC	Direction of Compliance	DOCs could be used where there is an immediate threat to the safety and soundness of the institution or in cases where the institution is not being co-operative.	
EC ( <a href="http://www.ec.europa.eu">www.ec.europa.eu</a> ) Brussels; Luxembourg	European Commission	Both the institution and the "college" of commissioners. The main goal is to improve regulatory environment in the EU; must equally represent the common good to all EU countries. The EC is responsible for enacting common EU policies and for managing budgets of the EU.	Composed of one commissioner from each EU country.



ACRONYM (WEBSITE) HEADQUARTERS	FULL NAME	PURPOSE	COMMENTS
ECB ( <a href="http://www.ecb.int">www.ecb.int</a> ) Frankfurt	European Central Bank	The ECB is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power and thus price stability in the euro area. The euro area comprises the 17 European Union countries that have introduced the euro since 1999.	The ECB and the national central banks together constitute the Eurosystem, the central banking system of the euro area. The main objective of the Eurosystem is to maintain price stability: safeguarding the value of the euro.
EIOPA ( <a href="http://www.eiopa.europa.eu">www.eiopa.europa.eu</a> ) Frankfurt	European Insurance and Occupational Pensions Authority	Part of the EU, EIOPA supports the stability of the financial system, transparency of markets and financial products as well as the protection of insurance policyholders, pension scheme members and beneficiaries.	Along with the EC, has developed Solvency II. Formerly known as CEIOPS.
ERM	Enterprise Risk Management	ERM is the discipline by which an organization in any industry assesses, controls, exploits, finances, and monitors risks from all sources for the purpose of increasing an organization's short- and long-term value to its stakeholders.	Four main forces have led to the utilization of ERM: more complex risks, external pressures, portfolio point of view, and quantification.
ESMA ( <a href="http://www.esma.europa.eu">www.esma.europa.eu</a> ) Paris	European Securities and Market Authority	Part of the EU, ESMA ensures the integrity, transparency, efficiency and orderly functioning of securities markets, as well as enhancing investor protection.	ESMA's efforts towards securities legislation contributed to the creation of a uniform rule book in Europe.
EU ( <a href="http://www.europa.eu">www.europa.eu</a> ) Brussels	European Union	Economic and political partnership between 27 countries; developed one single major market with a common currency, the euro. More than just an economic organization, as it addresses a wide variety of issues such as human rights and environmental policy.	Created after the aftermath of WWII; Countries include: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.
FACI	Federal Advisory Committee on Insurance	The FACI will advise the Treasury's FIO, which was established as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act.	The FACI will advise regulators at all levels on prudent measures to safeguard solvency, capital requirements, systemic risk, and other matters affecting insurers.
FATF ( <a href="http://www.fatf-gafi.org">www.fatf-gafi.org</a> ) Paris	Financial Action Task Force on Money Laundering	The FATF is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing.	Formed in 1990, it develops and promotes national and international policies to combat money laundering and terrorist financing.
FASB ( <a href="http://www.fasb.org">www.fasb.org</a> ) Norwalk, Connecticut	Financial Accounting Standards Board	The FASB establishes standards of financial accounting that govern the preparation of financial reports by nongovernmental entities.	The standards are officially recognized as authoritative by the SEC and the AICPA.
FCL	Flexible Credit Line	An FCL is designed to meet the increased demand for crisis-prevention and crisis-mitigation lending from countries with robust policy frameworks and very strong track records in economic performance.	The FCL originated from a G-20 initiative.
FINMA ( <a href="http://www.finma.ch">www.finma.ch</a> ) Bern	Swiss Financial Market Supervisory Authority	FINMA promotes the protection of creditors, investors, and policy holders as well as ensuring the smooth functioning of the financial markets.	The Swiss are not part of the EU and are thus not bound by their directives or initiatives.
FIO	Federal Insurance Office	Created by DFA, the FIO identifies gaps in regulation with systemic implications, coordinates the US insurance sector, identifies to the FSOC insurers that are systemically relevant, represents US in international insurance regulatory interaction.	Excludes health insurance; housed within the Treasury Department
FIU	Financial Intelligence Unit	An FIU is a central, national agency responsible for receiving (and, as permitted, requesting), analyzing and disseminating to the competent authorities, disclosures of financial information: (i) concerning suspected proceeds of crime and potential financing of terrorism, or (ii) required by national legislation or regulation, in order to counter money laundering and terrorism financing.	In 1995, a group of FIUs met at the Egmont Arenberg Palace in Brussels and decided to establish an informal group whose goal would be to facilitate international cooperation. This informal group of over 90 FIUs is known as the Egmont Group.
FRFI	Federally Regulated Financial Institutions	A bank, trust company or loan company in Canada.	OSFI regulates these institutions.
FSA ( <a href="http://www.fsa.gov.uk">www.fsa.gov.uk</a> ) London FSA ( <a href="http://www.fsa.go.jp">www.fsa.go.jp</a> ) Tokyo	Financial Services Authority	The FSA is a common name for a nation's single regulator over stock markets, banks and insurers.	Japan and the UK use this term.

