CAS Annual Meeting
Evolving Accounting Standards
IFRS and Insurance Contracts Project
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Current IFRS 4
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Section one

Background on IFRS, IASB and Convergence with FASB

Current IFRS 4

IFRS 4 – Phase II Progress

Objective of International Financial Reporting Standards

Objectives:

- One single set of high-quality financial reporting standards for companies world-wide
- No surprises with full transparency

“The whole objective of the International Accounting Standards Board is to boost transparency by having one single set of high-quality standards for companies world-wide. The real secret for confidence in the markets is: no surprises and full transparency—that’s going to mean some pretty uncomfortable standards coming in the future.”

“It’s silly having a different rule in the UK or Australia or the US when we should just see who’s got the better rule and let’s do it worldwide.”

Sir David Tweedie, Chairman IASB

IFRS and the IASB

IFRS—International Financial Reporting Standards

Standard setter—International Accounting Standards Board (IASB)

- 15 board members (from Europe, North America, Asia, etc.)

Founded in 2001. Based in London:

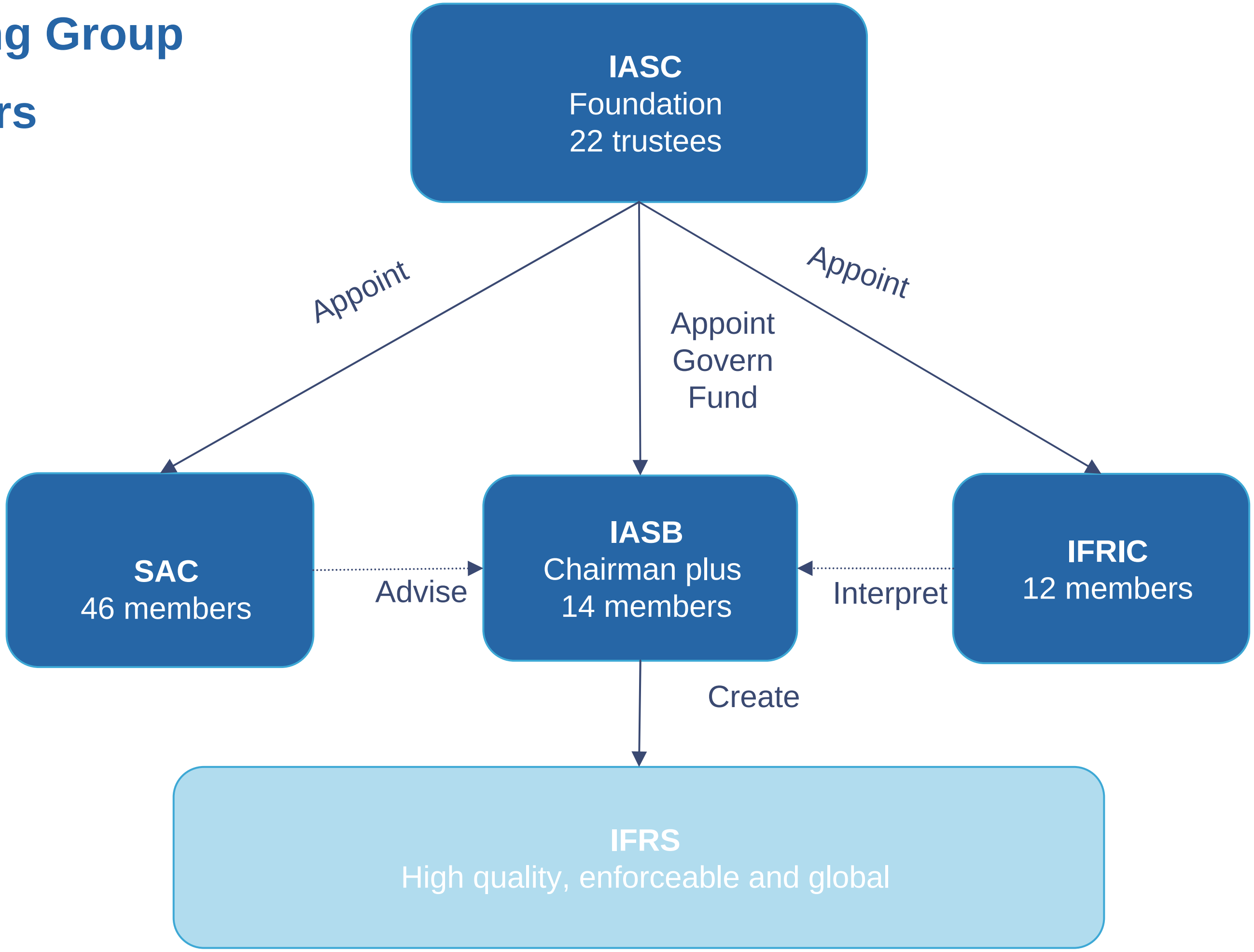
- Replaced the International Accounting Standards Committee (IASC), which previously published financial reporting standards referred to as International Accounting Standards (IAS), used in countries without their own accounting standards setter
- Impetus came from the G7 after the Asian Financial Crisis in the 1990s
- Current convergence efforts given further push by the G20 this year

