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International Accounting Standards—Current Developments

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Summary: International accounting standards for insurance are in the midst of being overhauled. Attendees learn the status of recent developments in international accounting standards for insurance, including Phase 1 for insurance companies, the International Accounting Standards Board's likely direction for Phase 2, related activities of the International Actuarial Association, and company implementation issues.

MR. MARK J. FREEDMAN: This session is an update on international accounting standards (IAS) for insurers. I'm a partner and consulting actuary with Ernst & Young. I'm currently the chair of the Financial Reporting Section Council. I'm told my term ends sometime this afternoon in the middle of the section council meeting. I'm also the representative of the Society of Actuaries on the International Actuarial Association's (IAA's) Insurance Accounting Committee.

Tricia O'Malley has been a liaison International Accounting Standards Board (IASB) board member from Canada since 2001. Before that, Tricia was a partner in KPMG's Professional Practice Group. Tricia has been extremely kind to the Society of Actuaries and has appeared at several of our functions.

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†Ms. Tricia O'Malley, not a member of the sponsoring organizations, is liaison board member (Canada) for the International Accounting Standards Board in London, United Kingdom.

Note: All handout materials are available through the link on the table of contents.

Sam Gutterman is a director and consulting actuary with PricewaterhouseCoopers. Sam is currently the chair of the Insurance Accounting Committee of the IAA. He owns a Fellowship designation in both the life and property and casualty (P&C) branches of the actuarial profession. Sam has more letters after his name than the number of letters in PricewaterhouseCoopers. Sam has also served as the president of the Society of Actuaries.

Henry is a vice president in the Office of the Chief Actuary at New York Life. He's now also a new member of the Financial Reporting Section Council.

Tricia will now give you an update from the IASB standpoint on recent activities and talk about potential future directions.

MS. TRICIA O'MALLEY: One of the things that we've learned from our colleagues at the Securities and Exchange Commission (SEC) is that before you say anything to a group like this, you have to say, "This is only my view. It may not be what the rest of my board and staff would agree with." Remember that if you want to say something about what happened in this session, it's what Tricia O'Malley said, not the IASB. This is very important.

I'll start off with a little history. Why are we doing an insurance project anyway? Well, we kind of inherited it. The project on accounting for insurance contracts was begun by our predecessor board, the International Accounting Standards Committee (IASC). When we came to make our first agenda decision, we decided to put it on our agenda, or at least continue to work on the topic, for the same reasons that they put it on their agenda. There was no standard that covered accounting for insurance. There were scope exclusions in all the standards that you would have thought would have applied to insurance contracts, like financial instruments and provisions and contingencies. There was considerable diversity in practice between insurance companies in different countries and, in some cases, between companies in the same country. The accounting that was followed by insurance companies was often very different from accounting for the same things in other sectors of the financial reporting community. More importantly, we came to the conclusion that it was important to have transparent information about insurance liabilities for the financial markets.

Right after we started, however, we ran into a problem. I labeled it "the 2005 problem." It was also an enormous opportunity, of course. The problem was that we started work in the beginning of April 2001, and we made our first actual formal agenda decisions in July of that year. Shortly after that, though this process had been in the works for some time, the European Commission passed the IAS regulation, which says that all listed companies in the European Union must use International Financial Reporting Standards (IFRS) for their consolidated financial statements starting with 2005. That's the big picture principle.

It was possible for individual member states to delay the application of that regulation until 2007 for some companies. Not all of the member states did that. They all had the opportunity to do that. Some of them specifically considered that option and decided not to delay, in particular the Netherlands. If you chose to do that, you could only do it for companies who were public because their debt was listed but not their equity, or if, at the date that the IAS regulation was adopted, the company was already reporting under U.S. GAAP. Australia and many other countries will also have adopted IFRS by 2005, so we had a fairly significant problem, given that all these companies were going to have to report in accordance with IFRS, and yet there were no standards to tell them what to do on accounting for their insurance liabilities.

Given the way our standards are set up, if there is nothing that provides specific guidance, a company is obliged then to go and look at analogous standards, which would be the financial instruments and provision standard, generally speaking. If there isn't anything that they can find by analogy there, they have to go into our conceptual framework. People actually thought that many European companies were using U.S. GAAP anyway for their insurance liabilities and thought that they would be able to do that. The problem is that U.S. GAAP is the third level of our hierarchy. You don't get there until you've already tried to figure things out under the framework, and you're only allowed to use the third level—some other national GAAP that deals with the subject—if it's consistent with the hierarchy. There was a fair degree of debate about whether U.S. GAAP actually was consistent with the conceptual framework.

We split the project into two phases because we came to the conclusion we were never going to get the whole main standard done in time for 2005. Phase 1 had a number of objectives. The most important one was to ease the transition of companies into IFRS without making everybody go through that nasty process of trying to figure out whether their existing policies were acceptable under our hierarchy.

IFRS 4 was the main Phase 1 standard. IAS 39 deals with liabilities for investment contracts, so effectively what we did with both investment contract liabilities and financial assets was remove the scope exclusion from IAS 39. IAS 18, which is our revenue recognition standard, covers the recognition of revenue for services, and financial statement presentation, which is IAS 1.

The other objectives that we had here were to implement some components of where we thought we were likely to be going by the 2005 deadline. We wanted to implement only those things which we were virtually certain we weren't going to change our minds and reverse in Phase 2, because there was no way we wanted to make people jump through two hoops of change, and also changes that we could make without necessarily delaying Phase 2.

Here's the main model (O'Malley slide 1, page 3). The first question you have to ask yourself is: Does this contract meet the definition of insurance that is in IFRS 4, the insurance contract standards? If it does, then you fall into IFRS 4, which means you can continue to apply your existing accounting. There are some modifications to that, like the prohibition on recording catastrophe or equalization reserves, some additional liability adequacy tests and some enhanced disclosures. For a lot of companies, the biggest piece of this for Phase 1 in the accounting for the insurance contracts is, in fact, that the disclosures are way beyond what they're used to giving. But that's how you end up accounting for the insurance contracts. If it's not an insurance contract, it's an investment contract, and it will fall under the financial instrument standards IAS 39 and 32 or the revenue recognition standard in IAS 18.

I should also point out, because Sam just reminded me of it earlier, that those disclosures are the ones that are sitting now in IAS 32, which is presentation and disclosure. We also have an exposure draft out right now, ED 7, which proposes replacing those disclosures and the disclosures now sitting in our standard on financial disclosures for banks, and putting them all into one standard that applies to everybody (not just banks and insurers) that talks about financial risk disclosures. It gets rid of, in fact, a bunch of the detailed requirements that are sitting in IAS 32 at the moment and allows people to talk more about how they identify risk and how they manage it. That's a change that's coming. If you fall out of the insurance definition, you end up in IAS 39, which is where you end up accounting for the investment contracts.

