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SOA conference to tackle issues related to fair value accounting

by Irwin Vanderhoof

Planning is progressing for the SOA conference "Fair Value Accounting for Insurance Companies," March 18-19, 1999, at New York University (NYU), and some exciting new wrinkles have recently arisen.

Foremost among these was an offhand statement made by Wayne Upton, head of the corresponding project for FASB and a member of the SOA Fair Value Accounting Project Oversight Group (POG). During the POG's September conference call, Upton stated that FASB has settled the question of which assets or liabilities will be "fair valued" on insurance company balance sheets. This was a major question raised by a senior member of the FASB staff at the SOA's 1995 conference on fair value of liabilities. The answer, according to Upton, is "all."

The final form of these accounting standards will have a major effect on all financial institutions for the indefinite future. In light of the recent collapse of lending institutions around the world, a new set of standards for reporting seems necessary. The March conference will discuss the basis for realistic valuation and should thus be on everyone's list.

Upton's comment, if true, would in some ways simplify the whole problem of defining standards. But complexity remains. One reason is that it seems FASB does not have an iron-clad schedule for completing the project. Another is FASB's need for reality checks. For example, one method of setting values might seem fine for balance sheets, but for financial analysts valuing stock, that same method could distort earnings development in an unacceptable way. Also adding to the range of concerns is that FASB wants all methodological and theoretical considerations to remain open and all avenues investigated. Even the "all" mentioned earlier is subject to discussion if cogent reasons against setting such a standard for insurance contracts can be adduced.

The first day of the March conference will focus on the needs for fair valuation and theoretical developments in this area. The needs are particularly important. We need fair valuation:

1) To develop proper hedges
2) To do dynamic financial condition analysis
3) Make informed risk and reward decisions on investment and businesses
4) Demonstrate to management and investors the true value of earnings and capital
5) Demonstrate, over the years, the effectiveness of asset/liability management
6) Provide financial analysts with the information they need to properly value the stock of the company or its debt capacity

While these requirements cannot be disputed, they may not be compatible. Can the same accounting methodology satisfy them all, or should several different versions of fair value be defined based on the need addressed?

Other theoretical questions are raised in the fine work exhibited in the 1995 SOA conference papers (published as a book, *The Fair Value of Insurance Liabilities*, by the SOA, Stern School of Business, and Kluwer Academic Publishers, Norwell, Mass.) and the recent work of Robert Reitano and David Babbel (respectively, "Two Paradigms for the Market Value of Liabilities," October 1997, and "Economic Valuation Models for Insurers," July 1998, *North American Actuarial Journal*). There seem to be many remaining questions, including the seemingly simple one of which interest rate should be used to discount cash flows. Some believe in the "one true answer" of the Treasury rate, while others believe the choice should be the rate available to the issuing company for its own unsecured debt. Obviously, a great difference between those two values would exist for some companies.

The second morning of the conference heads towards the nuts and bolts problems. How can a company actually implement fair value accounting, introducing it into financial statements? A very few companies' statements now provide fair value of liabilities as addenda. How can other companies most effectively proceed? This may be the most interesting topic for many actuaries. A company's ability to implement fair value accounting may well determine how soon a company can adopt this new methodology.

The March conference is jointly sponsored by the SOA and the Salomon Center of the Stern School of Business, NYU (which also cosponsored the 1995 conference). Ernst & Young L.L.P. and Deloitte & Touche L.L.P. are joining with the SOA to fund the conference. The Association of Investment Management and Research and FASB are cooperating sponsors and are providing members for the project oversight group. Conference information is available from Zain Mohey-Deen, SOA research actuary, at the SOA office (847/706-3570).

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