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Mind The GAAP: U.S. GAAP for Asian Products and Insurance Companies

by Donovan North

I. Introduction

Increasingly U.S. GAAP is becoming more important to insurance companies in Asia. This is mainly due to:

- The quest for external finance. The largest markets for capital in the world are in the United States. Non-U.S. companies that register with the Securities and Exchange Commission (SEC) must file either full U.S. GAAP statements, or their annual local accounts together with a reconciliation to U.S. GAAP. In either case, a full U.S. GAAP conversion is usually needed in order to carry out this reconciliation.
- The use of U.S. GAAP financial statements by multi-nationals. The U.S. parent companies of foreign subsidiaries may have to prepare U.S. GAAP financial statements for those subsidiaries and include the results in the consolidated returns.
- The current de-facto International Accounting Standard being U.S. GAAP. The International Accounting Standards Committee is preparing an international approach to accounting for life insurance contracts, but this will take some time. It is also uncertain until the completion of the international standards whether the SEC will approve of the international standard for listing in the United

States. In the mean time, U.S. GAAP will remain not only the required basis for financial statements in the United States, but also the basis on which a company looking to raise external finance from an international source would consider producing its financials.

II. U.S. GAAP—Brief Background

This paper will not attempt to go into any great detail concerning the intricacies of U.S. GAAP, rather the intent is to examine the broader issues facing a company that is new to these concepts.

In the past, Asian companies have been exposed to local reporting requirements, emphasizing solvency and balance sheet results. The asset and reserve valuation methodology, basis and formulae may have been defined for the industry. A conservative reserving basis is commonly used. Acquisition expenses may be charged to earnings as incurred. A traditional actuary's role would involve calculating and checking reserve factors and then applying those factors to the inforce block to produce that year's financial statements.

U.S. GAAP reporting introduces many new concepts and disciplines. For example:

- U.S. GAAP emphasizes income recognition through the matching of costs and revenues in each accounting period. To achieve this, certain expenses related to the acquisition of new business (mainly commissions and issue costs) are capitalized and written off against future revenue, through the use of a deferred acquisition cost (DAC) asset. Additionally contract loads in the early policy years that exceed the ultimate load for the servicing of contracts such as variable life, must also be deferred and recognized into U.S. GAAP income in proportion to revenue.
- U.S. GAAP reporting results in more realistic reserves and profit reporting than statutory. Realistic reporting can be extremely valuable to the management of an insurance company that is new to this concept.



- Asset valuation concepts are likely to be more elaborate. Asset write-offs are generally required sooner under U.S. GAAP than with local regulatory requirements in Asia.
- The actual basis for U.S. GAAP is not precisely defined. It requires significant judgment by management and its advisers with regard to accounting and reporting. A considerable amount of communication and training of staff is required to ensure an effective implementation of U.S. GAAP.
- SFAS 120 *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts*. SFAS 120 is supported by AICPA Statement of Position (SOP) 95-1 *Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises*. This SOP defines an accounting standard that applies only to long duration participating life insurance contracts that are expected to provide dividends in accordance with the contribution principle.

It is this last point that this paper hopes to expand upon in terms of an Asian perspective.

III. Product Classification

The accounting rules and actuarial models for life insurance products are presented in Statements of Financial Accounting Standards (SFAS). Due to the specialized nature of the life insurance industry, a series of life insurance related SFASs have been produced over the last 30 years. One of the issues faced by Asian companies (and other non-U.S. companies) is in the interpretation of the SFASs for products for which the rules may not have been specifically designed. Additionally regulations and practices in other markets differ from those in the United States.

Various U.S. GAAP accounting standards exist for different types of insurance products. Therefore, when restating a company's financial statements on a U.S. GAAP basis it is necessary to determine which standard applies. This will affect the calculation methodology used to calculate revenues and costs, leading to potentially material differences in the timing of U.S. GAAP income under different standards.