You have another choice to make here. In IAS 39, and I will emphasize here that I'm talking about IAS 39 the way the board wrote it, you are permitted at the inception of a financial instrument to designate it as at fair value through profit or loss. That means that, at inception, you decide that you're going to account for that instrument at fair value, with changes reflected through profit and loss (P&L). That designation is made at inception, and it's irrevocable. If you make that election, you fair value the entire contract. If you don't make that election, the host contract will be at amortized cost. If the host contract has an embedded derivative, that embedded derivative will be at fair value. There are a couple of exceptions to that. In particular, when you're learning about insurance, if the embedded derivative is itself an insurance contract, you don't have to split it. If it's an option to surrender an insurance contract for a fixed amount, you also don't have to split it. Those aren't considered to be embedded derivatives, but the embedded derivatives definition, for those of you who are used to working with FAS 133, is pretty much the same.

In Phase 1 for investment contracts (this is actually going to be for most people applying IFRS), the big piece of the effort in applying IFRS 4 the first time is sorting out which contracts are insurance contracts and which ones are investment contracts. It's not a notion that was very common, I gather, in the European accounting regimes. If you were an insurance company and you wrote a contract, it was automatically accounted for as insurance, as long as it met the regulator's definition of insurance. It's also fairly clear, I think, that the basic philosophy about insurance risk to be an insurance contract is at least on the same page as the

Financial Accounting Standards Board (FASB) definition. It's also clear from the application questions that we've been getting that perhaps some of those companies that reconciled to U.S. GAAP have not been as diligent in doing those splits as they would have been if they had been embedding those reconciled amounts in their actual base financial statements.

In terms of applying the investment contract's notions, carrying the host contract at amortized cost, some of the things are going to change for people. The standard permits the capitalization of transaction costs only for direct and incremental costs, so some people who have been doing allocations of costs are not going to be permitted to do that anymore. You need to consider all of the cash flows in coming up with the amortized cost estimate. If the estimates of future cash flows change, you take the changed cash flows and discount them at the original effective interest rate, and changes in those estimates get caught up through P&L.

The other big issue in dealing with investment contracts, or switching from insurance accounting to investment contract accounting, clearly is the presentation of premium revenue. The inbound cash flow is no longer recorded as a premium. It's more like the bank deposit accounting where you have the inbound cash flow as a liability, and the thing that's recognized as revenue is essentially the service fee income.

If there is a discretionary participation feature in investment contracts, the company is going to have to figure out whether to classify all or part of that as either a liability or as equity, or to split it. The simple presence of that kind of a feature in a contract doesn't make the contract into an insurance contract. If, for example, you decide to put some part of a discretionary participation feature into equity, when you end up coming down to profit for the period, your split of that profit between your stakeholders is going to have to include that equity component of the discretionary participation feature. Clearly, if you've included the feature in as a liability, any amounts attributed to it will already have been deducted in getting down to that profit for the period notion.

I'm showing you this (O'Malley slide 2, page 4) as something that might not be familiar yet to a U.S. audience, because our IAS 1 on presentation already considers minority interest to be an element of equity. Therefore, any amounts attributable to minority interest are an allocation of profit and not a charge against net income in the determination of profit.

That's a fast overview of Phase 1. That is the finger in the dike, the holding pattern that hopefully is going to allow people who have to report under the IAS regulation to make a not-horribly-bumpy transition into IFRS reporting. We have just recently restarted Phase 2, which is to actually come up with a final standard, or at least a longer-term standard for accounting for insurance contracts. We set up a new insurance working group, and we actually expect them to work there. It's a much smaller group than our former advisory group. Sam is one of the members. He represents the IAA. We have participation essentially from all around the world, which is excellent. The meetings are already scheduled, and we're hoping to get a bunch of that input as the board begins to think about the issues that we need to talk about again.

We've said we are taking a fresh start, blank-sheet-of-paper approach to this, but the project has been around for long enough that we've probably identified most of the hard questions. We know what the issues at least; we may not have the answers.

The key issues are measurement, cancellation and renewal rights, the discretionary participation features and performance reporting. My colleague, Mary Barth, was asked at the American Accounting Association conference in August what she thought were our two most important projects. Much to the amazement of a lot of people in the audience, her top pick was insurance. I don't even remember what the other one was, because everybody was so surprised. People said, "Why? What about insurance?" She said, "If you look at all of the other projects that we have on our agenda, every hard issue we're dealing with is in the insurance project. We have a huge gaping hole in our conceptual framework on measurement. Cancellation and renewal rights are key to solving a bunch of problems in revenue recognition in IAS 39 and dealing with the deposit floor question. Discretionary participation features are absolutely testing the edge of our liabilities and equity project and trying to figure out which is which. Performance reporting, as we all know, is an extremely difficult and contentious issue. If we can manage to get through all of this stuff and try to deal with insurance, we're going to have knocked off a whole pile of other, very hard projects that are on our agenda."

International convergence in this area is obviously critically important, because insurance is such an international business. The most important thing that I wanted to point out here, especially for a U.S.-based audience, is that at our joint meeting with the FASB in April (we now meet jointly with them twice a year, April and October), we agreed that there should not be a major project on the agenda of either board that wasn't on the agenda of the other one. We clearly have a problem with insurance because they don't have a project on their agenda, and we're some ways down the road. However, we solved that by adopting something that we're going to call the "modified joint approach."

Generally speaking, what that means is that one board that's already started on something will beaver away at it until they come up with what you would call a "preliminary views document," which we will call a discussion paper, but it will have preliminary views. We'll have the preliminary views of the board that wrote the paper. At our meeting last week in Norwalk, we generally agreed that for a modified joint project, the board that wasn't carrying the weight of the project to start with would issue that document with a wraparound, asking their constituents to respond to it. That would be essentially the first part of the due process, and we would move, generally speaking, from there into the exposure draft stage. The project manager from the FASB is participating as part of our working group. I think it's fair to say that you can believe that the FASB is serious about eventually, in the not-too-distant future, revisiting the insurance accounting under U.S. GAAP.