ACRONYM (WEBSITE) HEADQUARTERS	FULL NAME	PURPOSE	COMMENTS
<b>FSAP</b>	Financial Sector Assessment Program	The FSAP's focus is to gauge the stability of the financial sector and to assess its potential contribution to growth and development. This review certifies that a jurisdiction's insurance regulatory process is acceptable according to accepted international standards. Sponsored by the IMF.	FSAPs examine the soundness of financial sectors; conduct stress tests; rate the quality of bank, insurance, and financial market supervision against accepted international standards; and evaluate the ability of supervisors, policymakers, and financial safety nets to respond effectively in case of systemic stress.
<b>FSB (www.financialstability-board.org) Basel</b>	Financial Stability Board	Established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies.	This was created by the G-20 in response to the GFC. Senior representatives of financial authorities, international financial institutions, standard setting bodies and committees of central bank experts. The FSB is headquartered within the BIS.
<b>FSC</b>	Financial Stability Committee	All EIOPA internal market and stability related issues for conducting supervisory tasks are supported by this committee.	The FSC is a committee within EIOPA.
<b>FSCS (www.fscs.org.uk) London</b>	Financial Services Compensation Scheme	The UK's statutory fund of last resort for customers of financial services firms.	There are limits to the amount of compensation the FSCS can pay depending on the claim. Compensation is only paid to cover financial loss.
<b>FSOC</b>	Financial Stability Oversight Committee	Created by DFA, the FSOC identifies systemically important companies; promotes market discipline; and responds to emerging risks to the stability of the United States financial system.	Housed within the Treasury Department; consists of 10 voting members and 5 nonvoting members consisting of federal financial regulators, state regulators, and an insurance expert appointed by the President. Treasury Secretary is chair of the Council, Fed Reserve and SEC Chairpersons are notable voting members.
<b>G-20</b>	Group of Twenty Finance Ministers and Central Bank Governors	The G-20 is the premier forum for our international economic development that promotes discussion between industrial and emerging-market countries on key issues related to global economic stability. The G-20 helps to support global growth and development and to reduce the world economy's susceptibility to crises. Countries reflecting the world's twenty largest economies plus the IMF and World Bank convene annually.	Established in 1999, it grew from its predecessor G-7 which was formed in 1975. The G-20 has no permanent staff of its own. The G-20 chair rotates between members, and is selected from a different regional grouping of countries each year. The chair is part of a revolving three-member management Troika of past, present and future chairs. The incumbent chair establishes a temporary secretariat for the duration of its term, which coordinates the group's work and organizes its meetings.
<b>GA (www.genevaassociation.org) Geneva</b>	Geneva Association	The Geneva Association identifies fundamental trends and strategic issues where insurance plays a substantial role or which influence the insurance sector.	Established in 1973, officially the "International Association for the Study of Insurance Economics", is a non-profit organization funded by its members. The Geneva Association membership comprises a statutory maximum of 90 Chief Executive Officers (CEOs) from the world's top (re)insurance companies.
<b>GC (www.gcactuaries.org) UK</b>	Groupe Consultif (Consultative)	GC is an association of European actuarial associations.	GC provides significant actuarial advice to CEIOPS.
<b>GDV (www.gdv.de/English/index.html) Berlin</b>	German Insurance Association	Articulates and represents the positions of the German insurance industry before society, politicians, businesses, the media and academia, working to achieve regulatory conditions which will allow insurers to perform their responsibilities in optimal fashion.	The Berlin-based German Insurance Association (GDV) is the umbrella organization for private insurers in Germany. Its 469 member companies, with about 217 thousand employees and trainees, offer comprehensive coverage and provisions to private households, trade, industry and public institutions, through about 450 million insurance contracts.
<b>GFC</b>	Global Financial Crisis	The 2008 financial crisis considered by many economists to be the worst financial crisis since the Great Depression of the 1930s. It resulted in the collapse of large financial institutions, the bailout of banks by national governments, and downturns in stock markets around the world.	It was ignited by complex and non-transparent financial instruments, leading to systemic risks due to the interconnectedness of the world's financial institutions. This crisis has motivated many activities which the reader will see listed here.

ACRONYM (WEBSITE) HEADQUARTERS	FULL NAME	PURPOSE	COMMENTS
<b>GIAJ</b> ( <a href="http://www.sonpo.or.jp/en/">http://www.sonpo.or.jp/en/</a> ) Tokyo	General Insurance Association of Japan	The objective of GIAJ is to promote the sound development of the general insurance industry in Japan.	The GIAJ has 5 pillars of activity: Enhancement of Communication with Consumers, Improvement of the Quality of Business Processes and Customer Interrelations, Development of the Business Infrastructure, and Requests and Proposals, Contribution to Safety and Security in Society and the Community, Contribution to the Global Community.
<b>GNAIE</b> ( <a href="http://www.gnaie.net">www.gnaie.net</a> ) New York	Group of North American Insurance Enterprises	GNAIE assists North American and global standard setters and regulators in cooperation with the global insurance industry and with insurance and other financial services industry trade associations.	GNAIE advocates high quality insurance accounting standards, supports high quality insurance solvency standards, and enhances cooperation, education and communication regarding insurance accounting and solvency among the insurance industry's standards setters, regulators, and diverse constituencies.