IFRS and the IASB

Standard Setting Structure

Monitoring Group

5 members



IFRS and the IASB

IASC Foundation's Trustees have oversight responsibility, with a Standards Advisory Council (SAC) that provides advice regarding the IASB agenda:

- The IASB develops IFRS and the International Financial Reporting Interpretations Committee (IFRIC) provides interpretations of IFRS
- Main functions of IASC Foundation trustees include:
  - Appointing IASB members
  - Exercising oversight
  - Raising funds

Monitoring Board, recently formed, made up of international regulators, provides oversight to the IASC Foundation

Key Principles to IFRS

Faithful presentation

Responsive to users' needs for clarity and transparency

Consistency with a clear conceptual framework

Criteria for principles-based standards

Based on an appropriately defined scope

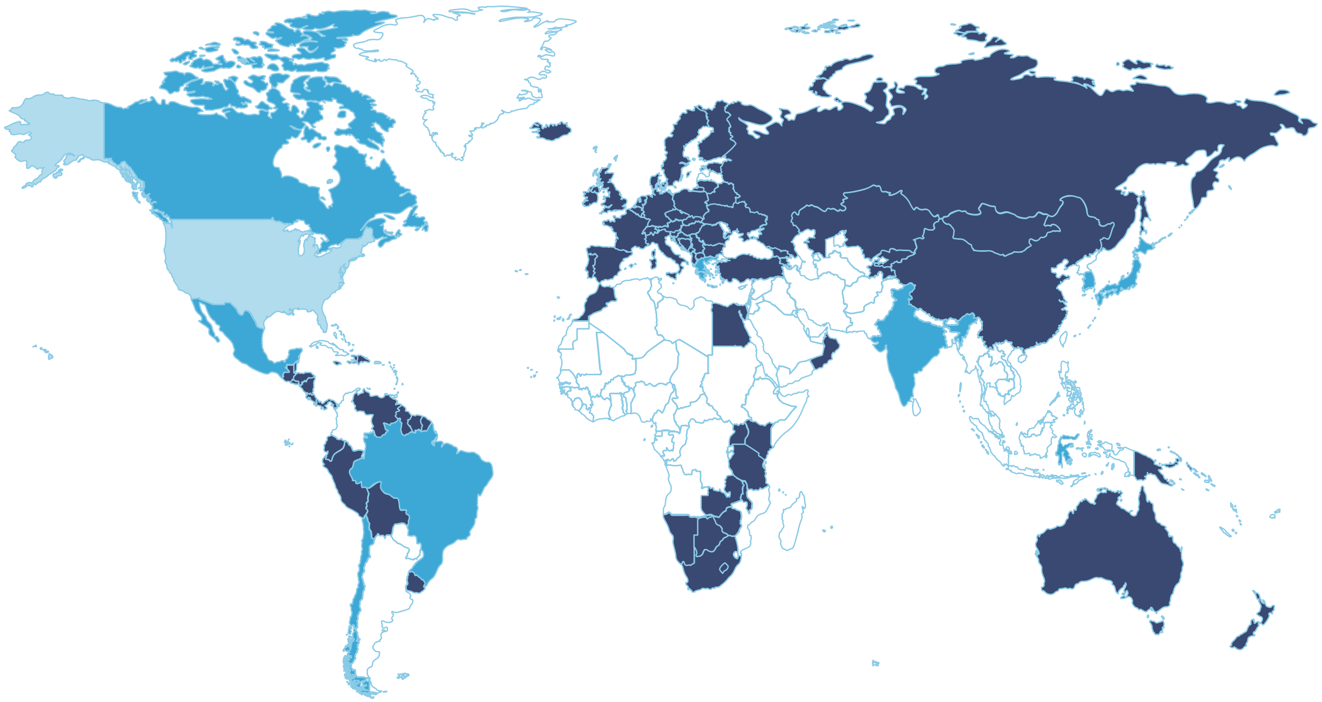
Written in clear, concise and plain language