I said that the key issues include measurement. There are also a bunch of questions, obviously, to ask about measurement. We have to figure out whether we're going to have a single model for all insurance contracts, and, if not, how we're going to separate the ones for which we would have different models. This is one of the major difficulties that we have when people urge us to write principles-based standards and then want us to make differentiations between different kinds of sets of circumstances, because every time you draw some kind of a bright line and you get dramatically different answers, depending on which side of that line you're on, the standard setters spend half their lives writing rules to police the line. To the extent that we can write standards that don't have bright lines and don't have exceptions to the main principles, we're much more likely to be able to keep things relatively simple and relatively straightforward.

We have to ask whether we want the measurement model to be fully prospective. Do we want to measure insurance liabilities directly, or do we want to measure them once and then have things emerge from residuals or allocations? Do we want to apply discounting to all liabilities? To discount non-life liabilities would be a big change in some jurisdictions. Do we want the assumptions to be locked in at some point? Do we want them to be unlocked and, if so, when? Do we want those assumptions to be consistent with market expectations or something else?

We need to figure out what the objective is for risk margins. That's a question that we have to answer under any measurement model that we choose to adopt, under any measurement objective. Do we need to have an explicit objective for risk margins? Should that risk margin objective be to reflect the market price or something else?

When we talk about considering all of the cash flows with respect to embedded options and guarantees, do we consider only the intrinsic value, or do we worry about the time value too? We also have to try to figure out whether the liability measurement should be independent of the measurement of related assets. If not, in what circumstances should they be related?

I pointed out before that we have an ongoing project with respect to financial risk disclosures. That one is hopefully going to be done before the end of 2005, because there are a number of insurance enterprises in Europe that have told us they prefer the disclosure requirements of the new standard to the ones that they will otherwise have to adopt under IFRS 4 and IAS 32. That one is going to be finished rather earlier than these, but we do have another working group dealing with financial instruments. It's a separate group. There are cross-links, both through the staff and through membership. That group is charged to come up with a way to improve and simplify the accounting for financial instruments, mainly financial assets in the medium to longer term. It's not expected to produce anything right off the bat.

When we talk about performance reporting, we've now changed the title of that project. We call it "reporting comprehensive income." The FASB has a slightly different name, but even if you see the two different names, that is now a joint project that we're doing with the FASB, and we are going to do it in two phases as well. The first phase is to try to at least get a common international package of basic financial statements that indicate which line items should be on which financial statements and how many years of comparatives. That sounds kind of trite, but it's not as easy as it sounds. We, for example, have a requirement for a statement of changes in equity. That's an SEC requirement in the United States, not a GAAP requirement, and so those are some of the basic things we have to sort out. The second phase is going to continue with the project that deals with the redesign of the income statement and cash flow statement. That's where we are to date.

MR. FREEDMAN: Thanks, Tricia. Now Sam Gutterman is going to talk about the recent IAA activity related to the international standards.

MR. SAM GUTTERMAN: The first objective of my presentation is to provide some further background of the IAA, and for that, I'd like to have a show of hands. How many people are familiar with the activities of the IAA? Since a little less than half responded affirmatively, I'll provide further background, some of which you are already aware. I will then proceed to cover my prepared remarks and hopefully leave a lot of time for questions and answers to address the issues in which you're most interested. I will cover the topic of IAA and IFRS, the role of the IAA in the insurance accounting projects and a brief mention of some research that the IAA has been conducting.

The IAA, as most of you are aware, has been around for a long time, for more than a century. For a long period of time, the major function of the IAA was to hold International Actuarial Congresses every four years, and they were great fun. But they didn't particularly contribute much other than providing a collegial atmosphere and dissemination of certain research ideas. As a result of the increasing pressure in terms of globalization that Tricia mentioned before, the actuarial profession, through a reconstituted IAA, has gotten its act together, becoming a more useful international body.

Since 1998, the IAA has been organized as an organization of actuarial organizations, with 50 full members from around the world. The minimum requirements for full membership include a code of professional conduct (everyone present should be familiar with that), a disciplinary process (I hope no one here is personally familiar with that), minimum educational guidelines (that goes into effect in 2005) and a due process for actuarial standards. It doesn't require that actuarial standards be implemented in each of these 50 member organizations, but if they do, the organization has to go through a due process for the approval of those standards.

I'd like to highlight two primary objectives of the IAA. The first is to promote high-quality, professional practice amongst actuaries. The second is to represent the actuarial profession on an international level to other international organizations. We have, as members, 35,000 actuaries in about 90 countries. They represent associations as diverse as the Society of Actuaries, with almost 18,000 members, to very small associations, such as the one in Estonia, with fewer than 20. So we have a wide range of member associations in terms of membership, resources and needs.

We also have something that is both old and emerging—individual member sections. Although all Fellows of the Society of Actuaries are automatically members of the IAA without additional dues (they are paid by the SOA), you have to pay additional dues to join the IAA sections. There are now six sections, two of which have been around for at least 50 years: Actuarial Studies in Non-Life Insurance (ASTIN), for non-life practice, and International Association of Consulting Actuaries (IACA), which was just incorporated into the IAA as a section in the last year. One that was formed around 15 to 20 years ago, Actuarial Approach for Financial Risks (AFIR), addresses financial risk. The Society of Actuaries, I'm glad to say, is now catching up to the ideas that have been discussed in AFIR for quite a while, regarding financial risks and risk management. There are three that are quite new, in the last year or so. Health insurance and health care is covered by the International Actuarial Association Health Section (IAAHS). The Pensions, Benefits and Social Security (PBSS) Section held its first meeting last week in Australia, and one entitled Actuaries Without Frontiers (AWF) is just being formed. In addition, there are rumors of a life insurance section that might be born in the next year or two.

The infrastructure of the IAA is based around a council represented by the 50 full IAA members, with 14 committees. These groups generally meet twice a year. The next meeting is in Washington in a couple of weeks. Relative to today's agenda, I would like to focus on only three of the committees. The first is the committee that I chair, the Committee on Insurance Accounting, with a subcommittee on actuarial standards regarding insurance accounting. In addition, we now have separate subcommittees, one that addresses actuarial standards regarding employee benefits, reporting to the Employee Benefits Committee that is starting to look at the need for actuarial standards for actuaries who practice within the scope of IASB's pension rule IAS 19. The second committee is the Professionalism Committee, which provides assurance that the standards subcommittees comply with required due process and are addressing the many current professionalism issues, for which there are many today in all professions. In addition, I am sure that you will be hearing a lot more about these issues in due course. The last committee that I will mention is the Regulations Committee that is dealing with solvency issues relating to the International Association of Insurance Supervisors

(IAIS), of which the National Association of Insurance Commissioners (NAIC) and the Office of the Superintendent of Financial Institutions (OSFI) in Canada are members.

