

IAS for Life Insurers

Presentation to Actuaries' Club
of the Southwest

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by

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Agenda

- Background and history
- Phase I : IFRS 4 for insurance contracts
 - Product classification
 - Accounting policies for insurance contracts
 - Liability adequacy test
- IAS 39: Accounting for financial instruments
 - Assets
 - Liabilities
- Phase II

Background and History

International Accounting Standards

- The role of IASB
- 2005: EU and Australia requires listed companies to follow IFRS
- United States, Canada and Hong Kong committed to convergence to IAS
- 2002: Norwalk agreement between IAS and FASB
 - Identify and remove differences

History of Insurance Standards

- December 1999: issues paper
- June 2001 DSOP
 - Fair value measurement of insurance liabilities
- May 2002 split into two phases
 - Lack of time
 - Industry opposition
- Phase I: IFRS 4 and IAS 39 apply
- Phase II: May 2004 : project “re-started”

Phase I

Product Classification

■ IAS definition of an insurance contract:

“ A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder”

■ Contracts meeting this definition current local GAAP will continue to apply

■ Others (financial contracts) IAS 39 will apply

■ Reclassification possibilities

Product Classification - Examples

■ Insurance

- Whole life contracts
- Life contingent annuities in payment
- Term insurance
- Variable annuities with significant death benefit
- Fixed or variable annuities with significant life contingent annuity guarantee

Product Classification Examples

■ Investment

- Annuities certain
- Variable contract without significant death benefit (e.g. 101% of unit value)
- Guaranteed investment contract
- Financial derivatives

Accounting Policies for Insurance Contracts

- Local GAAP permitted to continue
- Not required to eliminate excessive prudence
- Permitted to change to improve relevance or reliability
- No catastrophe or claims equalization reserves allowed

Liability Adequacy Test

- Minimum liability based on best estimates of future cash flows
- Options and guarantees included
- Test failure then IAS 37 applies
 - More onerous

IAS 39

Assets

Asset Categories

<i>Category</i>	<i>Measurement</i>	<i>Changes in Carrying Amount</i>
Trading	Fair Value	Income Statement
Available-for-sale	Fair Value	Amortized Cost – income Fair Value – equity
Held to Maturity	Amortized Cost	Income Statement

