SOCIETY OF ACTUARIES

Article from:

The Financial Reporter

December 2014 – Issue 99

IAA Report

By James B. Milholland

Complex models and supranational relations were recurring themes in the meetings and in hallway discussions during the conference of the International Actuarial Association (IAA) in London this past September. The IAA's pipeline of activities that relate to financial reporting is very full. These topics are the subjects of this report.

RECURRING THEME—COMPLEX MODELS AND CURRENT ESTIMATES

Complex models are nothing new to actuaries, but they are becoming ever more prominent. In addition to budgeting and capital planning, they are key to a growing number of compliance efforts. European companies will soon use them for Solvency II. They are key as well to ORSA,[1] IFRS and BCR, all of which are in various stages of development. The models have different objectives, but they have much in common. They all involve projections of estimated future cash flows. When referring to the estimated cash flows or to the value of the estimated cash flows, the term "current estimates" is often used, sometimes as a term of art and at other times simply as a descriptive term.

There are several ISAPs in development that involve current estimates—one on the new IFRS for insurance, one on BCR, and two on ERM. There are also several IANs being written on ERM and IFRS topics, which also involve current estimates. Several committees and task forces responsible for ISAPs or IANs are addressing current estimates. The ASC is taking steps to ensure that guidance is consistent. As we know, "consistent" does not mean "the same." For IFRS, projected cash flows are meant to be expected values, that is, unbiased and with no margin for adverse deviation from estimates. The discount rate for IFRS will follow the principles described in the emerging standard. BCR seems to be headed toward a basis similar to IFRS for the projected cash flows, but with a more prescribed basis for the discount rate. There were discussion and debate in meetings and in hallway discussions about the possibility of having a standard on current estimates to avoid the need to monitor the standard writing for consistency. The ASC has, for now at least, opted in favor of addressing current estimates according to specific requirements in the various ISAPs, believing that this approach is more useful to actuaries in practice.

ISAP 1 contains guidance that is useful when working with complex models. It addresses data quality and assumption setting. It does not refer to complex modeling specifically, and it does not speak to model development, validation or control. The ASC has begun discussions about whether there should be a standard specifically on complex modeling.

RECURRING THEME—SUPRANATIONAL RELATIONS

As an organization of member associations, which are themselves national or regional, the IAA finds that it has much in common with other organizations that have a global or supranational orientation. The IAA had memoranda of understanding (MOUs) with five such organizations; namely, the IASB, the IAIS, the OECD, the ISSA and the IOPS. An MOU creates a commitment for proactive involvement between the two parties.

The relationships with the IASB and the IAIS are of special interest to financial reporting actuaries. The IAA provides regular input to the IASB on accounting topics (not just insurance—more about which later). A representative from the IAA (currently Michelin Dionne of Canada) is on the IFRS Advisory Council, the formal advisory body to the IASB and to the trustees of the IFRS Foundation.

Ian Mackintosh, vice chair of the IASB, was a guest speaker at the IAA meeting. He asserted that the existence of multiple standards increases the cost of capital, but he acknowledged the difficulty of achieving a single set of global standards. Among other difficulties, he singled out the fact that the United States is no longer collaborating on many standards, notably, for example, the insurance standard.

The IAA has observer status with the IAIS, which allows it to closely follow the activities of the IAIS. In keeping with the objectives of the MOU, the IAA is more than a casual observer. For example, the IAA is developing an ISAP on current estimates (the one mentioned above) in support of the IAIS work on capital standards. The work of the IAIS in turn is in response to a request from the Financial Stability Board and the G20 to develop the capital standards. The significance

CONTINUED ON PAGE 20

Jim Milholland, FSA, MAAA, is a retired partner from Ernst & Young, LLP. He can be reached at actuary@milholland.com.

> For now the major activity of the IAC is writing IANs to assist practitioners when applying IFRS.

is that the standards that originate from the IAIS may become required, for affected insurers, whereas the guidance from the IAIS is normally not binding on local regulators or on insurers. Under the principle of subsidiarity, the ISAP of the IAA will not be binding on actuaries, but it will be a model for member associations to consider. Its presence may make it a de facto point of reference for actuaries, notwithstanding its lack of authority.