I would now like to discuss the development of IAA's international actuarial standards of practice. Based on procedures that were adopted recently, preliminary exposure drafts of such standards are exposed for a minimum of four months. Depending on the feedback received, we may have to expose them again, or we can have them adopted immediately as a class 4 standard, which is somewhat analogous to a practice guideline corresponding to the Academy's practice notes or guidance on current practice.

So far, we have developed or are in the process of developing two sets of international actuarial standards of practice, both class 4 (Practice Guidelines, or "PG" for short). One is not relevant to the current attendees at this session, but is still worth mentioning as it was a prototype developed two years ago. The first one was entitled, "Guidelines for Actuarial Practice in Social Security programs," originally requested by the International Social Security Association (ISSA). The IAA adopted it in 2003 after about three years of discussion. This provides practice guidelines to those actuaries practicing in the area of social insurance.

The second set will affect far more actuaries. This is the one that we're currently working on, regarding insurance and investment contract practice, which originally was focused on IFRS 4 for insurance contracts, but it also intended to address other related investment and service contracts that are offered by insurance contracts with which actuaries are involved. As I mentioned, the IAA Employee Benefits Committee is starting to work on something comparable with respect to those benefits.

Phase 1 of the IASB's insurance contracts project has been under development for about seven years, but to be fair, prior to the last year or so, the far broader fundamental concepts were discussed. This is what Tricia just discussed. The IAA is attempting to provide guidance through educational material for actuaries practicing in the field, for companies that are implementing international accounting standards. But I have to emphasize that although we are providing assistance and guidance, the definitive source for that guidance and all interpretations are the responsibility of the IASB through its IFRSs and IASs. We are not trying to re-invent the wheel or provide definitive interpretations; we are trying to provide appropriate educational guidance, particularly in pulling together some of the relevant information from several diverse sources.

It is important to recognize what practice guidelines (again, PG, or class 4 international actuarial standard of practice) are and what they are not. They are intended to be educational and non-binding in nature. They represent the current consensus of appropriate practice, without defining the only practices that are applied by all actuaries and without being an interpretation of the applicable standard. As the actuarial profession has found from both Canadian and U.S. experience, typically such a statement is intended to codify existing practice and identify the range of current practice. Unfortunately in this case, we don't have the luxury of observing current practice because these are first-time standards, so we don't have a specific practice to codify or to describe. As a result, we're trying to anticipate what will be practiced beginning 2005.

There are three other classes of international standards of actuarial practice (IASPs). Note that IAA practice guidelines are the "lowest" level of standard, measured in terms of "highest" being the most restrictive and indicative of required practice. The first type is *mandatory*, for which all actuaries practicing in the area covered have to comply. The second is termed *voluntary* on behalf of the actuaries; however, actuaries whose practice is relevant to their scope have to disclose any areas where they don't comply. The third is termed *recommended practice*, which is a description of the profession's expectation of how an individual actuary will practice; the word "should" would be relevant to this type of standard. My committee will likely recommend the proposed PG on actuarial practice be changed to this third type of standard in the matter of the next year or two.

The subcommittee is concentrating its current efforts on a description of the range of actuarial practice with respect to IFRS. The first standard is entitled "Actuarial Practice Under IFRS." This PG is being created because there is now no common actuarial practice infrastructure on an international level to cover things like: who can practice as an actuary; what types of things should be disclosed in an actuarial report or to an actuary's principle; the types or characterizations of assumptions that are likely to be made; how to treat various data issues; and other areas such as reliance and materiality.

These are covered in several countries. The Actuarial Standards Board (ASB) in the United States and the Canadian Institute of Actuaries (CIA) in Canada have existing standards covering many, if not all, of these issues, but there are many countries around the world where they are not covered, who do not have the benefit of such standards. But I have to admit that this is probably the most controversial standard that we're working on. There are significant differences in culture between actuarial practice in different countries, some of whose associations currently believe that this should be a matter of unspoken practice, rather than being codified in writing, and that this PG is not needed, nor is it wanted, and is better addressed in the context of the culture of each country. I certainly respect those opinions. However, we are still trying to develop a minimum level of international practice, particularly in view of some of the significant pressure that professions are under right now. I think this is far more important today than it was even five years ago—developments such as the Morris Commission that is currently reviewing the profession as it operates in the United Kingdom (by the way, I recommend that if you haven't been following its developments, you should do so, because it will affect actuarial practice internationally). This is an area that we as an international profession have to address in some manner.

The second type of standard that we are developing deals with technical guidance and technical practice. They relate to what Tricia just discussed, that is, technical actuarial practice under IFRS. Technical topics include providing supplementary actuarial guidance regarding what the IASB has provided in the area of classification of contracts. Regarding measurement of the liability associated with non-insurance contracts, as Tricia indicated, IFRS 4 generally carved out insurance contract measurement in Phase 1 (relying on existing rules instead for the next several years), deferring their treatment to Phase 2; therefore, these are not anticipated to be covered here.

Current estimates are to be used in a liability adequacy test: What should actuaries consider in developing the assumptions? The liability adequacy testing itself, for which the IASB has provided very broad and brief guidance, is also very important. In many cases, it will be up to the actuaries to try to work through the issues associated with developing current estimates for the purpose of these tests in a reasonably consistent fashion.

The technical guidance and the PGs have either been exposed in September or will be exposed in October or November 2004. Four of them will be likely exposed later on in the year or in January 2005. These latter ones deal with some of the toughest issues, at least from a technical perspective. Included is one covering embedded derivatives in insurance contracts; even though they don't have a wide impact, they certainly are much more technically oriented.

Another deals with disclosure issues, some of the most significant requirements relating to insurers, in areas such as sensitivity testing. Those are also tricky, in that it would be quite easy to write a lengthy book on disclosures each quarter. In attempting to come up with a disclosure statement for insurance contracts, I know that one company developed an initial rough draft of what a disclosure statement would consist, coming up to the hundreds of pages. Is such a document sound disclosure, or is it information overload? This can be a significant issue in determining what constitutes useful information to users. Also, the possible future standards include the topics of business combinations and reinsurance, both of which have some interesting and challenging issues involved.

The role of national actuarial organizations may depend on whether the organization has a rigorous set of standards in the first place. They shouldn't be concerned with issues like qualifications to practice, because they already have national standards that would apply in this area in any event. It may vary depending upon the existence of variations of IFRS in actual application, i.e., whether there is a single IFRS in place or if variations will apply in practice.