<b>GSF</b>	Group-Wide Supervision Framework	A supervisory framework for insurance groups that sets out the preconditions for group-wide supervision, group-wide regulatory requirements and group-wide supervisory review and reporting.	The GSF has been established by the IAIS.
<b>G-SIFI</b>	Global Systemically Important Financial Institutions	SIFIs are financial institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity. G-SIFIs are SIFIs on a global scale.	See SIFI for more information.
<b>HHI</b>	Herfindahl-Hirschman Index	A commonly accepted measure of market concentration.	The HHI is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers.
<b>IAA</b> ( <a href="http://www.actuaries.org">www.actuaries.org</a> ) Ottawa	International Actuarial Association	The IAA represents the profession internationally, develops education standards, and encourages research in order to address changing needs.	The IAA is an association of national actuarial organizations from around the world (about 90); it meets in person twice a year.
<b>IAASB</b> ( <a href="http://www.ifac.org/auditing-assurance">www.ifac.org/auditing-assurance</a> ) Washington	International Auditing and Assurance Standards Board	The independent standard setting body which issues auditing, review, other assurance related services and quality control standards to be applied by the global auditing profession.	IAASB is a body initiated by IFAC.
<b>IAESB</b> ( <a href="http://www.ifac.org/education">www.ifac.org/education</a> )	International Accounting Education Standards Board	The IAESB is an independent standard-setting body that serves the public interest by strengthening the worldwide accountancy profession through the development and enhancement of accountancy education, which encompasses professional knowledge, skills, values, ethics, and attitudes.	IAESB is a body initiated by IFAC.
<b>IAIG</b>	Internationally Active Insurance Group	Insurance company groups with a larger presence and high profile in and across numerous countries and markets.	This is the term for enterprises that will be supervised under ComFrame.
<b>IAIS</b> ( <a href="http://www.iaisweb.org">www.iaisweb.org</a> ) Basel	International Association of Insurance Supervisors	The IAIS promotes effective and globally consistent supervision of the insurance industry and fosters financial security.	Covers nearly 200 jurisdictions from 140 countries. The IAIS was established in 1994.
<b>IASB</b> ( <a href="http://www.iasb.org">www.iasb.org</a> ) London	International Accounting Standards Board	Promulgates accounting code for international financial reporting standards; applies to companies around the world.	The IASB has 15 Board members. It cooperates with many political bodies such as the European Union, the FASB, the IAIS just to name a few.
<b>IASP</b>	International Actuarial Standards of Practice	Twelve standards of practice promulgated by the IAA.	These are being phased out, being replaced by either ISAPs or International Actuarial Notes (IAN's).
<b>ICAAP</b>	Internal Capital Adequacy Assessment Process	Australia's ORSA.	Australia's banks also follow an ICAAP.
<b>ICP</b>	Insurance Core Principle	The 28 ICP's are key insurance regulatory and supervisory standards, intending to establish a globally accepted framework for supervision. They will also serve as a benchmark for insurance supervisors in all jurisdictions.	ICP's are created and maintained by the IAIS.

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<b>IFA (www.actuaries.org.uk) London</b>	Institute and Faculty of Actuaries	The IFA is the chartered professional body for actuaries in the UK.	Known in the UK as the Actuarial Profession, it has 22,000 members. The IFA is the name of the merged organization of the former Institute of Actuaries and the Faculty of Actuaries of Scotland. Fellows are called FFA or IFA.
<b>IFAC (www.ifac.org) New York</b>	International Federation of Accountants	IFAC is the worldwide organization for the accounting profession. IFAC serves the public interest by (1) contributing to the development, adoption and implementation of high-quality international standards and guidance, (2) contributing to the development of professional accountancy organizations and accounting firms, and to high-quality practices by professional accountants, (3) promoting the value of professional accountants worldwide, and (4) speaking out on public interest issues where the accountancy profession's expertise is most relevant.	Founded in 1977, IFAC comprises 164 members and associates in 125 countries and jurisdictions, representing more than 2.5 million accountants employed in public practice, industry and commerce, government, and academia.
<b>IFIAR (www.ifiar.org) London</b>	International Forum of Independent Audit Regulators	The IFIAR serves the public interest and enhances investor protection by improving audit quality globally, including through independent inspections of auditors and/or audit firms.	Established in 2006, its members are independent audit oversight authorities.
<b>IFRS</b>	International Financial Reporting Standards	The names of accounting standards produced by the IASB.	Its predecessors were called International Accounting Standards (IAS).
<b>IFSB (www.ifsb.org) Kuala Lumpur</b>	Islamic Financial Services Board	An international standard-setting organisation that promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include banking, capital markets and insurance sectors.	The IFSB also conducts research and coordinates initiatives on industry related issues, as well as organises roundtables, seminars and conferences for regulators and industry stakeholders.
<b>IGCS (or IGS)</b>	Insurance Groups and Cross-Sectoral (Issues) Subcommittee	This committee sets international regulatory standards for insurance companies with global operations.	This originates from the IAIS.
<b>IGD</b>	Insurance Group Directive	A way to communicate interpretations and instructions for implementing Solvency II.	The IGD's come from EIOPA.
