

World Bank Contractual Savings Conference
Supervisory and Regulatory issues in Private
Pensions and Life Insurance
November 5, 2003

Fair Valuation of Liabilities in Insurance Companies

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Agenda

- History of International Financial Reporting Standards and insurance
- Current status of two phase IASB project and timetable
- Possible future for fair value

History of International Financial Reporting Standards

- International Accounting Standards Committee (IASC)
 - Thirty year history
 - Originally used in countries in which no standards existed
 - o Due to differences in circumstances and lack of sophistication of those countries, relatively less rigorous and more options than standards in developed countries
 - Converted to International Accounting Standards Board (IASB) in 2001 due to pressure from
 - o Asian financial crisis of late 1990s, blamed in part to lack of transparency of accounts
 - o From IOSCO and G7

History of International Financial Reporting Standards

- Charged by IOSCO to develop rigorous set of standards by 2000
- Europe to use International Financial Reporting Standards (IFRS) by 2005
 - Created tremendous pressure to complete development of rigorous set of standards
 - Controversial financial instrument standard still has yet to be approved by Europe – derivatives, banking, insurance
- IASB and FASB have recently agreed to move to convergence

IFRS and Insurance

- 1996
 - IASC had no industry-specific standard
 - Began an insurance contracts project
- Late 1999 – distributed an Issues Paper
 - 3 alternatives – deferral/matching, fair value asset/liability and non-fair value asset/liability
- 2001
 - Informally made available a Draft Statement of Principles
 - 2 alternatives – fair value and entity-specific value
- 2002 – the IASB began deliberations
 - After 6 months, decided issues were too difficult
 - o Split project to two phases, first for EU for 2005
 - Tentative ultimate solution – fair value for liabilities

Why Insurance

- Reasons why insurance has been addressed
 - No existing IFRS
 - Those that do exist – exclude insurance
 - National diversity in practice
 - Divergence from other sectors
 - Lack of transparency, i.e., no one can understand insurers' financial statements

IFRS and Insurance

Phase I

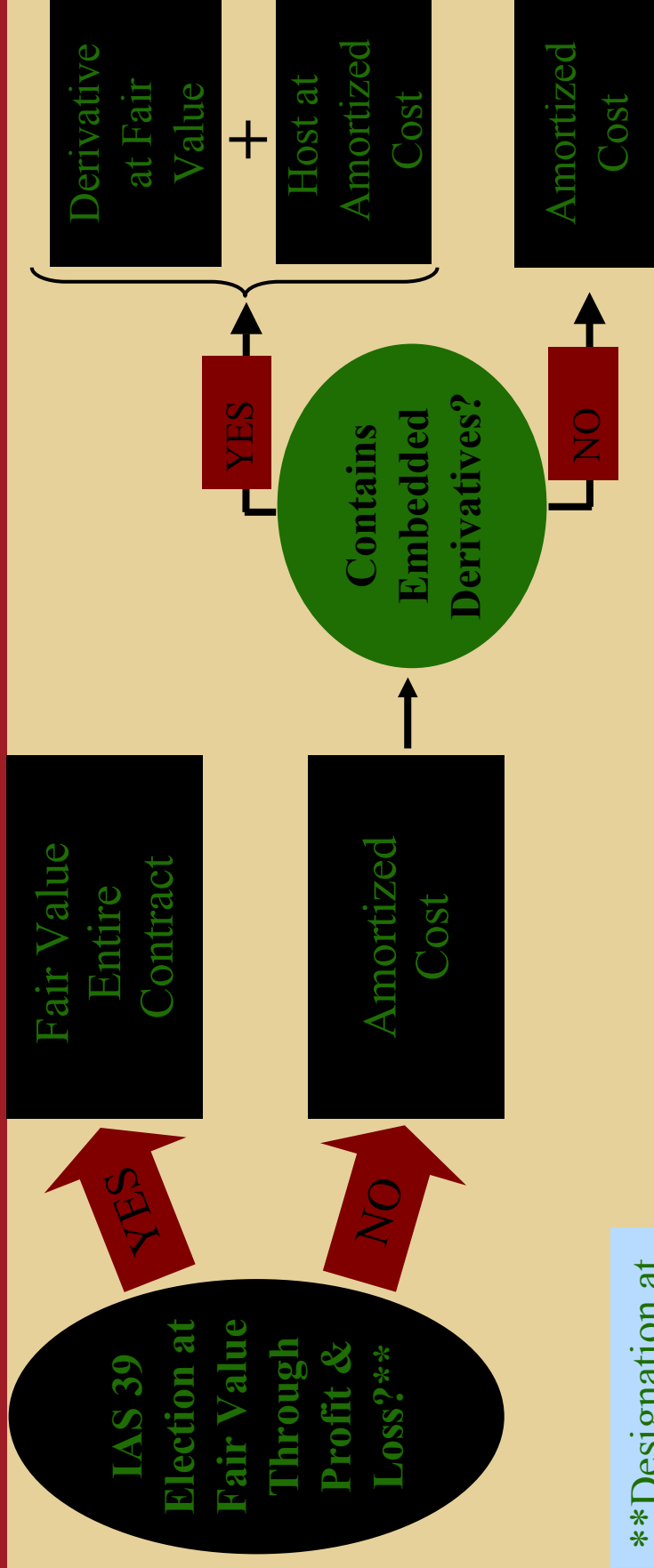
- Exposure Draft (ED 5)
 - Exposed in July
 - Comments – due last week
 - Has to be adopted by March 2004
 - Means that major decisions have to be made by December
 - Objectives
 - o Provide guidance for insurers for 2005
 - o Not require too many resources from companies to comply that would have to be changed with phase II
 - o Make progress to and don't delay phase II
 - o Make some quick fixes for “low-hanging fruit”
 - Eliminate equalization, catastrophe reserves