Allows for use of reasonable judgment

IFRS Framework

Where is IFRS Reporting Permitted/Required?

More than 100 countries require or permit the use of IFRS, or are converting



Top 10 Global Capital Markets	
US	US GAAP
Japan	Converting to IFRS
UK	IFRS
France	IFRS
Canada	Converting to IFRS
Germany	IFRS
Hong Kong	IFRS
Spain	IFRS
Switzerland	IFRS or US GAAP
Australia	IFRS

- Countries seeking convergence with the IASB or pursuing adoption of IFRSs
- Countries that require or permit IFRSs
- Countries with no current plans to convert to IFRS

View from the Chairman of the Financial Accounting Standards Board (FASB)

"Recent years have been marked by a continuing and rapid globalization of capital markets, cross-border investing, and international capital-raising. In light of this rapid change, we agree with the Securities and Exchange Commission that a widely used single set of high quality international accounting standards for listed companies would benefit the global capital markets and investors. The ultimate goal, we believe, is a common, high-quality global financial reporting system that can be used for decision-making purposes across the capital markets of the world."

"Thus, we believe that planning for a transition of U.S. public companies to an improved version of IFRS would be an effective and logical way forward to achieving the goal of a set of common global standards."

Robert Herz, Chairman of the FASB
October 24, 2007
Senate Hearing on Global Reporting Standards

Reasons for Convergence based on the benefits of capital markets experienced outside the US

- Increased efficient access to capital for global corporations
- Reduced the cost of capital
- Improved comparability across borders and within global industries
- Reduced cost of compliance for global corporations
- Enhanced the effectiveness of management reporting
- Streamlined M&A activity for global corporations