Also, they are intended to be complementary to local standards, not to replace sound standards already in place, particularly as they address actuarial practice. One of the operating principles of the IAA is referred to as "subsidiarity," that is, in any situation or regarding any issue that is better handled or is first handled by a local member association, that is where it should be addressed. The IAA should only go into areas where there is no existing applicable standard of practice in place already.

In the United States and Canada, the ASB and the CIA have the ability to modify IAA standards to fit local conditions. Alternatively, they can make them a recommended practice or a mandatory practice if they so desire—that is, put a little more onus on the fact that actuaries will have to comply with the IAA standards when dealing with IFRS issues. They can also rely on existing standards if they believe that they are more relevant to their members. They may also have to provide supplementary educational material to provide more educational guidance to actuaries regarding local conditions or issues. For example, the IAA is starting to develop a practice note (educational material) on stochastic processes because, although these are currently used by some actuaries, there is a wide variety of literature that is accessible to different actuaries worldwide, even though many have not yet applied it. This will initially be more relevant to European actuaries, although North American subsidiaries of European insurers will also be affected.

The IAA has played an advisory role, providing informal assistance to accounting standards setters when we are requested to do so and providing responses to exposure drafts of relevant organizations. In Phase 2 of IASB's insurance contracts project, we will continue to provide an advisory role to the accounting standards setters when we can provide objective and value-added advice. Associated with this effort, we will develop new or revised actuarial standards when appropriate.

The last area that I will address regards research that we have conducted in coordination with the American Council of Life Insurers (ACLI). Henry Siegel has provided actuarial assistance on behalf of the ACLI. We've had two series of research projects and efforts, the first one of which was distributed last year. In it, we focused on the effect of the mismatch of asset and liability valuation methods, such as when assets are valued on fair value and liabilities are valued on a book-value-type basis. The research indicated that such a mismatch created financial results that were not consistent with economic reality.

Although not as thoroughly developed, also discussed was an evaluation of the possible effect of the use of risk-free discount rates for life insurance and annuities. It was found that if a risk-free discount rate was used, in many insurance contracts a first-year loss will be reported; in some cases a significant first-year loss, in cases in which they assume that the business will turn out to be profitable, as many insurance companies anticipate that they will be able to earn interest at greater than a risk-free rate.

The most recent research report, just recently released, focused on two issues—the measurement of renewal premiums and of non-guaranteed elements in contracts. I'm not going to cover these issues in depth, but we did conclude that in many instances, the financial results may turn out to be misleading to some if those two issues were ignored.

In this project, we studied a typical universal life (UL) contract issued in the United States. We studied three alternative approaches of recognizing renewal premiums and their effect on expected earnings. The first was to ignore their recognition until received. The second was to recognize the amount of expected renewal premium, while the third only recognized the minimum required premium level that would keep the contract in force. Many actuaries wonder why this subject even needs to be discussed, as the answer seems obvious. Why is this an issue? The problem is that these renewal premiums are not guaranteed; they don't have to be paid and thus are not under the control of the insurer. The definition of an asset is that it has to be under the current control of the entity. In fact, in sales illustrations, policyholders may not desire to pay a premium.

So the question remains: How should you recognize renewal premiums—as a contra-liability or an asset? How do you recognize something if you don't have control over it? Currently, a fundamental difference in approach between accountants and actuaries is that accountants say, "First you have to decide whether something should be recognized." In contrast, an actuary would typically say, "It's there, so you have to measure it." In addition, if you can't recognize expected premiums, an unwarranted loss at issue may arise, possibly a significant one, just because you cannot expect future revenue that will help provide for insurance risk for which an insurer has to provide. If you can only recognize the minimum required premium, you get a little bit less unusual pattern. In any event, the point is that the interpretation of results using some approaches may be quite difficult and possibly misleading.

The effect of non-guaranteed elements is somewhat different than what Tricia mentioned when she described discretionary participation features (they provide a guaranteed return to the policyholder of a certain percentage of profits from the contracts). There are not that many U.S. insurance contracts currently issued with such a discretionary participation feature, but one example is a universal life contract with a maximum cost of insurance. In this case, if you recognize guaranteed maximum charges in a contract in a prospective measurement, what you might get is a large profit at issue, unless you decide that no profit should be recognized at issue at all. In addition, if you anticipate paying future excess interest payments or dividends but are not able to recognize them, the insurer will recognize an initial profit at issue, which many people think is improper because the company will anticipate, based on current conditions, that a certain level of excess interest will be paid in the future.

In Gutterman slide 1, page 11, the blip on the green line in year 10 arises when the company realizes that, based on historical experience, the policyholders will be required to pay greater premiums in order to keep their policy in force for the entire coverage period. In summary, the treatment of renewal premiums and non-guaranteed elements will determine whether you'll get very unusual and possibly misleading reporting results.

If you are interested, copies of these reports are available on both the IAA and the ACLI Web sites, or, if you want me to send you a copy, I can easily send them to you. Both of these issues that Tricia mentioned will have to be thoroughly discussed over the next year or so.

As my last point, I would like to indicate that we need further research in this area. I very strongly encourage association committees, individual actuaries and industry associations to conduct further research as the IASB continues with its Phase 2. It's very important to have practical examples of the possible effects of their future decisions. Although it's very useful to examine and agree upon principles from an ivory tower point of view in some cases, as we certainly have at the IAA, only through case studies or real analysis can the best approaches be found and analyzed. Field tests, case studies and examples are really important. I hope that the IAA will continue its efforts in this area. Others, such as the SOA, have put on several seminars on the subject of fair valuation and related topics. We continue to hope that more useful discussion and study of the issues involved will be held in the future.

MR. FREEDMAN: Thanks, Sam. Now Henry is going to talk about how U.S. insurers are viewing all of this activity.

MR. HENRY W. SIEGEL: How many people here know what FRED is? Okay, good, because I didn't know what it was either until I got a thick book labeled "FRED 30" something or other. FRED stands for "Financial Reporting Exposure Draft." It's what the British Accounting Standards Board calls its exposure drafts. Another acronym that I thought nobody might be familiar with is IAIS, which is a very important organization that not too many people know. How many people know what IAIS is? It looks like four. Okay. Think of the NAIC multiplied by 120, so you can see how much trouble they can cause. They have a very big problem, because a lot of countries use GAAP, or whatever their local GAAP is, as their statutory accounting, unlike the United States, which has separate standards. So if you change international accounting standards, you change their statutory accounting. Their concern is that what is done makes sense for statutory as well as public reporting.