The four main standards that apply to life insurance are:

- SFAS 60 *Accounting and Reporting by Insurance Enterprises*
- SFAS 91 *Accounting for Non-refundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*
- SFAS 97 *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realised Gains and Losses from the Sale of Investments*

Broadly speaking, SFAS 60 applies to traditional life, annuity and health contracts and also defines which acquisition costs qualify for deferral. SFAS 97 is applicable to universal life type products and investment type products. SFAS 97 also applies to limited payment traditional contracts where the accounting for these plans diverts back to SFAS 60. SFAS 120 applies to traditional contracts, but is concerned with mutual life company participating contracts. SFAS 91 applies to investment contracts that have no significant revenue sources apart from investment return. The optimal choice between each of the accounting standards can be one of the most difficult and contentious decisions to be made in a U.S. GAAP conversion and will require careful consideration by management and its advisers at the outset of the project.

Notwithstanding the above, other rules relating to the valuation of assets, timing differences (that lead to a deferred tax liability or asset), and life company purchase situations (Purchase GAAP or PGAAP) result in further complexity. Therefore, a project of this nature involves a significant amount of interaction between a company's actuaries and accountants, and further with its advisers such as external auditors and actuarial consultants.

The recently published book "U.S. GAAP for Life Insurers" contains an excellent chapter on non-U.S. products, however most of the specific detail concerns European products. The reader is especially directed to the flowchart showing the decision-making process in determining which accounting standard will apply.

Predominantly, products sold in Asia are traditional whole life, endowment, term assurance and health-type contracts. Therefore, SFAS 60 or SFAS 120 is likely to be the main accounting standard used, with SFAS 97 applying to limited payment products (SFAS 97 LP).

Therefore, when restating a company's financial statements on a U.S. GAAP basis it is necessary to determine which standard applies.

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However, where product design features, local regulations and/or industry practice differ greatly from the United States, the classification issues become more complex. Generally product classification should be performed on a case-by-case basis to ensure that a company's specific experience has been allowed for. The following section looks at some examples from Asian markets where the products can be considered to differ most from those products available in the United States. Many of the issues considered here are not country specific and will arise in other Asian countries.

Japan

While many new types of products have been introduced in Japan in recent years, most of the products in force and currently being sold are traditional products such as whole life, endowment and term. A common combination is to sell a whole life base product with a large amount of term rider. Riders that cover accidental death and disability, hospital and surgical benefits and various other health coverages are also offered. Riders in Japan often have substantial profit margins and so greater attention should be paid to riders in Japan than is often given to them in the United States.

Life annuities are also commonly sold in Japan. These products may be sold as single premiums or regular premium products. Typically annuities are very long term with an accumulation period and then a payout phase. The payout phase may be as a life annuity or as an annuity certain.

Another feature common in the Japanese life insurance market is the pre-payment of premiums. For example, a policyholder can put down a lump sum that will then be used to pay premiums in the future.

The original 20 domestic companies were predominantly mutual companies, so participating (par) products are very common in Japan. There are two general types of par products offered. The first is the usual par product, which pays dividends based on a three-factor formula reflecting gains on mortality, interest and expenses. Semi-par products are the second type, which pay dividends based on gains from interest only.

One of the first decisions to be made in implementing U.S. GAAP is whether the par products offered and the dividend practices followed by the company qualify the products for SFAS 120 treatment or should be treated as SFAS 60 products (or SFAS 97 LP). The key requirements for SFAS 120 classification are whether:

- The products are long-term products with dividends based on the actual experience of the company.
- Divisible surplus is identified and paid in proportion to the contribution of each policy, the contribution principle as defined by SFAS 120 in paragraph 5(b).

Generally par products in Japan are of a long-term nature in accordance with the definition of SFAS 60. Whether in fact the company pays dividends based on the actual experience and contribution of each policy will depend on the practices at the given company. It would seem less likely that a semi-par product would qualify for SFAS 120 treatment given the contribution to divisible surplus from mortality and expense gains is not reflected. Even for the regular par products, it is fair to say that some companies may conclude the business qualifies for SFAS 120 treatment, while others will reflect SFAS 60 treatment.

