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Report on the International Actuarial Association Meeting in The Hague, May 2013

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Actuaries at the meeting of the International Actuarial Association (IAA) in The Hague in May got the message directly from a member of the staff of the International Accounting Standards Board (IASB) that the revised exposure draft (ED) on accounting for insurance contracts would be out in June. And in fact, since the time of the meeting, the IASB has released the revised ED. Internationally active insurance groups are also anticipating expanded reporting on capital adequacy in the near future. These topics headlined the meetings of the Insurance Accounting Committee and Education and Practice Subcommittee (IAC) and of the Insurance Regulation Committee (IRC) in The Hague (den Haag) in May. This report is prepared from information provided by Burt Jay on the IAC and Tom Herget on the IRC.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

The long-anticipated replacement to IFRS 4 is finally within sight.[1] The IASB has released the revised ED, and there will be a 120-day comment period. The IAC's top priority in the near term is responding to the ED. This is in fact the second exposure draft (the third preview if you consider the initial Preliminary Views). The IASB targets certain issues for which it will seek feedback. These are aspects of the ED that are different from the first exposure draft or that have been more fully developed. The IAC has organized to comment on these topics and will likely comment on topics not specifically targeted by the IASB.

The targeted issues and some preliminary views by actuaries are profiled in the following chart (page 23).

The IAC's comment letter will likely reflect the actuarial perspectives shown in the chart. It may also comment on issues that the IASB has not targeted. It will likely include a comment that the IASB and the United States Financial Accounting Standards Board should resolve their differences and adopt a common standard. The IAC has done some preliminary work to write a comment letter and will get started with a special meeting in late July.

SOLVENCY REPORTING

There is clearly a global movement to expand analysis and reporting on solvency and capital adequacy. By now the names of the regulatory initiatives are familiar to reporting actuaries, even those not involved in solvency testing. In Europe, there is Solvency II; in the United States, Own Risk and Solvency Assessment (ORSA)—although this term is also used elsewhere; and in Canada Directive IV.

The effective date for Solvency II in Europe was variously reported as 2014, 2016 and 2017. The 2014 date seems unrealistic, given the common perception, purportedly based on not-yet-published reports of Solvency II studies. If the reports show what was discussed at the meeting, the testing will indicate that many companies have too little capital if the capital ratio (ratio of actual capital to the minimum required capital according to the Solvency II calculations) is based on discounting at risk-free rates. Testing will indicate that more companies generally have adequate capital if the discounting is at risk-free rates adjusted for liquidity and countercyclicality.

As an editorial aside, one is not surprised that the results are sensitive to the discount rate. Deciding if the results indicate a problem with the capitalization of the industry or a problem with the testing criteria may cause the effective date to slide.

In the United States, ORSA is slated for a 2015 effective date. Results of field-testing will be ready in October 2013. U.S. companies are concerned about confidentiality of results.

Regardless of the floating facts about the effective dates, expanded solvency reporting is not far away. The discussions showed that there are a lot of unresolved issues—about operational risk, mortality trends, long-term guarantees, catastrophes, and, above all, discount rates.

As another editorial aside, the profession will be challenged to find practical solutions before the effective date. The issues and topics should sound familiar to

Targeted Issues	Description	Actuarial Perspective
Presenting information on insurance contract revenue.	The approach presents amounts released from the liability for benefits and expenses, the amortization of the contractual service margin and the change in the risk margin as revenue. It also excludes the deposit element of contracts from revenue and expenses. A description of the proposed approach can be found in *The Financial Reporter* issues of June 2012, Sept. 2012 and Feb. 2013.	Most actuaries do not like the earned premium approach that appears in the ED. They prefer premiums as revenue and they dislike disaggregating the deposit element from the insurance element.
Presenting in OCI the effects of changes in the liability due to discount rate changes.	The objective is to have matching treatment of the movement of liabilities and of supporting assets.	Many actuaries believe that there will be situations where matching is improved if the changes in the liability due to discount rate changes is in profit and loss. They believe the proposed treatment should be optional.
Adjusting the contractual service margin to reflect changes in cash flows for future services.	Rather than creating profit or loss in the period in which a change in assumptions is made, the effect of the changes would be offset by an adjustment to the contractual service margin.	This approach is generally liked by actuaries, although some actuaries want to see the effects of changes in discount rates on cash flows (e.g., for interest-sensitive products) in OCI as well, rather than as an adjustment to the contractual service margin, as the ED proposes.
Measuring and presenting cash flows from contracts with contractual link to underlying items.	The board wants to avoid accounting mismatches for contracts for which the cash flows are contractually linked to assets. They propose a mirroring approach under which the movement in the liability is presented in the same manner as the movement in the assets.	There is a lot of confusion about what the IASB expects with contracts that are contractually linked to assets and with respect to participating contracts in general. For example, it is not clear if mirroring means that the liability value is the same as the asset value and if or how the building blocks in fact apply—to the contract as a whole or in part.
Approach to transition—apply standard as if always effective with some simplifications and relief provided.	The IASB's initial proposal was to have no contractual service margin on a contract in effect before the transition to the new rule. Actuaries universally disliked this idea.	Actuaries generally welcome this proposal. The relief is an acknowledgment that the estimate of the contractual service margin may be less precise for contracts in effect before the transition date.

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financial reporting actuaries, even if they are not also the solvency testing actuaries. They are also topics that must be addressed for IFRS reporting. It seems too that there should be consistency between financial reporting and solvency testing. There are economies to be had if common platforms and analysis are used, and the risk of sending conflicting messages if they are not.

The International Association of Insurance Supervisors (IAIS) ComFrame initiative continues to move forward. The IAIS began developing ComFrame, which is a Common Framework for the supervision of Internationally Active Insurance Groups. A Field Testing Task Force has been formed to recruit participants to test and determine the best ways to report on group capital adequacy to regulators. The field-testing will evaluate ComFrame so that it can be modified as necessary prior to formal adoption. The next exposure draft is scheduled for release in September 2013, but may be deferred to November 2013. The IAA will seek ways in which to provide input to the field-testing process, such as input on the use, purpose and value of economic capital models.

OTHER TOPICS

Pension actuaries and insurance actuaries continued their discussion about what would happen if the concepts in the insurance standard were applied to pension liabilities. The focus of the discussion is on risk margins and discount rates. The profession is ahead of the accounting standard setters on this topic. It is not on the agenda of the IASB. However, the implications are potentially huge to many companies and the profession is wise to take up the topic while there is plenty of time for deliberations.

The monograph on discounting is well advanced and may be published by mid-2014. The monograph on risk margins is also progressing and could be published as early as the end of 2014. This timing makes them available for practitioners when they pick up the conversion to the new insurance standard.

The IAA will also commence creating a "purple book," an addendum to the 10-year-old "blue book" that addresses solvency topics. New chapters will include items such as intra-group reinsurance, group solvency, diversification, concentration, dependency of risk, and time horizon. The IAA will also be developing a sample ORSA report, illustrating the value of such a report to regulators and boards of directors. ■

END NOTES

[1] I realize the reader may have heard this before.