I have to make the same kind of comments that everybody else has made here. What I'm saying here, unless otherwise noted, are my own positions. They are not the positions of the Academy, the Society, New York Life, the ACLI, the IAA or the Group of North American Insurance Enterprises (GNAIE), about which I'll talk in a second.

The purpose of my talk is to talk about some of the reactions to the IASB proposals in the United States. At the end, I'm going to talk about a possible actuarial approach that I think has some potential for providing an overall result that might make some sense. It would be easy for me to overstate the reaction to IAS in the

United States for the first two or three years that it was in place, because there was almost none. That's what the first part of my talk says. There are a bunch of reasons that you could think of for that, but the key thing that has happened and has changed that is something to which Tricia referred. International accounting or insurance accounting is going to become a joint project of FASB and the IASB. A joint project means that it's coming here. The IASB is starting the project. They're going to put out the first set of initial positions, but then FASB is going to join in, and whatever is going to end up as a result is very likely to be adopted by FASB as accounting for in the United States. So if the United States wasn't paying attention before, you all ought to wake up, because it's coming, whether you like it or not.

As a result of the fact that not too many people were paying attention, a group of companies that were paying attention formed GNAIE. The members are: ACE, AIG, Allstate, ERC, GenRe, Hartford, Liberty Mutual, MetLife, New York Life, Prudential and XL. I apologize for the name, but we had a very long committee meeting to try to figure out what the name would be, and this was the camel that came out. We are a group only dealing with insurance accounting internationally and domestically now because it's a joint project. We fully support the development and convergence to high-quality global insurance accounting standards. We're going to do research in areas where there is concern, whatever proposals come out, and we are coordinating with other interested parties.

GNAIE has a Web site (www.gnaie.org). You're welcome to visit the Web site. There is a report that is on the Web site about financial reporting modeling for P&C, which I know nobody here is terribly interested in except Sam, who is interested in everything. But you're welcome to download it. The last time we looked, it had something like 400 downloads of a 120-page document. I kind of fell over when I heard how many downloads had been on it.

I want to point out that we had a meeting of GNAIE this morning. I wasn't sure that I was going to get here on time, and the one thing that everybody on the call told me was that I should thank the IASB, the staff and Tricia as representative. There are three members of GNAIE who were on the working group that she mentioned. We appreciate very much (because it didn't look like it was going to go this way) that the IASB has agreed to basically start over and rethink all the positions and all the issues on insurance accounting. At one point in January 2003, there were some tentative positions taken that we thought had real problems with them. Basically they said, "Okay, we're going to back up and start over again. We're going to listen to what the preparers, the users and everybody else say, and we'll try to come up with something that everybody can live with." We really appreciate that. Here I'm talking on behalf of GNAIE.

So now I had a problem. I gave a talk on international accounting to the ACLI annual meeting about a year ago. Eight people showed up, which shows you how interested they were. One of the eight people asked me, "So, Henry, what do you think accounting for insurance really should be? You don't like the IASB; nobody really is in favor of that. People complain about GAAP daily. Anybody who has ever tried to do a FAS 97 unlocking on a UL contract probably thinks that there are better things they could do with their lives. So what do you think is the right answer?" I said, "Well, you should let the actuaries do it." I didn't have a good answer and I knew that would shut him up, but I also knew that actuaries didn't have an answer either. So I said to myself, "Okay smart guy, you said this, now what do you really think it's going to be?" Let's go back to basic principles. I think I can get agreement from actuaries in the entire world that the reserve for an insurance policy should be equal to the present value of future benefits and expenses minus the present value of future premiums. I think that's a principle on which I can get an agreement.

I said that's one principle. Now what's the other principle that I think is important? The other principle I think is important is that you shouldn't have any gain or loss at issue. If I sell you a life insurance policy, that's a free market transaction. You presumably are paying what you think the insurance policy is worth. Ignoring buy and sell spreads, that's pretty much a fair market value. There shouldn't be a gain or a loss at the moment of sale. Now there are exceptions to that. We all know of companies who sell no-lapse guarantees at a loss. We all know companies that sell disability income premium at a loss, because they think they're going to get other business with it. We're not talking about that; we're talking about normal policies that people think they're going to make money on. So this is what we said: let's take those best estimate assumptions and let's increase them by margins, so that in the end, the present value of future benefits and expenses equals the present value of future premiums at issue. We'll do the discounting the way we do it at pricing. I mean, people get very upset about how you discount things. We all know how to discount things, because we do it all the time. Pricing actuaries discount things—you price it on the basis of what you think you're going to earn, right? So we'll do that, we'll tie it all into pricing assumptions, and we'll just have prospective unlocking because I can't deal with FAS 97 retrospective reacting. I'm not going to worry about deferred acquisition cost (DAC), because DAC becomes a geography question for the most part. Maybe an important geography question, but a geography question.

If I do that, what kind of results do I get? I wasn't able to put the graphs in, but I can tell you what it looks like. If you look at, for instance, a 20-year term policy, under U.S. GAAP, it starts out pretty high and comes down slowly, because a lot of the margin runs off as premium. It's not a complete straight line, because you have the provision for adverse deviations (PADs) running out, but it starts out pretty high and comes down. On the proposal that I put together, where most of your margin is based on mortality, the curve is much more deferred. Earnings are much more deferred. But it looks like a nice curve, and it works very well if your mortality goes bad (as reinsurers have found out does happen) and you unlock. You get a loss in the year that you unlock, and then from then on, things work out pretty well.

The interesting thing is that we did a UL contract, and there again GAAP earnings emerge in accordance with a bunch of margins. One of the margins is surrender charges. When do surrender charges happen? They happen in the beginning because that's when (a) you get a lot of surrenders and (b) you have surrender charges still in place. So the earnings on GAAP tend to be front-end loaded on UL, much more than I would have expected.

Now we picked a particular set of assumptions, and I know that if you pick a different set of assumptions for pricing you get a different result, but that's what we got. For the project as I put it together, it was, again, much more of a deferred curve, where it's much more related to the risk involved, namely the amount of reserves and the amount of face amount. There's a lot of work to be done on this, but that's work that is ongoing and that we're thinking about.

In conclusion, we need to work out an acceptable basis. As actuaries, it's critical that our voice be heard, because if we don't do it, the accountants are going to do it for us, and we'll get FAS 97 with retrospective unlocking again, and nobody will be happy with it.