Stock companies have a choice as to whether to apply SFAS 120 or SFAS 60/97 LP. In general stock companies in Japan have found SFAS 60/97 LP easier to implement and have gone this down route, although some have selected SFAS 120 due to the added flexibility for DAC amortization under this standard.

An additional liability is required for terminal dividends under SFAS 120. Whereas one might expect the U.S. GAAP reserve to be less than the statutory reserve, the inclusion of a terminal dividend reserve may result in a higher U.S. GAAP reserve.

The other classification issue to consider is whether any products should be treated as investment products rather than insurance products. This is primarily an issue for annuities where the mortality component can be a relatively small portion of the total premium. This will require the testing of the products in question to determine the extent of the mortality benefits reflected in the premium. Below is a test used in one specific situation in Japan that was accepted by the accounting firm involved:

PV of incremental death benefits < 5% of PV of total benefits

Note that "incremental" is important because the return of cash values as a part of a death benefit paid, should not be counted in this part of the calculation.

A related issue is how the pre-paid premiums should be treated. If they are not considered to be part of the base contract, they are likely to be considered an investment contract.

Riders in Japan often have substantial profit margins and so greater attention should be paid to riders in Japan than is often given to them in the United States.

Furthermore, some companies view the accumulation period for annuities separate from the payout period while others view it as one contract. Where the accountants have preferred to split the contract into the accumulation and payout pieces, it is much more likely that the accumulation piece will be treated as an investment contract. On the other hand, if the payout benefit is a life annuity and the accumulation phase and payout phase are treated together, it is almost certain to be classified as an insurance contract. Clearly these are issues that need to be discussed with the auditors involved and will impact the classification of the products and the reserves to be held by the company.

Korea

Korean Traditional Business

Korean products can be broadly grouped into two categories—traditional and interest sensitive, the latter including the variable life products available in Korea as of July 2001. These products are generally long-duration, and can be either participating or non-participating. The traditional products include significant amounts of mortality and/or morbidity risk, such that classification as investment contracts is not applicable. Therefore, traditional products generally fall either into the SFAS 60 classification (where the premium and the benefit periods are equal), SFAS 97 LP or SFAS 120.

An interesting debate arises when deciding on which accounting standard to apply to Korean participating business—SFAS 60 or SFAS 120. The question of SFAS 120 classification relates to:

- Does the dividend scale follow the contribution principle?
- If so, could a stock company elect to follow SFAS 60 anyway?

Current regulatory guidelines specify that a minimum of 90% of all pre-dividend profits on participating policies must be returned to policyholders. In total the dividends clearly reflect the contribution principle. However, on an individual basis it is questionable as to whether the dividend practices strictly follow the contribution principle and this could be argued either way. Even though Korean participating business meets the criteria to apply SFAS 120 (paragraph 5), it also seems possible to account for these contracts using SFAS 60, given the wording of SFAS 120.

This demonstrates that product classification is not a trivial exercise. A substantial amount of work performed to calculate benefit reserves and DAC under the rules of SFAS 60 could potentially be wasted if the product classification proved to be incorrect in the eyes of the SEC. Therefore, some initial clearance on the accounting standard to be implemented should be performed in such circumstances.



Of course, in countries where U.S. GAAP financials have been performed previously, these decisions are easier to make given the experience in the market place and the availability of public information. However, in the case of Korea where there are currently no domestic listings, let alone U.S. listings, these decisions will initially require careful thought and advice.

Other more practical considerations may influence the use of SFAS 120 over SFAS 60. For example:

- SFAS 120 policyholder benefit liabilities are based on the net level premium method. In Korea the statutory reserve is also based on the net level premium method, therefore this should be easier to calculate and analyse than SFAS 60 reserves that can allow for future dividends and withdrawals.
- The data requirements necessary to calculate historical gross margins for SFAS 120 may not be readily available if the company did not keep these records.
- Similarly assumptions required for SFAS 60 should be those appropriate at

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the time of policy issuance. This data may also not be readily available. Note that this is not a problem with PGAAP accounting, which only requires assumptions from the date of purchase.