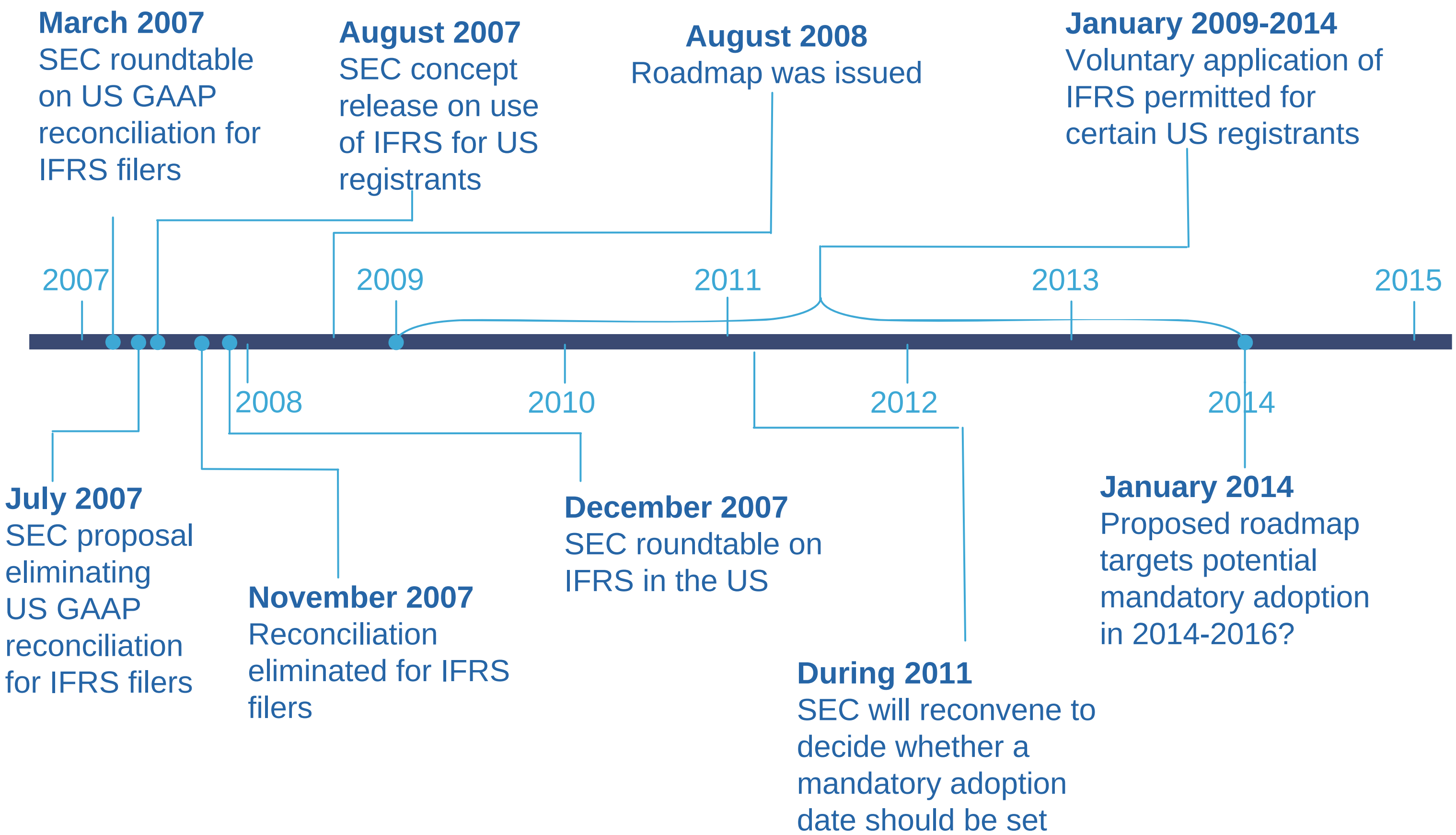
The transition to IFRS in the US appears inevitable – question is on the timing

- Globalization of business and finance requires a common set of high-quality, global accounting standards
  - Confirmed this year by both the G20 and President Obama
- The US Congress, the SEC and the various US exchanges are seeking to enhance the competitiveness of the US capital markets
- Convergence of US GAAP and IFRS is a slow process and differences remain even after completion of convergence projects, causing questions whether convergence can be truly achieved in a reasonable period of time

The transition to IFRS in the US appears inevitable – question is on the timing

- IFRS vs. US GAAP
  - IFRS may offer a solution to the complexity of the current US GAAP model.
    - Principles, without the burden of rules and interpretative baggage, facilitates more focus on underlying economics
    - Challenges in the US regarding consistency
- In various industries, companies are considering the potential for cost efficiencies by adopting IFRS for multiple purposes
  - External reporting
  - Statutory reporting
  - Internal management reporting

When might the transition to IFRS occur in the US? One possible path is below:



Some Key Points on Convergence

Targets potential mandatory adoption of IFRS in the U.S. beginning in 2014 (or 2014-2016)

- Optional early adoption of IFRS in the U.S. possible in certain cases
- Lays out several milestones that need to be achieved prior to the SEC mandating use of IFRS for all U.S. issuers
- Proposed rule for certain qualifying domestic issuers to use IFRS as early as 2009

Existing plan requires future SEC action; SEC would determine in 2011 whether

- Certain milestones have been achieved
- Mandatory IFRS adoption date should be set for all issuers
- Option to early adopt IFRS should be expanded to a larger population of issuers
- Existing plan subject to modification

Section two

Background on IFRS, IASB and Convergence with FASB

Current IFRS 4

IFRS 4 – Phase II Progress

Current IFRS 4 – Insurance Contracts

IFRS 4 in its current form:

- Adopted in 2004
- Originally designed as an interim solution (2 years)

Detailed guidance provided on:

- Contract Classification
- Disclosures

Primarily relies on local standards (e.g. US GAAP in the US)

- Policyholder and Claim Liabilities
- Revenue Recognition

A great deal of diversity in practice

Current IFRS 4 – Insurance Contracts

Current IFRS 4 guidance for p/c loss reserves

- Start with amounts reported under current local standards; then:
  - Eliminate liabilities for future claims (e.g. catastrophe reserves)
  - Perform a liability adequacy test (type depending on prior or newly adopted test)
  - Continue to measure liabilities on an undiscounted basis if this is the current policy
  - No netting for reinsurance

Phase II would provide a global framework for claim liability and revenue recognition.