<b>IHC</b>	Insurance Holding Company System Model Laws and Regulations	This model law increases oversight of transactions between insurers and affiliates in the insurer's holding company system (including non-insurance affiliates) and gives regulators the power to require from insurers financial information concerning the insurer's non-insurance affiliates.	This model law, passed in 2010, is a part of the NAIC's larger SMI. Regulators can also participate in "supervisory colleges" with respect to insurers that are part of an insurance holding company system with international operations.
<b>IIF (www.iif.com) Washington</b>	Institute of International Finance	The IIF is a global association of financial institutions. Its mission is to support the financial industry in prudently managing risks, including sovereign risk; in developing best practices and standards; and in advocating regulatory, financial, and economic policies that are in the broad interest of its members and foster global financial stability. The IIF strives to sustain and enhance its role on the basis of professional excellence of research, unmatched breadth of membership, extensive relationships with policymakers and regulators, and the strength of governance.	Created in 1983, the IIF's members include most of the world's largest commercial banks and investment banks, as well as a number of insurance companies and investment management firms. Among the Institute's associate members are multinational corporations, trading companies, export credit agencies, and multilateral agencies. Approximately half of the IIF members are European-based financial institutions, and representation from the leading financial institutions in emerging market countries is also increasing steadily. The IIF has more than 450 members headquartered in more than 70 countries.
<b>IMF (www.imf.org) Washington</b>	International Monetary Fund	The IMF is an organization of 187 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.	Unlike the General Assembly of the United Nations, where each country has one vote, decision making at the IMF reflects the position of each member country in the global economy. Its Board of Governors is the highest decision-making body of the IMF. It consists of one governor and one alternate governor for each member country. The governor is appointed by the member country and is usually the minister of finance or the head of the central bank.

ACRONYM (WEBSITE) HEADQUARTERS	FULL NAME	PURPOSE	COMMENTS
<b>IOPS</b> ( <a href="http://www.iopsweb.org">www.iopsweb.org</a> ) Paris	International Organisation of Pension Supervisors	IOPS is an independent international body representing those involved in the supervision of private pension arrangements. The major goal of the IOPS is to improve the quality and effectiveness of the supervision of private pension systems throughout the world, thereby enhancing their development and operational efficiency, and allowing for the provision of a secure source of retirement income in as many countries as possible.	IOPS, formed in 2004, was instigated by the International Network of Pension Regulators (INPRS), an informal network of regulators and supervisors. The organization currently has around 70 members and observers representing approximately 60 countries and territories worldwide, covering all levels of economic development and bringing together all types of pension and supervisory systems.
<b>IOSCO</b>	International Organization of Securities Commissions	IOSCO is an association of organizations that regulate the world's securities markets.	IOSCO comprises over 100 members that regulate over 90% of the world's securities markets. US participants are the SEC, the Commodity Futures Trading Commission and the North American Securities Administrators Association.
<b>ISAP</b>	International Standard of Actuarial Practice	ISAPs are model standards, developed by the IAA, that may be adopted by member associations.	As of 2011, one has been developed and is in exposure status.
<b>JF</b> ( <a href="http://www.bis.org/bcbs/joint-forum">www.bis.org/bcbs/joint-forum</a> )	Joint Forum	The Joint Forum was established in 1996 under the aegis of the BCBS, the IOSCO and the IAIS to deal with issues common to the banking, securities and insurance sectors, including the regulation of financial conglomerates.	The JF is composed of an equal number of senior bank, insurance and securities supervisors representing each supervisory constituency.
<b>LIAJ</b> ( <a href="http://www.seiho.or.jp/english">www.seiho.or.jp/english</a> ) Tokyo	Life Insurance Association of Japan	A public policy organization that focuses on representing industry opinions, conducting research, taking opinions, education, public relations and social services.	Since 1908, the LIAJ has provided for the development of the life insurance industry and maintenance of its reliability. All life companies in Japan are members.
<b>MCL</b> ( <a href="http://www.naic.org/documents/committees_e_capad_RBCoverview.pdf">www.naic.org/documents/committees_e_capad_RBCoverview.pdf</a> )	Mandatory Control Level	MCL is one of the five outcomes of the NAIC's RBC calculation which is determined by comparing a company's TAC to an ACL calculated amount. TAC of less than 70% of ACL requires a regulator to take steps to place the insurer under control.	The five outcomes of the RBC calculation are: (1) No action, (2) Company Action Level, (3) Regulatory Action Level, (4) Authorized Control Level and (5) Mandatory Control Level.
<b>MCR</b>	Minimum Capital Requirement	Part of Solvency II. The MCR is the minimum level of security below which the amount of financial resources should not fall. The MCR will be equal to the Value-at-Risk of basic own funds subject to a confidence level of 85% over a one year period.	When the amount of eligible basic own funds falls below the MCR, the authorization of insurance and reinsurance undertakings should be withdrawn where those undertakings are unable to re-establish the amount of eligible basic own funds at the level of the MCR within a short period of time.
<b>MCS</b>	Market Conduct Subcommittee	This subcommittee of the IAIS Technical committee is charged with developing international supervisory standards on insurers' behaviour in the marketplace.	The subcommittee will consider the market conduct of insurers and intermediaries in the selling and handling of insurance products and services and in disclosure of information to customers.