Korean Interest Sensitive Business

Interest sensitive products (ISP) typically are based on a general investment account that produces a fund value as the roll up of the premium received less contractual loads. Credited interest is usually tied to an index such as the company's policy loan rate or the one-year term deposit interest rate of the major banks in Korea.

The product is clearly an investment contract and therefore the question arises as to

10(b)) seems to be satisfied due to the mechanism whereby interest is usually credited to the business through an index rather than being fixed by contract. For the majority of the ISPs that do not contain significant insurance risks as required for SFAS 97 UL, treatment as investment contracts would be appropriate. For ISPs with significant mortality or morbidity risks, treatment as universal life contracts is possible.

A suggested test to assess the significance of mortality and morbidity risks is to see what percentage of the total present value of future revenue sources at policy issuance was due to mortality and morbidity revenues. In practice the level of significance can vary between 5% and 20%, depending on circumstances. This is guidance and is not actually prescribed.



Singapore and Malaysia

Participating business sold in Singapore has an earnings distribution system whereby most companies return at least 90% of distributable profits to policyholders. Malaysia has a similar structure whereby most companies return at least 80% of distributable profits to policyholders. This is similar to the system in the United Kingdom, and therefore some of the U.S. GAAP conversion issues will be more familiar as they are likely to have already been dealt with in the U.K.

The distribution of profits takes the form of:

- a) an annual reversionary bonus, allocated to policyholders in the year in which the profits emerge
- b) a terminal bonus, which is allocated only at maturity, death or surrender. This portion of benefits is usually highly significant, especially at maturity.

This distribution has been commonly viewed as not following the contribution principle. For example it is recognized that there may be cross subsidies across generations of participating policyholders. Therefore, SFAS 60 should apply.

If participating profits are not restricted by law or company charter, policyholder dividends or bonuses are assumed to be policyholder benefits and included in the calculation of U.S. GAAP benefit reserves. Where there is a restriction on policyholder dividend payments, as in this and the Korean example, SFAS 60 indicates that future bonuses be excluded from the benefit reserve calculations. An insurer in this situation would be required to hold an additional liability to take into account 90% of the valuation differences between the U.S.

whether SFAS 97 or SFAS 91 applies. Practice Bulletin No. 8, an interpretive document issued by the American Institute of Certified Public Accountants, provides guidance in this area. For classification as an investment contract under SFAS 97, there must be significant revenue sources other than investment return. For the majority of Korean ISPs, there are significant revenue sources other than investment return. For example, contracts may include a premium load for expenses, risk charges and/or a surrender charge.

Within the SFAS 97 classification there is the choice between SFAS 97 Investment Contract (SFAS 97 IC) and SFAS 97 Universal Life Contract (SFAS 97 UL) classification. Treatment as universal life-type business under SFAS 97 may be considered. The criteria for SFAS 97 UL classification (paragraph

GAAP and the local statutory basis. This is commonly known as the undistributed participating policyholders earnings account (UPPEA). The UPPEA can be thought of as a roll up of the undistributed policyholders' share of surplus each year, less the dividends or bonuses awarded in the year.

Taiwan

Currently products sold in Taiwan are traditional in nature, mainly savings-type products and long-term health. It is expected that unit-linked or variable life products will be sold in the near future.

The Taiwanese Ministry of Finance (MoF) prescribes a dividend formula that applies to life insurance policies issued in Taiwan. The dividend is made up of an interest and mortality component. The interest component is based on a specified interest rate less the assumed pricing interest rate, if positive. (Currently for most inforce business this is likely to be negative.) The specified interest rate is the average of the maximum two-year term deposit rate of four specified financial institutions in Taiwan. The mortality dividend is based on the standard pricing mortality table less the life industry experience rates as declared by the MoF.

This form of profit distribution clearly does not follow the scope of SOP 95-1. For example the profit distribution does not take into account the actual experience of the company and it would be difficult to argue that it follows the contribution principle. Therefore, SFAS 60 should apply.