Current IFRS 4 – Contract Classification and US GAAP

	IFRS 4 (Current)	US GAAP
Single definition of an insurance contract?	Yes	No
Required probability of significant insurance loss	Any possibility with commercial substance	Reasonable possibility; requirement for underwriting and timing risk
Requirement for both underwriting and timing risk?	No, underwriting and/or timing is OK	Yes
Significant loss required?	No	Yes
Scope limited to insurance companies?	No	Yes
Separate contract for accumulation phase versus payout phase?	No	Yes

Current IFRS 4 – Disclosure Requirements

Identify and explain significant amounts in financial statements

- Accounting policies and significant assumptions
- Changes in amounts and assumptions

Help users understand future cash flows:

- Objectives in managing risks and policies for mitigating risks
- Effect on cash flows of contractual terms and conditions
- Insurance risks - sensitivity analysis, concentrations, loss development
- Interest rate and credit risks

Section three

Background on IFRS, IASB and Convergence with FASB

Current IFRS 4

IFRS 4 – Phase II Progress

IFRS 4 and Phase II
The 2007 Exposure Draft

IASB Discussion Paper “Preliminary Views on Insurance Contracts”

- Published May 2007

Included ideas for financial reporting of insurance contracts:

- Basic model – current exit value
- Reflected policyholder behavior and acquisition expenses
- Other measurement issues
  - Reinsurance
  - Unbundling
  - Guaranteed insurability as the basis for recognizing renewal premiums
- Gain at issue possible, although expected to be small

IFRS 4 and Phase II
The 2007 Exposure Draft – Themes to Responses

Respondents expressed general support for:

- A single model for life and non-life
- 3 building block approach to establishing liabilities (expected value, discounting, risk margin), but many differences in opinion about each block
- Discount rate should not be asset-based
- Premiums as revenue
- Expensing of acquisition costs

Were generally against:

- Including own credit characteristics
- Unbundling
- Service margins
- Guaranteed insurability test for future premium recognition
- Discounting loss reserves (non-life insurers in US)

IFRS 4 and Phase II

The FASB joined with the IASB for Phase II of the IFRS 4 – Insurance Contracts project:

- It is expected that the outcome of Phase 2 will become US GAAP irrespective of if and when there is overall convergence between US GAAP and IFRS
  Purpose – comprehensive financial reporting standard for Insurance contracts (life and non-life)

Current Timetable:

- IASB and FASB are committed to April 2010 Exposure Draft (this has been delayed), with a comment deadline of August 2010
- Final IFRS standard is due by June 2011 (when key IASB membership turns over)

IFRS 4 and Phase II

The FASB and IASB each have their own project teams that work on issues and present to their boards; there are joint meetings as well.

- The FASB's and IASB's views and perspectives can differ

Several key issues the teams are working through (P/C perspective):

- Revenue Recognition
- Acquisition Costs
  - If no DAC, then what?
- Claims Liability Measurement Objective
  - Fulfillment vs. Modified IAS 37 Approach
  - Building Block Approaches
- Presentation
- Reinsurance – Risk Transfer and Unbundling

IFRS 4 and Phase II
Revenue Recognition

IASB and FASB issued a joint Discussion Paper (DP) on Revenue Recognition in December 2008

- **Not specific to insurance, will cover all industries**
- **Distinguishes between goods and services**
- **Revenue will be based on fulfilling a contract for services**
- **Guides user to identify each individual performance obligation and recognize the revenue for each separately.**

Several key points as it relates to Insurance Contracts project:

- **DP concepts are expected to influence the Insurance Contracts project**
- **What is the definition of a "performance obligation" for non-life insurance contracts?**
  - **Insurance coverage (i.e., risk protection), and/or**
  - **Duty to defend**
  - **Claims handling**
- **How will onerous contracts be determined (aggregate or individually)?**

IFRS 4 and Phase II
Acquisition Costs

Currently, both the IASB and FASB have the view that acquisition costs should be expensed; that is, no deferred acquisition cost (DAC) would be accrued

Why no DAC?