<b>MoU</b>	Memorandum of Understanding	A general term for an operating agreement between two parties. In an accounting context this often refers to the agreement in 2006 between the IASB and FASB to create a common internationally accepted accounting standard. It particularly creates certain long-term projects for resolving areas of current disagreement that need to be converged, specifically: business combinations, revenue recognition, financial instruments, financial statement presentation, intangible assets, leases, and liability and equity distinctions.	It is much easier to craft an MoU that 200 countries can point to rather than each country legislate 199 understandings. MOUs have been used by insurance and other financial services regulators with regard to information sharing. They are a way for the US states to share solvency regulation information with another country's regulators without having to use a treaty.
<b>MOCE</b>	Margin Over the Current Estimate	MOCE is a generic term developed by the Insurance Contracts Subcommittee of the IAIS to mean the excess of a liability value over the mean present value of future cash flows.	First advanced down under, in Australia.
<b>NAIC</b> ( <a href="http://www.naic.org">www.naic.org</a> ) Kansas City	National Association of Insurance Commissioners	The NAIC is an organization that supports insurance company regulation for the 50 states, 1 district and several territories in the United States. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review and coordinate their regulator oversight.	The regulators meet in person three times a year. The NAIC by itself has no legal authority. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the US.

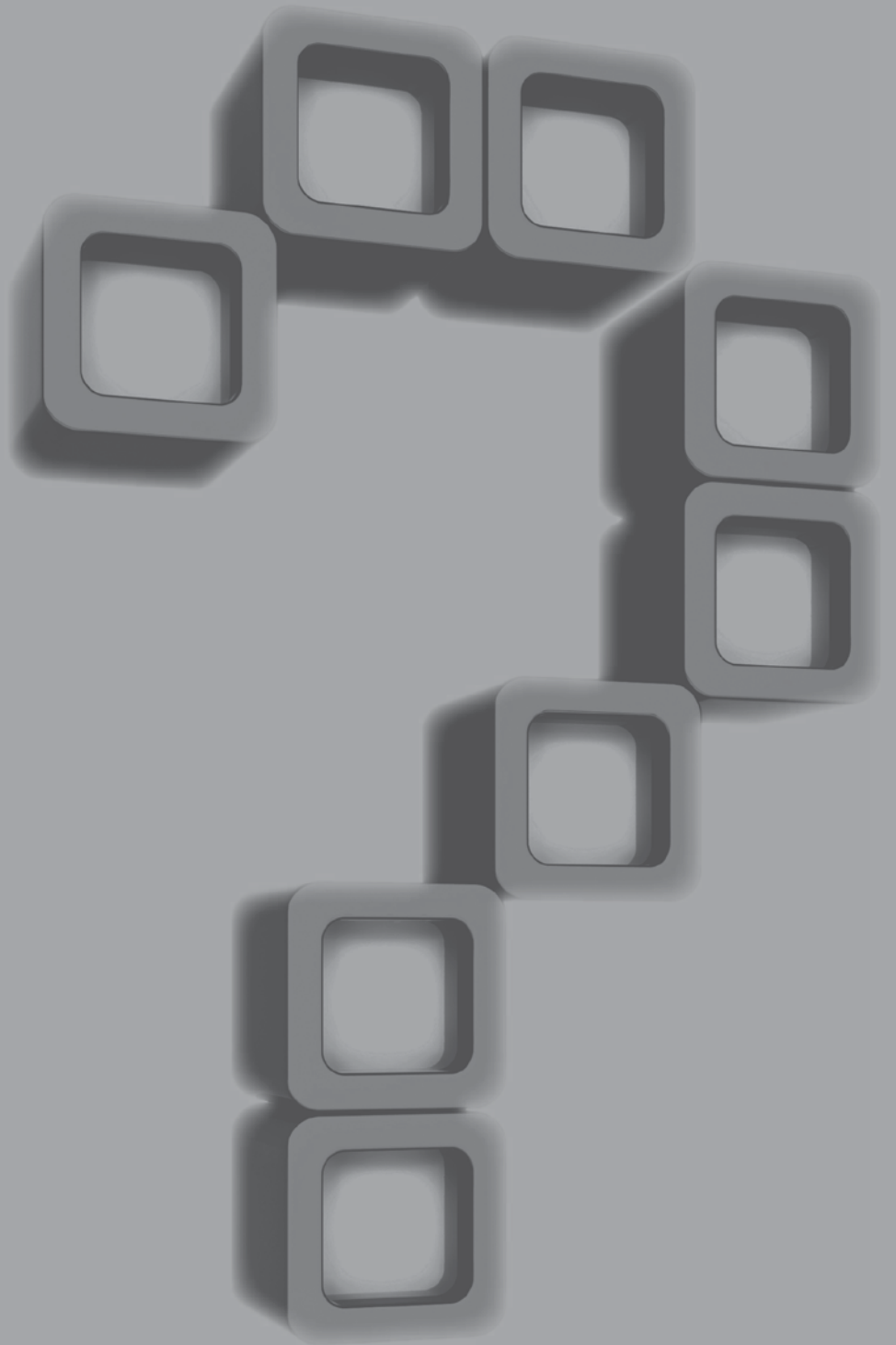
ACRONYM (WEBSITE HEADQUARTERS)	FULL NAME	PURPOSE	COMMENTS
<b>NAMIC</b> ( <a href="http://www.namic.org">www.namic.org</a> ) Washington and Indianapolis	National Association of Mutual Insurance Companies	NAMIC is a trade association for property/casualty insurers in the US. Its 1,400 member companies write all lines of property/casualty insurance business and include small, single-state, regional, and national carriers accounting for 50 percent of the automobile/ homeowners market and 31 percent of the business insurance market. Since its inception in 1895, NAMIC has been advocating for a strong and vibrant insurance industry.	Non-mutuals and reinsurers can apply for membership as well. It is the largest and most diverse P&C trade association.
