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International Accounting for Insurance Contracts

Property & Casualty issues

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Session 20

A New Millennium. A New Challenge for Actuaries

Overview

- Current accounting standards
- Proposed accounting standard and issues
- Other issues

Current accounting standards

- Currently, with exceptions
  - No discounting
  - Conservative claim estimates (some places)
  - Deferral-Matching approach
  - Catastrophe reserves (some places)

Current accounting standards (cont'd)

- Continually re-estimate
- Estimation methods
  - > Locked-in some places
  - > Actuary's choice in other places
- Do not anticipate renewals
- Performance measurement - loss ratio

Proposed standards - Discounting

- Everything is discounted
  - Start with neutral estimates (no conservatism)
  - Add risk margin
  - Discount at risk-free rate

Proposed standards - Discounting

Whose neutral estimates?

Entity-specific value	***versus***	**Fair value**
Runoff (settlement) value		Value if immediate exit
Entity's assumptions		market assumptions for:

> Size of cash flows
> Expenses
> Size of risk (but market risk tolerance)

- But is there a difference?
    - If no market data, fair value = entity specific?

Proposed standards - Discounting

- Risk Margins
  - Risk margin ≠ conservatism
  - Reflect in cash flows or discount rate
  - Allowed only if "reliable"
  - What does "reliable" mean?
    > Process versus parameter, model risk
  - Reasonable estimates versus reliable estimates

Proposed - Discounting

- Profit at inception
  - IF can't produce "reliable" estimate of risk margin?
    THEN choices are:
    a) No risk margin - yes, profit at issue
    b) No profit at issue - back into risk margin
  - Latter is current proposal
  - But when should profit be reflected?
  - No release until "reliable" risk margin estimate -

    Maybe never reflect profit

Proposed - Discounting

- Risk Margin Choices

  a) Make best estimate - disclose
  b) Only use if "reliable"

  > When should profit be reflected?

Proposed - Discounting

- Discount rate
  - Risk-free rate is starting point
  - Adjust for risks not reflected in cash flows
  - Don’t reflect anticipated investment margin

Proposed - No Deferral-Matching

- No more “earned premium” or “unearned premium”
- No more prepaid expense asset
- Only claim and expense liabilities
  - Claim liability for incurred claims
  - Claim liability for not yet incurred claims
  - Claim liability for contracts not yet effective
- MORE ESTIMATES

Proposed - No Catastrophe Reserves

- No catastrophe or equalization reserves
- Results more volatile
- Need to change capital standards

Proposed - Continually re-estimate

- No change, except more work
- Need to always update for interest rates
- May need to update for risk margin

Proposed - methods

- Left to actuarial standards project?
- Principle based vs. prescriptive
- Accounting principle
  - Consistency is good
  - Should change with environment, knowledge?
  - U.S. principles/standards - try multiple methods

Proposed - Renewals

- Don't value, unless
  - Would produce a liability OR
  - Valuable option owned by policyholder
- Generally not an issue for general insurance
- Danger -
  - Big issue for life insurance
  - Will rule meant for life insurance hurt general insurance

Proposed - Performance Measurement

- No more “earned premium”
- Not clear what would replace loss ratios, other performance measures
- No firm proposals yet from IASB
- How to reflect?
  - Unwinding of discount
  - Change in discounted estimates
  - Current versus prior year, if no “earned premium” concept
  - Change in risk margin
  - Change in discount rate
  - Change in risk adjusted discounted claim estimate over time

Proposed - Credit standing

- Concept

  Liability worth less if insurer has lower credit rating

- Entity-specific value

  Don’t reflect credit standing

- Fair Value

  Maybe reflect credit standing, if done for assets

Proposed - Credit standing Cont'd.

Note:

- Life and annuity insurers may want this to prevent negative profit at issue
- They are not allowed to reflect investment margin
- They may want this to replace investment margin
- They may argue based on investment margin decision Not based on credit standing theory
- General insurers may disagree with life/annuity insurers here

Other

- Standard applies to
    - Insurance contracts, not insurance entities
    - Insurers, reinsurance, and policyholders (not self-insurers)

- Business combination standard also an issue
    - How should acquired liabilities be valued?
    - Value at fair value?

Summary

- Discounting will be a major impact
  - Big change in reported data
  - More work to maintain

- Standard increases use of estimates

- Performance measurement rules unknown

- Actuarial standards may (or may not) decide "methods" issue