- Would make insurance consistent with other industries

Is there a premium offset for upfront acquisition expenses?

- Initially, IASB voted yes, but has since narrowly re-voted no
- FASB has voted no

Result would result, in effect, in a day one loss

Significant issue for certain life insurance contracts

IFRS 4 and Phase II
Pre-claim and Claims Liabilities

Current discussions:

Single approach for all life and non-life insurance and reinsurance contracts

Though a tentative decision by the IASB may lead to a distinction for pre-claims liability between short-duration and long-duration contracts (although no definition of distinction yet decided). FASB has not yet addressed this issue

Three basic building blocks of measuring liabilities are:

- Future cash flows
- Time value of money
- Margin

IFRS 4 and Phase II
Pre-claim and Claims Liabilities

Building block 1 – Expected value of future cash flows

Determining expected value (per the IASB):

- Identify each possible scenario
- Estimate the cash flows under each scenario
- Make unbiased estimate of probability of each scenario

Key open question:

- Will insurers need to develop estimates of each scenario by identifying individual scenarios, estimating the cash flows for those scenarios, and then weigh them together in a probability weighted manner?

  OR

- Will current P&C non-life actuarial approaches be suitable for building block 1?

IFRS 4 and Phase II
Pre-claim and Claims Liabilities

Building block 2 – Discount – Time value of money

Discount rates

- Consistent with observable current market prices
- For cash flows whose characteristics match those of insurance liability (not matching assets) in terms of:
    - Duration
    - Liquidity
    - Currency

All liabilities would be subject to discounting

Possible interest rates being considered:

- Risk free or similar rate
- Not insurer's investment yield rate
- IASB still considering whether liquidity adjustment

IFRS 4 and Phase II
Pre-claim and Claims Liabilities

Building block 3 – Risk margins

Definition: An amount or margin reflecting an assessment of uncertainty associated with insurance risk

- Possible risk margin objectives
  - Price of bearing risk (market-based approach)
  - Cost of bearing risk (fulfillment-based approach)
  - Confidence level (regulatory/policyholder view)
  - Shock absorber

[from the IAA Risk Margins paper]

IFRS 4 and Phase II
Pre-claim and Claims Liabilities

Plusses and minuses of margin:

- Advantages of no margin
  - Consistent with pure contract fulfillment approach, assuming no cost associated with uncertainty of claims payment
  - Performance obligation is provided over coverage period, assuming that no service is applicable over the coverage period
  - Avoids possible inconsistent estimation of risk margins
- Advantages of a risk margin
  - Related to extent of uncertainty
  - Consistent with economic value of expected value of uncertain cash flows
  - More consistent with IAS 37 approach for non-contractual obligations

[from the IAA Risk Margins paper]

IFRS 4 and Phase II
Pre-claim and Claims Liabilities

Families of risk margin methods

- As given in IAA Risk Margins paper:
  - Quantile methods
  - Cost of capital
  - Explicit assumptions (related to specific risk factors)
  - Discount rate related
  - Implicit

- Actuaries generally favor the cost of capital approach

IFRS 4 and Phase II
Presentation of the Performance Statement

No decisions reached yet.

Some possibilities discussed:

- Traditional life model
- Traditional non-life model
- Fee approach
  - The part of the premium that the policyholder pays for services under the contract would be reported as revenue, not the deposit receipt that relates to expected future repayments to the same policyholders
- Margin approach
  - Treats all premiums as deposits and all claims and benefits as repayments to the policyholder. Recognition of the margin(s) as revenue would occur as the margin is released

IFRS 4 and Phase II
Reinsurance – Unbundling, Risk Transfer, Other Issues

Items at various stages of discussion at the IASB, generally not addressed yet by the FASB:

- Unbundling
  - Discussed by IASB, staff generally against unbundling when parts are “interdependent” – subject to further discussion
- Risk Transfer
  - Not discussed by IASB; current version of IFRS 4 is less restrictive than current US GAAP
  - FASB will discuss in the future
- Many issues not yet addressed
  - Assuming company accounting
  - Reinstatement premiums

Questions and Comments

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