<b>NCOIL</b> ( <a href="http://www.ncoil.org">www.ncoil.org</a> ) Troy, New York	National Conference of Insurance Legislators	NCOIL helps legislators make informed decisions on insurance issues.	NCOIL exists for state legislators in the US.
<b>NOHC</b>	Non-Operating Holding Company	A corporate entity whose only function is to own other corporate entities.	These are generally formed for tax or regulatory purposes. The term was coined in Australia and exported to the IAIS.
<b>NROE</b>	Non-Regulated Operating Entities	A NROE is a component of a group that is not regulated by any government entity.	The term is used by the IAIS. ComFrame would identify NROEs.
<b>NRSRO</b>	Nationally Recognized Statistical Rating Organizations	NRSRO's are firms that issue credit ratings. The SEC and the NAIC allow financial institutions to use these ratings in the course of determining solvency requirements.	Typical NRSRO's are AM Bests, Standard & Poor's (S&P), Moody's and Fitch. In the past there were fewer NRSRO's, but with the growth of the financial markets, they have increased in number. This is because some of the newer NRSRO's focus on distinct subsections of the fixed income marketplace. For example, Kroll is a newer NRSRO and is noted for its analysis on the municipal bond market.
<b>OCS</b>	Own Credit Standing	The evaluation of whether a company will be able to meet its obligations as used in valuing those liabilities on the company's balance sheet. This usually refers to increasing or decreasing the liability discount rate.	If a company's own credit standing improves, the value of its liabilities on its balance sheet would increase if OCS is reflected in their valuation. The opposite is true as a company's OCS declines. This can create the anomalous situation where a company whose credit standing is worsening shows profits because the value of its liabilities is declining. Changes in OCS will cause volatility as credit standing and credit spreads change.
<b>OECD</b> ( <a href="http://www.oecd.org">www.oecd.org</a> ) Paris	Organization for Economic Co-operation and Development	The mission of the OECD is to promote policies that will improve the economic and social well-being of people around the world. Established in 1961, the OECD has 34 country members.	The OECD provides a forum in which governments can work together to share experiences and seek solutions to common problems. The OECD works with governments to understand what drives economic, social and environmental change. They measure productivity and global flows of trade and investment. They analyse and compare data to predict future trends. They set international standards on a wide range of things, from agriculture and tax to the safety of chemicals.
<b>OFR</b> ( <a href="http://www.treasury.gov/initiatives/Pages/ofr.aspx">www.treasury.gov/initiatives/Pages/ofr.aspx</a> ) Washington	Office of Financial Research	Created by DF, OFR is organized within the Treasury to improve quality of financial data available to policy makers and facilitate more robust and sophisticated analysis of financial systems.	The OFR has two centers: (1) a Data Center to standardize, validate and maintain the data necessary to help regulators identify vulnerabilities in the system, and (2) a Research and Analysis Center to conduct coordinate and sponsor research to improve regulation of financial firms and markets.
<b>ORSA</b>	Own Risk and Solvency Assessment	The ORSA is a process and will likely be performed annually. The ORSA report is prepared by the company and will offer meaningful insights into its risk profile and risk management practices. The ORSA will be used by the regulator as part of pillar two solvency regulation.	ORSA will exist in the US solvency framework. Also, the IAIS' ICP 16 ERM addresses the preparation and use of an ORSA. Components across jurisdictions will be similar but not identical. The ORSA should increase the efficiency and effectiveness of the supervisory review process.
<b>OSFI</b> ( <a href="http://www.osfi-bsif.gc.ca">www.osfi-bsif.gc.ca</a> ) Ottawa	Office of the Superintendent of Financial Institutions Canada	OSFI is an independent agency of the Government of Canada reporting to the Minister of Finance created to contribute to public confidence in the Canadian financial system.	OSFI regulates banking, insurance and securities.
<b>PACICC</b> ( <a href="http://www.paiccc.ca">www.paiccc.ca</a> ) Toronto	Property and Casualty Insurance Compensation Corporation	Mandatory organization that protects Canadian policyholders in the event that their P&C insurance company should fail.	In the unlikely event of the collapse of a P&C insurer in Canada, this industry-funded, non-profit PACICC will respond to claims of policyholders under most policies issued by P&C companies. Coverage is extended automatically to eligible policies.



ACRONYM (WEBSITE) HEADQUARTERS	FULL NAME	PURPOSE	COMMENTS
PCAOB ( <a href="http://www.pcaobus.org">www.pcaobus.org</a> ) Washington	Public Company Accounting Oversight Board	The PCAOB is a nonprofit corporation established by Congress to oversee the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.	The Sarbanes-Oxley Act created the PCAOB in 2002. SOX required that auditors of U.S. public companies be subject to external and independent oversight for the first time in history. Previously, the profession was self-regulated. The five members of the PCAOB Board are appointed to staggered five-year terms by the SEC after consultation with the Federal Reserve System and the Secretary of the Treasury. The SEC has oversight authority over the PCAOB, including the approval of the Board's rules, standards, and budget. PCAOB activities are funded primarily through annual fees assessed on public companies in proportion to their market capitalization and on brokers and dealers based on their net capital.