IFRS and Insurance

Phase I – Key Features

- Definition of insurance
 - Proposal expands current definition (i.e., scope for insurance standard) so that the IASB has classed as many contracts as possible as insurance
 - As long as there is significant risk it is an insurance contract
 - At least one plausible scenario of a non-trivial amount
- Underlying approaches used
 - Insurance
 - o Primarily national GAAP should be followed
 - Investment
 - Choice of amortized cost and fair value methods

IFRS and Investment Contracts



**Designation at inception and irrevocable

IFRS and Insurance

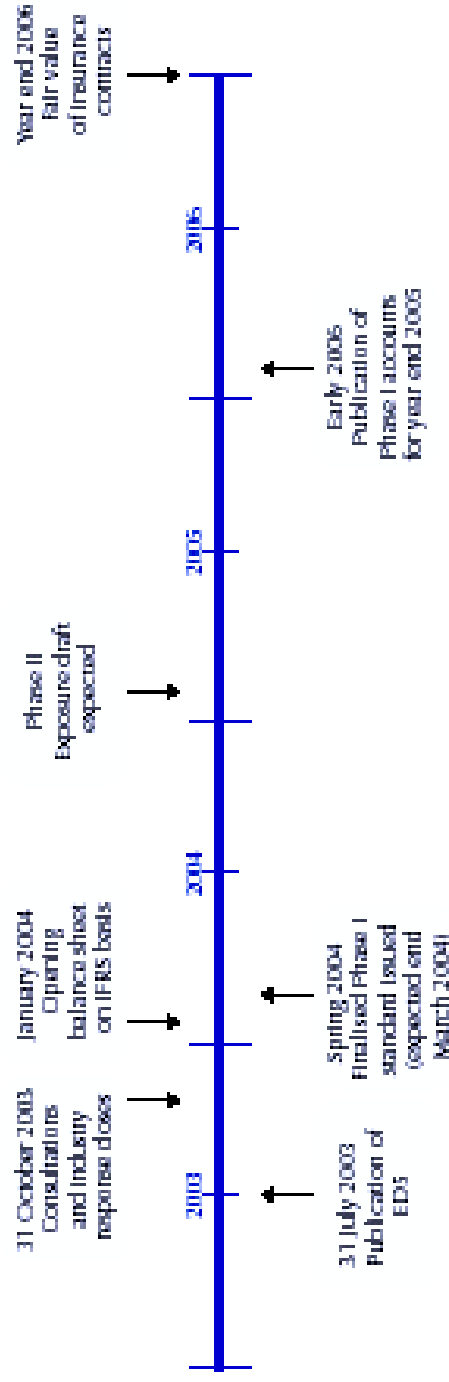
Phase I – Key Features

- Loss recognition test required
- Presentation – both gross and net of ceded reinsurance
- Separate and fair value non-insurance embedded derivatives
- Enhanced disclosures suggested
 - Particularly controversial – fair values for insurance and investment contracts at end of 2006
- Key concerns expressed by industry
 - Different bases for measurement for assets and liabilities
 - Liability for reinsurance potentially inconsistent with direct written exposures
 - Timing

Current IASB Timeline

Key timings – Phase I

Figure 1 | IFRS timetable



Phase II – Initial Discussions

- Prospective present value of future cash flows – probable
 - Possibly fair values
- Issues and concerns
 - Income volatility
 - Reliability
 - Comparability
 - Possible loss at issue due to discounting at risk free rate
 - Lack of specificity on income statement treatment
 - Uncertainty due to unresolved issues including treatment of renewals
 - Calibration to market when limited data available
 - Requirement to fair value all embedded derivatives and options
 - Discounting and risk adjustment for non-life loss reserves
 - How to treat participating business
 - Cash value floor
 - Exit value or entry value

Phase II Timeline

- Initial discussions to begin in March 2004
- Many difficult issues to resolve
 - Made more difficult because no generalized principles established for fair value
 - Board has to be concerned about precedence set for other areas
- Current proposal for implementation in 2007
 - Seems unrealistic now, if two years required for preparers to get ready