Taiwan applies various other taxes in addition to its corporate tax on profits such as a "Gross Business Receipts Tax" (or premium tax), stamp duty and a contribution to a "Stabilization Fund." These taxes, which do not depend on profits, are generally treated as variable maintenance expenses under U.S. GAAP and are usually not considered in the calculation of US GAAP deferred taxes.

In addition to the statutory liabilities required in Taiwan, a "Special Claims Reserve" is required to be set up for rider and group business. This reserve increases and decreases depending on the actual claims experience of the company. For U.S. GAAP purposes, the increase in this reserve will be reversed out of statutory earnings to derive U.S. GAAP earnings, in the same manner as changes in statutory reserves are reversed, since the associated benefits are already reflected in the U.S. GAAP reserve.

China

The majority of the business sold in recent years contains an endowment savings element. Personal accident and medical riders have also been popular. Pure life insurance or protection coverage has proved to be less popular. These products are traditional in nature and SFAS 60 or SFAS 97 LP would be deemed appropriate.

From 2000 most companies began to sell participating contracts, with a requirement that at least 70% of the mortality and interest surpluses are distributed to par policyholders. Generally the domestic companies have not distributed any expense surplus and therefore would find it difficult to classify their par products under SFAS 120. In order to demonstrate SFAS 120 classification, it would be necessary to show that the two-factor dividend approach reflects surpluses from all sources, either due to the immateriality of other sources or their offsetting of each other. Those companies that do intend to distribute expense surplus would find it easier to argue that their products satisfy the SFAS 120 requirements.

Unit-linked products were first launched in China in 1999. These products are investment products with a small mortality component. They would be expected to satisfy the classification requirements of SFAS 97, with significant revenue sources other than investment return, for example from premium loads for expenses and risk charges. Due to the early stage of the development of investment-linked products in China, it is difficult to generalize and it is important to check the product classification criteria on a case-by-case basis.

Hong Kong

A variety of products are sold in Hong Kong. The products sold are mainly traditional par whole life or anticipated endowments. Most par products have the U.S.-style cash dividend, although some have the U.K.-style reversionary bonus system. Historically dividend scales have been set relatively passively, not following the contribution approach, and therefore implying SFAS 60 classification. Unit-linked products are becoming increasingly popular, often with a simple front-end load or reduced allocation charging structure but there are also some more complex designs sold by offshore companies. Many of the products sold in Hong Kong are based on U.S. product designs, therefore making product classification issues relatively simple.

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Assumption Setting

Assumption setting for U.S. GAAP is a similar process to that used in setting assumptions for pricing or embedded value work. However, in the past, Asian companies have had prescribed pricing bases and perhaps are new to embedded value techniques. For example, Japanese companies have used either a net level premium or the Zillmer method to calculate reserves. Premiums are then set as the valuation net premiums plus expense loads. The process of setting best estimate assumptions (including lapse rates) may thus not be familiar to some Asian companies.

U.S. GAAP assumptions vary by accounting model. SFAS 60 uses best estimate assumptions as at the time of policy issue together with provisions for adverse deviation (PADs). These assumptions are then locked for the life of the contract unless a loss recognition scenario occurs. SFAS 97 and SFAS 120 use best estimate assumptions with no margin for adverse deviation. SFAS 97 reserves are usually the policyholder's account value before surrender charges and SFAS 120 reserves are net level reserves based on the assumptions that underlie the participating dividend structure.

Best estimate assumptions require significant actuarial judgement and should reflect the actuaries' most likely outcome of events. The actuaries' task is made easier if sufficient experience data and studies are available. PADs require actuarial judgement and no detailed guidance has been given. Broadly speaking, the assumptions that the actuary expects are most likely to differ from the assumed best estimate would require PADs. The introduction of PADs should not increase the U.S. GAAP net premium above the gross premium. The provision for adverse deviations may appear small when compared to the margins typical in statutory reserves.