PCI ( <a href="http://www.pciaa.net">www.pciaa.net</a> ) Des Plaines, Illinois	Property Casualty Insurers Association of America	PCI is a P&C industry trade association that promotes and protects the viability of a competitive private insurance market for the benefit of customers and insurers.	Advocates at the state, federal and judicial levels. Has ten regional offices.
PCR	Prescribed Capital Requirement	From the IAIS, the PCR is a solvency control level that defines the level above which the supervisor would not require action to increase the capital resources held or reduce the risks undertaken by the insurer.	The PCR should be defined such that assets will exceed technical provisions and other liabilities with a specified level of safety over a defined time horizon.
QIS	Quantitative Impact Study	These are studies sponsored by supervisors and regulators to test the impact of proposed initiatives.	QIS's have been most prominently used to test the impact of Solvency II. This term is used in Canada and the U.S. as well.
RAA ( <a href="http://www.reinsurance.org">www.reinsurance.org</a> ) Washington	Reinsurance Association of America	Trade association of property and casualty reinsurers doing business in the United States.	Established in 1968. The RAA is committed to promoting a regulatory environment that ensures the industry remains globally competitive and financially robust, unhindered by conflicting state and federal regulation.
RAL	Regulatory Action Level	RAL is a concept from the NAIC's RBC. There are five outcomes to the RBC calculation determined by comparing a company's Total Adjusted Capital (TAC) to its Authorized Control Level (ACL) RBC. TAC of 100% to 150% of ACL triggers the RAL. At this level, an insurance company is required to file an action plan and the state insurance commissioner is required to perform any examinations or analyses to the insurer's business and operations that he or she deems necessary.	Other control levels include: <ul style="list-style-type: none"> <li>• No action: 200% or more of ACL;</li> <li>• Company Action Level (CAL): TAC of 150 to 200% of ACL;</li> <li>• Authorized Control Level (ACL): TAC of 70 to 100% of ACL, first point that the regulator can legally take control of the company;</li> <li>• Mandatory Control Level (MCL): TAC of less than 70% of ACL; requires regulator to take steps to place the insurer under control.</li> </ul>
RBC	Risk Based Capital	The NAIC's RBC was created to provide a capital adequacy standard that is related to risk, raises a safety net for insurers, is uniform among the states, and provides regulatory authority for timely action. RBC is the NAIC's financial regulatory safeguard to (1) guarantee regulatory action and (2) provide the legal authority to intervene without extensive litigation.	RBC identifies weakly capitalized companies. RBC is typically calculated by applying factors to accounting aggregates that represent various risks to which a company is exposed. Some or all of the RBC could be determined by other methods. One example is the calculation of the interest rate mismatch risk by use of modeled projections using a set of stochastic interest rate scenarios.
SCR	Solvency Capital Requirement	A part of Solvency II, the SCR is the capital to be held in order to ensure that insurance and reinsurance undertakings will be in a position, with a probability of at least 99.5%, to meet their obligations to policyholders and beneficiaries over the following 12 months. That economic capital should be calculated on the basis of the true risk profile of those undertakings, taking account of the impact of possible risk-mitigation techniques, as well as diversification effects.	The SCR should be calculated at least annually, monitored closely and recalculated whenever the risk profile alters significantly. There should be an adequate ladder of intervention between the SCR and MVR.
SEC ( <a href="http://www.sec.gov">www.sec.gov</a> ) Washington	Securities and Exchange Commission	The mission of this US agency is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.	While the SEC has delegated general purpose accounting standard-setting to the FASB, it retains veto power and some interpretation powers. It does have the final word on US GAAP.

ACRONYM (WEBSITE) HEADQUARTERS	FULL NAME	PURPOSE	COMMENTS
SIFI	Systemically Important Financial Institutions	A financial institution important in markets as identified by three criteria: <ul style="list-style-type: none"> <li>• size (the volume of financial services provided by the individual component of the financial system),</li> <li>• substitutability (the extent to which other components of the system can provide the same services in the event of a failure) and</li> <li>• interconnectedness (linkages with other components of the system).</li> </ul>	Systemic risk is the risk of disruption of financial services that is: <ul style="list-style-type: none"> <li>(i) caused by impairment of all or parts of the financial system and</li> <li>(ii) has the potential for serious negative consequences for the real economy. These definitions come from the FSB/IMF.</li> </ul>
SMI	Solvency Modernization Initiative	The SMI is a self-examination of the United States' insurance solvency regulation framework; it includes a review of international developments regarding insurance supervision, banking supervision, and international accounting standards and their potential use in U.S. insurance regulation.	The review has concluded that the U.S. will stay with the RBC concept, strengthening it with updated parameters and introducing an ORSA. A major driver of the SMI has been the need for the NAIC to prepare for the next FSAP.