My boss has often told me that international accounting is a black hole as far as you can turn. If you get too close to it, you get sucked in and you never get out. I can only tell you that the amount of paper that I get on international accounting work is just unbelievable. We need more help. You can help at the Academy. You're going to be able to help soon at the Society. You can help at the IAA. If there is anybody who wants to get copies of those drafts and wants to comment on them, Sam will be glad to give them to you and I'll be glad to give them to you. If you are the chief financial officer (CFO) of a company and you want to join GNAIE, you're welcome. This is any insurance company domiciled in North America. That includes Bermuda, the Cayman Islands (I think) and Mexico. Join us. We're trying, again, to help the industry as a whole.

MR. STUART F. WASON: I'm one of the three who knew IAIS or could say it with great speed, having practiced it a lot in the last couple of years. I've been active on the IAA solvency side of things. One of the papers produced by the IAA in the last year was one that was written at the request of the IAIS on the topic of solvency. The paper was one that was to describe a global framework for solvency assessment. One of the principles that's in that paper talks about a total balance sheet approach to solvency assessment. Tricia, also let me pass on my congratulations. I'm so glad the IASB is taking a fresh look at all the issues. There's a lot of goodwill on all sides, I think, to come to an effective resolution. Going back to your presentation, I notice one of your key points on Phase 2 was with respect to whether there should be an independence in the calculation of the liabilities, independence from the valuation of the assets. I was wondering if you're going to have, instead of that point, one that would talk about consistency of treatment of assets and liabilities?

MS. O'MALLEY: Consistency of treatment, independence of measurement—I'm not sure exactly how they're the same or different. I think the reason the issue arises from an accounting point of view is that, generally speaking, the measurements of assets and liabilities are independent. To the extent that in some particular case they're linked, we have to figure out in what circumstances and why. That's really the question. It's going to be a tough one because we know (it's one of the things that has come up, I think, probably since the beginning of the project) that in the valuation of insurance liabilities for pricing, running the company and solvency purposes, often asset rates are taken into account in valuing the liabilities. That is not the normal accounting model, and so that's why it's a huge question for us and not for you. Like so many of the other issues, they're big questions because we're trying to fit stuff that's very familiar to you and principles that you've been working with for years into an accounting framework that wasn't necessarily built to deal with them. That's the fundamental issue. That's why it's so important that we work together on this stuff.

I know from talking to some of the people who have been involved with our committees and advisory groups for years that it took them two or three years of talking to accountants before they figured out why we were so pigheaded and unable to understand the issue. It's just because you really have to understand the conceptual framework that the accountants are working from to try to figure out why some of this stuff that is obvious is not so obvious.

MR. WASON: Thanks. Just to be clear on my question, it was, I guess, the concern coming from the solvency side as (trying to put it in simple terms), if there are three different methods allowed for valuing the asset side of the balance sheet and there's one approach for valuing the liability side of the approach, there's going to be an inconsistency. That's one example of an inconsistency between the treatment of assets and liabilities.

MR. GUTTERMAN: This represents a real challenge to the two professions. No one (certainly not actuaries) wants misleading financial statements. Therefore, it's an important issue to thoroughly discuss and develop a sound, jointly developed solution. It has to be remembered that if a decision is made in one way for insurance, it will be difficult to avoid the fact that other financial institutions or other companies would have to be subject to those rules. Some who are involved in accounting discussions can't understand what is so unique about insurance. Although those of us involved in insurance understand its unique nature (i.e., its long-term nature involving significant uncertainties and risks), it can be difficult to describe what is so unique about it. This is certainly an important issue. Possibly the use of replicating portfolios might have some use here, an approach that the IAA described about seven years ago. In addition, we have expressed the opinion that it is important to be able to recognize assets and liabilities measured in a consistent manner, because otherwise, misleading results might arise.

MR. MARTIN E. UHL: I'm with Aviva Life. As a subsidiary of a European parent, I'm wondering if there has been any more talk or interest in going to a type of embedded value approach on IASB?

MS. O'MALLEY: There are a number of features about embedded value that are common to the tentative conclusions that we got to in January 2003. There are also some things in it that are not consistent. That's why IFRS 4 says that if you're already using embedded value in your main financial statements, you can keep on doing it, but you can't adopt embedded value as a change in accounting policies, unless you leave out some of the features of embedded value like future investment margins and some of the other stuff that we don't think belongs there. At least, that was the tentative conclusion before. There are, in fact, some things about the embedded value models, particularly as they've been more standardized through the work by a lot of the European companies to try to get a consistent way of doing it, that actually are consistent with where the original Draft Statement of Principles (DSOP) thinking and then the board thinking was going, so I wouldn't be surprised if some of those notions end up getting carried forward into the final standard. But it's hard to say that embedded value as sort of undefined as it is today would end up in the standard.

MR. DAVID K. SANDBERG: My question is for Henry, if you're willing to speak on behalf of GNAIE, or at least your understanding of where GNAIE is going. As you went through, you talked about here's kind of the first-blush actuarial look at how to handle insurance accounting. One of the things that Tricia emphasized in her presentation is that in reality, all the hard questions are in here. So at the end of the day, for us to come up with something, we have to be able to do something that talks about performance measurement, that talks about how to define or understand what is an insurance contract, versus something else. I'm curious to know where GNAIE is at, as far as working through one more step back, which is: How does this fit into a larger context of performance reporting and revealing what's going on? You mentioned, for example, that you don't want too much volatility, but you also mentioned there are some bad products out there that have guarantees in them. The question I have is: How do you design, then, the process that's going to identify those pieces? My question isn't a specific one, but I'm curious about where GNAIE is at. Are you focused so far on a basic insurance approach, or are you also asking what this will mean about performance measurement and how do I tell what's traditional insurance versus something that may be more financial in nature?

MR. SIEGEL: We're still in the beginning stages, but, basically, I think that if you take what I outlined before, you end up with an approach that answers all of your questions. Or, if it doesn't answer your questions, it gives you the opportunity to answer them. For instance, as far as revenue recognition is concerned, take the normal premiums, normally recognized over time, the way we do it today for FAS 60. We would just probably continue doing that.

MR. SANDBERG: So UL would fit in that as well then?

MR. SIEGEL: UL would fit in that as well. The whole point is, if you get the liabilities right, the revenue recognition, in a sense, is a balancing item. What are some other tough issues?

MR. SANDBERG: The revenue is part of it. The other piece of it is trying to make clear what business decisions a company has made.

MR. SIEGEL: I'm going to give you my personal view (after talking with a lot of people), which is that you're going to end up with a dual system. You're going to end up with some kind of an income statement on some basis—I hope it's something similar to what I pointed out—and you're going to have a disclosure of embedded value. The combination of the two of them will give you not only what is kind of an ongoing annual thing, but it will also give you a feeling for what the company is worth and how decisions you made during the year affected that value. Is that what you were going for?