The choice of the best estimate investment assumption is an interesting issue in Japan. The interest rates have been at historical lows with 10-year government bond rates in the 1.0% to 1.5% range in recent years. Some companies have assumed that interest rates will remain at this low level indefinitely into the future while others have a perspective that interest rates will rise slowly over time. Again, this is an important but subjective decision to be made by the actuaries and accountants involved in the specific situation.

Data availability and quality will affect the ability to derive suitable assumptions. The next section deals with this issue.

Data Capture

Under U.S. GAAP, companies need to establish a view on their best estimate for each relevant assumption. This will require regular mortality, morbidity, lapse, and expense analyses on the part of the company implementing U.S. GAAP. Many Asian companies will not have sufficient experience studies and analyses in these areas and will need to expand their analyses to implement U.S. GAAP.

SFAS 60 requires assumptions to be set based on information as at policy issuance. For an inforce block of business this may require data from over 30 years ago. The availability of historical information is likely to be a problem for most companies worldwide, not just Asia. Approximations would therefore be widely used and any relevant data such as historic financial statements and pricing bases should be used to attempt to validate the approximations.

This is not an issue for PGAAP, which requires best estimate assumptions only as of the purchase date. However, recent experience data and studies are needed to derive these assumptions. One issue for Asian companies is that not only are these studies currently unavailable, but also the current systems are not capable of producing the data required. For example, a company may be required to produce quarterly U.S. GAAP financials, but its systems may only show interest credited on SFAS 97 investment type contracts at the end of the year. This data is required to produce estimated gross profits (EGPs). Approximations at each intermediate quarter may be required.

Even though SFAS 97 and SFAS 120 require current best estimate assumptions, historical data is required to derive outstanding DAC and unreleased profit reserve balances. The data required includes original acquisition costs, product loads and historical EGPs and/or estimated gross margins (EGMs)

U.S. GAAP requires the classification of expenses into four categories:

- Deferrable acquisition
- Non-deferrable acquisition
- Maintenance
- Overhead

This type of expense analysis is likely to be new to many Asian companies. Not only will an initial expense analysis be required for the initial U.S. GAAP financials, but annual expense studies thereafter will likely be required as well.

It should be noted that the U.S. GAAP definition of acquisition expenses versus maintenance expenses might be different than the definition used for regulatory reporting.

Companies will need to do additional analyses of their expenses to split them between acquisition and maintenance and deferrable versus non-deferrable acquisition expenses. SFAS 60 gives guidance as to the classification of deferrable acquisition expenses—“costs that vary with and are primarily related to the acquisition of new and renewal insurance contracts.” It should be noted that the U.S. GAAP definition of acquisition expenses versus maintenance expenses might be different than the definition used for regulatory reporting. For example, in Japan the head office expenses that support the acquisition of new business (such as underwriting) need to be reclassified from maintenance under the statutory guidelines to acquisition under U.S. GAAP. Similarly, there may be branch office expenses relating to the servicing of policies that need to be reclassified from acquisition expenses to maintenance expenses.

A particular challenge for Korean and Japanese insurance companies with the traditional “sales lady” distribution is the split between deferrable and non-deferrable remuneration and expenses. The system of compensating sales ladies is complex and it is difficult to determine which portions directly vary with production and which do not. This area will require significant analysis and judgment on the part of the actuaries and accountants implementing U.S. GAAP.

Asset Valuation

Traditionally Asian asset valuations have been book valuations. U.S. GAAP also requires a book value basis, but with some adjustments as required by SFAS 115—*Accounting for Certain Investments in Debt and Equity Securities*. Under U.S. GAAP, assets are to be classified as “available for sale,” “trading” or “held to maturity.” For assets classified in the former two categories, the adjustments relate to marketable securities (such as bonds, mortgage-backed securities and equities) that are to be reported on a fair value (market value) basis.

Under PGAAP all assets must be restated at fair value as of the purchase date. Certainly in some countries in Asia, the need to restate all assets at fair value will bring into question the asset quality of certain companies. Therefore, in preparation for a U.S. GAAP conversion, companies should pay particular attention to their asset portfolios.