S I	Solvency I	Solvency I is a method to assess insurer solvency used by countries in Europe.	Under the old Solvency I regime, the formulas applied to Premiums and Claims to come up with a Minimum Solvency Requirement (together with all the asset admissibility rules) resulted in the creation of a number that did not sufficiently reflect the specific insurer risks, in the views of many.
S II	Solvency II	Solvency II is the successor to Solvency I. This initiative harmonizes capital requirements for all insurers in the EU. It has pillars 1, 2 and 3. Pillar 1 quantifies the minimum and desirable levels of capital based on internal models. Stress testing is used. Diversification effects are recognized.	QIS's are still underway, indicating some final tuning is needed. This will be an EU directive but apply to all subsidiaries whether or not they are in the EU.
SOA ( <a href="http://www.soa.org">www.soa.org</a> ) Schaumburg, Illinois	Society of Actuaries	The SOA is an educational, research and professional organization dedicated to serving the public and Society members. The SOA's vision is for actuaries to be the leading professionals in the measurement and management of risk.	The SOA has 22,000 members, mainly in the US and Canada but growing in Asia as well.
SQA	Swiss Quality Assurance	SQA is a qualitative self assessment framework. It is a list of questions that companies have to fill out.	The SQA is a precursor to an ORSA.
SST ( <a href="http://www.finma.ch">www.finma.ch</a> )	Swiss Solvency Test	The SST is a risk based solvency system based on a market consistent valuation standard. It is required for all insurers and reinsurers in Switzerland.	It has been in force since 2006. About 150 companies use it; about 70 apply internal models.
SVO ( <a href="http://www.naic.org">www.naic.org</a> ) New York City	Securities Valuation Office	The SVO is responsible for the day-to-day credit quality assessment and valuation of securities owned by state regulated insurance companies. Insurance companies report ownership of securities to the Capital Markets and Investment Analysis Office when such securities are eligible for filing on Schedule D or DA of the NAIC Financial Statement Blank.	The SVO is part of the NAIC.
TAC	Total Adjusted Capital	TAC is the adjusted capital level that is used in the determination of the RBC ratio in the NAIC RBC formula.	For life companies, TAC = Capital & Surplus + Asset Valuation Reserve + 50% of Dividend Liability + Amount of Capital Notes. For P&C companies, TAC = Capital & Surplus - Non-tabular Discounts + Amount of Capital Notes.
TBS	Total Balance Sheet	A term used to describe approaches to financial analysis, usually focusing on capital. This approach is focused more on the risks than on the accounting rules.	In North America, TBS refers to the amount of assets necessary to meet liability and capital needs. In Europe, TBS means looking at all liabilities, all assets, and then capital, independently. Asset and liability values are based on an economic valuation; capital is the result of applying shocks to that economic balance sheet.
TLTF	Too Large to Fail	Financial institutions that are so large and so interconnected that their failure would be disastrous to an economy.	

ACRONYM (WEBSITE) HEADQUARTERS	FULL NAME	PURPOSE	COMMENTS
<b>TVaR</b>	Tail Value-at-risk	The TVaR for a given percentile in a distribution of losses (for a given time horizon) is the mean or average loss in the distribution beyond the given percentile. For example, a 99% TVaR is the average for the curve beyond the 99th percentile.	Also known as conditional tail expectation (CTE), TVaR accounts for the severity of the failure, not only the chance of failure. TVaR is a measure of the expectation only in the tail of the distribution.
<b>UNCITRAL</b>	United Nations Commission on International Trade Law	The UNCITRAL is a commission that formulates and regulates international trade in cooperation with the World Trade Organization.	
<b>VaR</b>	Value-at-Risk	For a given distribution of loss for a given time horizon, the VaR for a given percentile is the amount of loss at that percentile. For example, if a distribution of losses for a product line for a given period has a loss of \$1 million at the 99th percentile, then the 99th percentile VaR for that time period is \$1 million.	VaR is a threshold value such that the probability that the loss over the given time horizon exceeds a specified value. VaR measures are often criticized for not reflecting the size of the tail risk beyond the given percentile.
<b>WB (www.worldbank.org) Washington</b>	World Bank	The WB is an international financial institution that provides loans to developing countries for capital programs.	WB is owned by its 187 member countries and was established in 1944. Their mission is to fight poverty and to help people help themselves.
<b>WTO (www.wto.org) Geneva</b>	World Trade Organization	The WTO is an organization for trade opening, a forum for governments to negotiate trade agreements, and a place to settle trade disputes. The WTO is a place where member governments try to sort out the trade problems they face with each other.	The WTO is run by its member governments. All major decisions are made by the membership as a whole, either by ministers (who usually meet at least once every two years) or by their ambassadors or delegates (who meet regularly). While the WTO is driven by its member states, it could not function without its Secretariat to coordinate the activities. The Secretariat employs over 600 staff, and its experts — lawyers, economists, statisticians and communications experts — assist WTO members on a daily basis to ensure, among other things, that negotiations progress smoothly, and that the rules of international trade are correctly applied and enforced.
<b>WURA</b>	Winding-up and Restructuring Act	Liquidation procedures for Canadian banks and insurance companies. They are excluded from the more general Bankruptcy and Insolvency Act.	WURA has been neglected and many of its provisions reflect its 19th century origins.



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