MR. SANDBERG: My concern is that it's just trying to step back, and the question of performance. How do I tell if premiums are an income item, and is that indicative of performance?

MR. SIEGEL: The whole approach I outlined out there is very bottom-line-oriented. It says that if we don't get the right bottom line, it doesn't matter how the little pieces fit together. We're going for bottom-line results that make sense, so that I never again have to have a CEO stand up there and say, "We had a terrific year, sales went through the roof, but by the way, our earnings went down." That's not an acceptable answer.

MR. GUTTERMAN: The IAA has not yet developed a definitive position on this subject. In fact, it will be a challenge to get all of our national members to agree on any approach. Nevertheless, we will attempt to address this on a principles-based approach to address the important issues involved, but we know that developing a single set of standards is quite difficult. We don't particularly want to have a different standard for insurance contracts and for investment contracts; if significantly different, many disagreements will likely arise regarding how to distinguish between the two. We'd like to be able to have a seamless system, so that the whole system works together.

These are also some of the challenges confronting the IASB, and I appreciate the fact that the IASB seems to be willing to look at some of the significant framework issues on a longer-term basis to try to deal with some of these issues that are standing in the way of the development of a more comprehensive approach. So as we search for the "ultimate" solutions for insurance contracts, we should also search for a more comprehensive solution that recognizes the economic and business reality of business transactions.

MR. DAVID J. MERKEL: I'm an actuary, but I'm also an equity analyst right now.

I'm the one who uses these things, and I used to use them before as a corporate bond manager, as well. My first thought is that you're always going to have a need for some form of historic cost-type accounting, because most of the debt covenants out there are based on that and are defined that way. A lot of companies that have issued debt with covenants are going to be forced to at least continue to do parallel accounting for some time, at least for the debt holders.

Secondly, as an equity analyst, most of the analysis that I see, at least here in the United States, is to try to develop your estimate of run-rate earnings, whether pre-cash-flow-based or just try to get to some sort of operating earnings level. I actually discount that and don't use that to the same extent. But regardless of what is done, here in the United States, there's going to have to be a huge mindset shift among analysts, if they ever have to move to a more market-value-type or fair-value-type standard, as to what they really think is the continuing margin. That will be a huge shift.

Alternatively, some people who are equity analysts in other parts of the world focus more on embedded value now as it is and will value companies relative to a multiple of embedded value, based on how sustainable they think the increment to embedded value will be over a period of time. So, what I come to finally is this: when I analyze companies, I look at GAAP and I look at statutory as well, since that's the lifeblood. I have no problem looking at dual statements. It wouldn't bother me at all if we had one set of statements that were, say, the historic cost held to maturity statements, a balance sheet and income statement, get rid of FAS 115 on that one, and then on the other side, have an embedded value, balance sheet and income statement, and disclose both. The statement and cash flows will be the same for each one, and the statement of shareholder's equity will be the same. In the end, you end up with two sets of statements and then both sides can be happy. One side uses one part when it makes sense, and the other side uses the other part. More information is better; however, it's more expensive.

MS. O'MALLEY: Henry was joking with me before about once we're finished, we'll reduce the amount of disclosure to 200 pages. I think you just doubled it again. He's not going to be a happy camper. I'm actually very glad to meet a user of financial statements, because, especially in this area, they're as scarce as hens' teeth. It's not just important for the actuaries and the accountants to be sitting around trying to figure out what we think is the right answer, but it's critically important that we hear from the people for whom we're producing all of this information, who make judgment calls about share price and whatever.

I think I should say first off, on the question about moving models and debt covenants, it is explicitly in the IASB's conceptual framework that we expect that preparers of financial statements know that accounting changes over time. If they want to write covenants based on existing GAAP and freeze them, then the consequences of moving GAAP is that you're going to have to keep two sets of books. I think it's also true, based on some research that I've seen in the accounting area, that the United States has much more of that frozen GAAP kind of covenant than other countries do. Certainly in my country, most of the covenants based on GAAP are continuous GAAP covenants, which cause you a huge problem when GAAP changes and you have to re-negotiate them, but at least you're not stuck keeping two sets of books every time the rules change.

I agree with you that it would be possible to do more than one set of reporting. I think one of the concerns that we have with alternative measurement systems is that people want to know what the right numbers are. Sophisticated financial statement users have the ability to sort that out and pick which information they feel is more relevant for which purpose, but I think, unfortunately, that we're going to have to come up with one answer. We desperately need the help of the financial statement user community to figure out which way of presenting that information is going to be the most relevant.

MR. GUTTERMAN: I note that certain regulators such as the SEC frown on alternative financial reporting measures.

MR SIEGEL: But the SEC did say that you could disclose embedded value in your management discussion and analysis (MD&A), if you want.

MR. MERKEL: I understand what you're saying. It's just that we're using one set of statements to try to answer different questions. Debt holders have different interests than equity holders. People who are holding for a long period of time have different interests than those people who are trying to do short-term sorts of things. We're trying to make one thing do too much.

MS. CAROL A. MARLER: It troubled me a lot when I heard the comment that if we discount at the risk-free rate, we show a loss at issue. I wanted to get a little clarification on that. Is this loss at issue coming about just because of a difference in the discount rate, or are we also making some changes in other assumptions that generate that loss at issue?

MR. GUTTERMAN: That's a good question. I think the answer depends in part on your point of view and in part on the fact that using a non-risk-free discount rate can be viewed as anticipating future profits. Many accounting standards setters do not want to anticipate any future profit. This is an issue that so far has not been thoroughly addressed. In addition, the practical aspects of measurement of a discount rate has yet to be thoroughly explored. On what basis?

Some people strongly believe that you have to use a risk-free discount rate. I happen to believe that we need to thoroughly examine this issue and its ramifications. Its use in life insurance can lead to losses at issue when economic losses are not grounded in any economic reality. In fact, some like to use embedded values because it can appropriately recognize a truer reflection of the expected profit at issue. I am not particularly interested in a system where the information provided is a loss on all your new business.

MR. SIEGEL: Let me just clarify one thing. The particular instance that Sam was talking about was a single premium intermediate annuity. Nobody prices their single premium intermediate annuities based on a risk-free government return, because you wouldn't sell any.

MS. MARLER: Right, and that was my question about whether it was the return or the discount rate that was causing it.

MR. SIEGEL: It's both.