ACTUARIAL PIPELINE

The IAC has a number of ongoing activities. It continues to monitor the development of the IFRS on insurance. The subject of greatest interest relates to participating contracts. Having discarded the notion of mirroring, the IASB is seeking a single model to fit all contracts, and is struggling to find one. The problems with a single model derive from the multiplicity of participating features and the differing investment strategies. Some actuaries favor the so-called European model (see the position of the DAV as reported in *The Financial Reporter*, June 2014), but the IAC has not embraced the European model and has decided for now not to comment formally beyond what it has already said in its response letter to the exposure draft (ED) (see *The Financial Reporter*, March 2014).

For now the major activity of the IAC is writing IANs to assist practitioners when applying IFRS. The new standard will require modification of the existing IANs on IFRS 4 and the development of a number of new ones. This activity is expected to take place over the next couple of years. The IAC intends for the IANs to be in place as insurers are implementing the new standard. The presumed effective date of the IFRS is 2018, but guidance is needed well in advance of that date. Enough is known about the new standard to allow the IAC to work on many of the IANs. Others will have to wait until the IASB makes final decisions.

IFRS-related work is not limited to the insurance standard. The IASB plans to issue in 2015 an ED on potentially significant revisions to its Conceptual Framework (CF). The CF sets out the concepts that underlie the preparation and presentation of financial statements. It is not a standard, but it provides foundations for the IASB to use when developing standards. The IASB uses the CF to keep the standards grounded in a common set of concepts. One of the proposals of the IASB is to require itself to make clear when it adopts a standard that does not conform to the CF. The interest of actuaries in the CF relates mainly to measurement. Accountants seem to prefer individual contracts and best estimates as the accounting basis. Actuaries generally prefer grouping of contracts and the use of expected values. The earlier discussion paper was encouraging to actuaries (see *The Financial Reporter*, April 2009). It will be interesting to see what the IASB puts into the ED. The IAA is certain to submit a comment letter.

The IASB also has boldly announced that it is starting a research project to look at why discount rates are not conceptually consistent across different IFRS standards (insurance vs. pensions, for example). This project is obviously of interest to actuaries and the IAA will get involved as appropriate.

The IAC has involvement with other supranational bodies. William Hines is on the advisory group to the IAASB. The IAA has provided input in the past on topics such as auditing accounting estimates and the use of experts (such as actuaries).

The IAC, together with the PEB, has discussions with the IVSC. Insurance contracts are not in the scope of the IVSC's mandate, but actuarial input to the IVSC is nonetheless relevant.

The IAC has started following the activities of the IIRC. The IIRC defines an integrated report as "... a concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term." In other words, an integrated report is more than financial statements. The IIRC is working to develop a framework for integrated reporting. The IAA will naturally want to understand the implications to insurers.

Still in the pipeline is the monograph on the adjustment for risk. The monograph is held up by the delay in the finalization of the insurance standard. If the IASB's current timetable for the standard is met, the monograph may be publicly exposed, and perhaps even published, in 2015.

NEXT MEETING

The IAA meets again in April 2015. By then there will be progress to report on all the activities mentioned here.

ACRONYM KEY

ASC - Actuarial Standards Committee of the IAA

BCR - Basic Capital Requirement

DAV - German Actuarial Association

ERM - Enterprise Risk Management

IAASB - International Auditing and Assurance Standards Board

IAC - Insurance Accounting Committee of the IAA

IAIS - International Association of Insurance Supervisors

IAN - International Actuarial Note

IASB - International Accounting Standards Board

ICS - Insurance Capital Standard

IFRS - International Financial Reporting Standard

IIRC - International Integrated Reporting Council

IOPS - International Organisation of Pension Supervisors

ISAP - International Standard of Actuarial Practice

ISSA - International Social Security Association

IVSC - International Valuation Standards Council

OECD - Organisation for Economic Co-ordination and Development

ORSA - Own Risk and Solvency Assessment

PEB - Pension and Employee Benefits Committee of the IAA ■

ENDNOTES

1 Acronyms are defined in the "Acronym Key" at the end of the article.