However, there does seem to be a trend in Asia to a more market-based approach to asset valuation; for example in Korea in order to improve the transparency of financial

statements in the light of the 1998 financial crisis, life insurers are now required to mark assets to market under an approach similar to U.S. GAAP. This will clearly help smooth the transition of Korean asset valuation techniques to those required for U.S. GAAP.

Other issues

Systems Requirements

U.S. GAAP requires software systems capable of complex calculations in order to determine items such as the U.S. GAAP benefit reserves, DAC, EGPs, etc. and also to project these items into the future. It may be possible to modify current internal systems and to perhaps use a spreadsheet package for those calculations not easily performed on the internal systems.

Where this is not possible or too costly or time-consuming, external software systems are available with full U.S. GAAP capabilities. The



advantage of using these systems is that they are likely to have been fully developed and thoroughly tested.

Rating Agencies and Stock Analysts

Organizations that rate life insurance companies analyze numerous sources of data. A company with U.S. GAAP financial statements with a clean audit opinion may be viewed positively relative to its competitors by ratings agencies. For listed companies, stock analysts often have greater comfort with U.S. GAAP and enjoy the ability to compare results with companies in other markets and sectors.

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It should be noted that the U.S. GAAP definition of acquisition expenses versus maintenance expenses might be different than the definition used for regulatory reporting.

Materiality

The purpose of the U.S. GAAP conversion will dictate the materiality of the issues covered above. For example a simple U.S. GAAP approximation may be all that is required so as to supplement information used for raising external capital. At the other extreme, great attention to detail would be required for an SEC listing. However, if the Asian company is a subsidiary of a company seeking an SEC listing, if small enough, the materiality of the subsidiary may allow the use of broad approximations at the subsidiary level.

For a company embarking on a U.S. GAAP conversion with concepts that may be very new to some staff, it is important to set clear mate-



riality criteria at the start of the project. This is not an easy task and no well-defined guidelines exist. Assistance should be sought from auditors to assess the materiality of an item. Part of an actuary's role may be to assess the materiality of an omission or misstatement. The actuary is expected to select and obtain appropriate data and information for the purposes of the analysis and to make appropriate reliance on data supplied by others.

Demutualization

As insurance companies begin to demutualize (for example in Japan) and consider a U.S. GAAP conversion, the data-gathering process becomes particularly important. A well-planned and documented effort during the demutualization process may save a significant amount of effort if the company later pursues a U.S. GAAP conversion. This is similarly true for a company that is about to

produce embedded value information for the first time. However, this exercise will concentrate on assumptions in respect of the future and therefore further work will be required for historic-based accounting (HGAAP).

Reinsurance

SFAS 113—*Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, covers the treatment of reinsurance relating to the economic transfer of risk for U.S. GAAP purposes. Reinsurance contracts that do not transfer risk, such as those used for financing arrangements have separate guidance. In practice it may be difficult to identify the nature and/or purpose of a reinsurance contract. Generally speaking, reinsurance in Asia is used most extensively by subsidiaries of larger multinationals. For other companies, where reinsurance is immaterial, this may be ignored for U.S. GAAP purposes. When reinsurance is material, it can have the effect of changing the pattern of gross and net U.S. GAAP profits.

Conclusion

U.S. GAAP is becoming more important in Asia. Full U.S. GAAP reporting is a major undertaking for any company that has only reported on a statutory basis in the past. Implementation on a smaller scale (for example for use as a management reporting tool), which although maybe simpler to prepare and produce, will require training in order to facilitate a change in the management's understanding of life insurance financials.

In summary, for a company starting out on a U.S. GAAP project, aside from general project management issues, some of the key issues are:

- Product classification
- Investigations and analyses concerning assumptions and data capture
- Asset valuation
- Training

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Donovan North, FIA, is a consulting actuary at Milliman Asia in Hong Kong. He can be reached at donovan.north@milliman.com.