Measurement of Investment Contract Liabilities

■ Two options

- Amortized cost
- Fair value

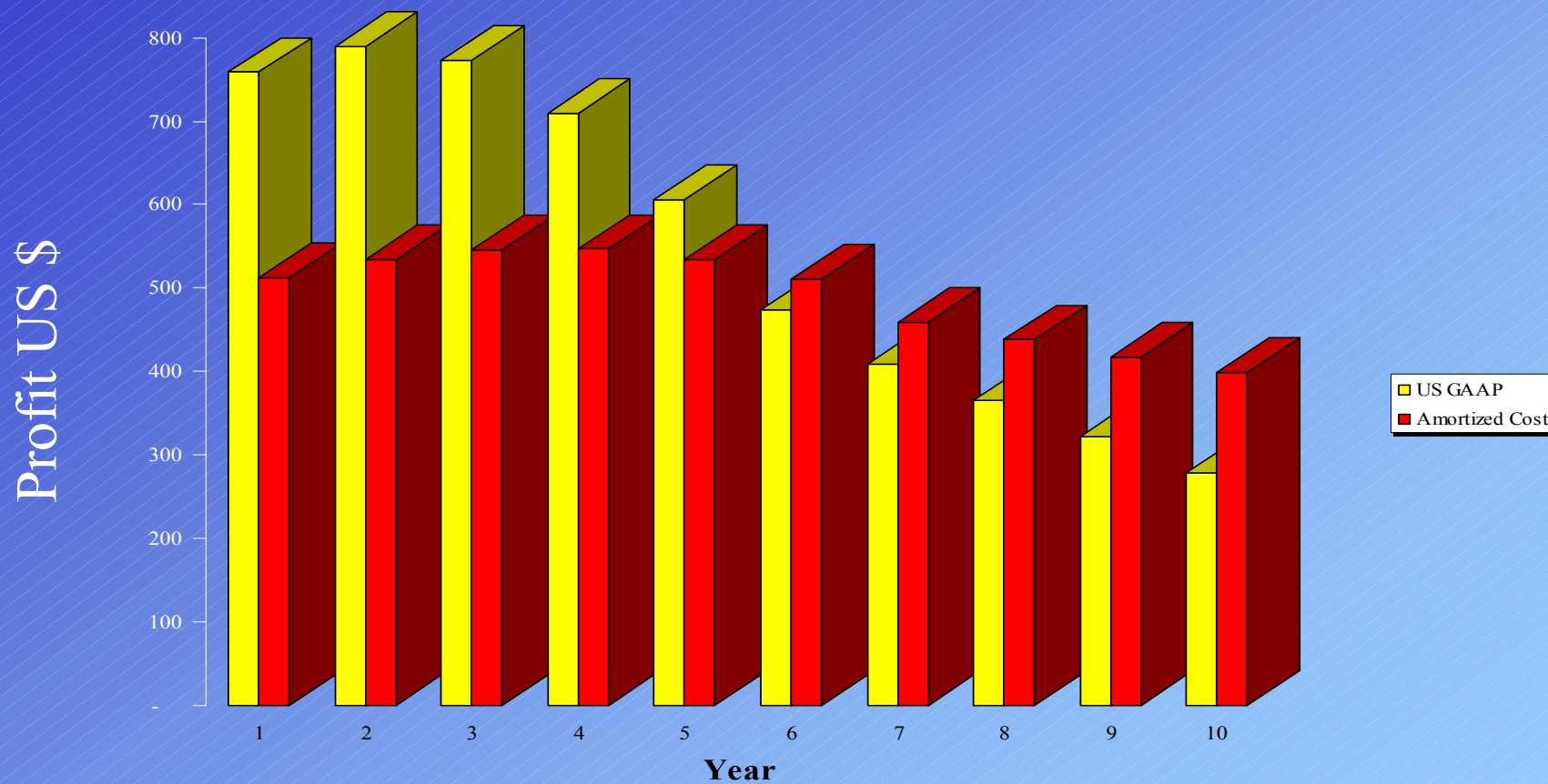
■ Amortized cost

- Value is the present value of future cash flows - original effective interest rate
- Original effective interest rate equates value at issue with future cash flows
- Value at issue = fair value = premium minus variable costs
- Disclosure requirement

Example : Variable Annuity

- Term = 10 years
- Single premium: \$ 100,000
- Commission 5%
- Fees 1.3% of the account balance
- Expenses: 0.4% of the account balance
- Surrender charges: 10%, 8%, 6%, 4%, 2%, 0%
- Lapse rates: 2%, 4%, 6%, 8% 10% 15%,
10%, 10%, 10%
- Account value growth 7%pa

Profit Signatures Variable Annuity Products



Phase II

Dates

- July 2004: IASB announced plan to assemble working group and insurance background paper circulated to members
- September 2004: members of working group announced
- Planned timeline
 - Disclosure paper....No time line
 - Exposure draft: June 2005
 - Final standard in 2006?
- Optimistic

Insurance Background Paper

- Back to basics
- Recognition and measurement issues in 11 areas need resolution
- Issue No. 1- accounting model
 - Asset / liability model
 - Deferral and matching

Accounting Models

■ Deferral and Matching

- Examples: US GAAP, Australia's margins on services
- Relates claim and expense costs to revenue
- Acquisition costs deferred and amortized
- Profits spread over the lifetime of the contract.

■ Asset and Liability Measurements

- Examples: Embedded Value and Fair Value
- Profits are the relative changes in assets and liabilities

Embedded Value

- Used in UK & Europe
- Embedded Value = Value of in-force business plus net worth
- Value of in-force = Present value of future statutory earnings using best estimate assumptions and a risk discount rate.

Embedded Value Earnings

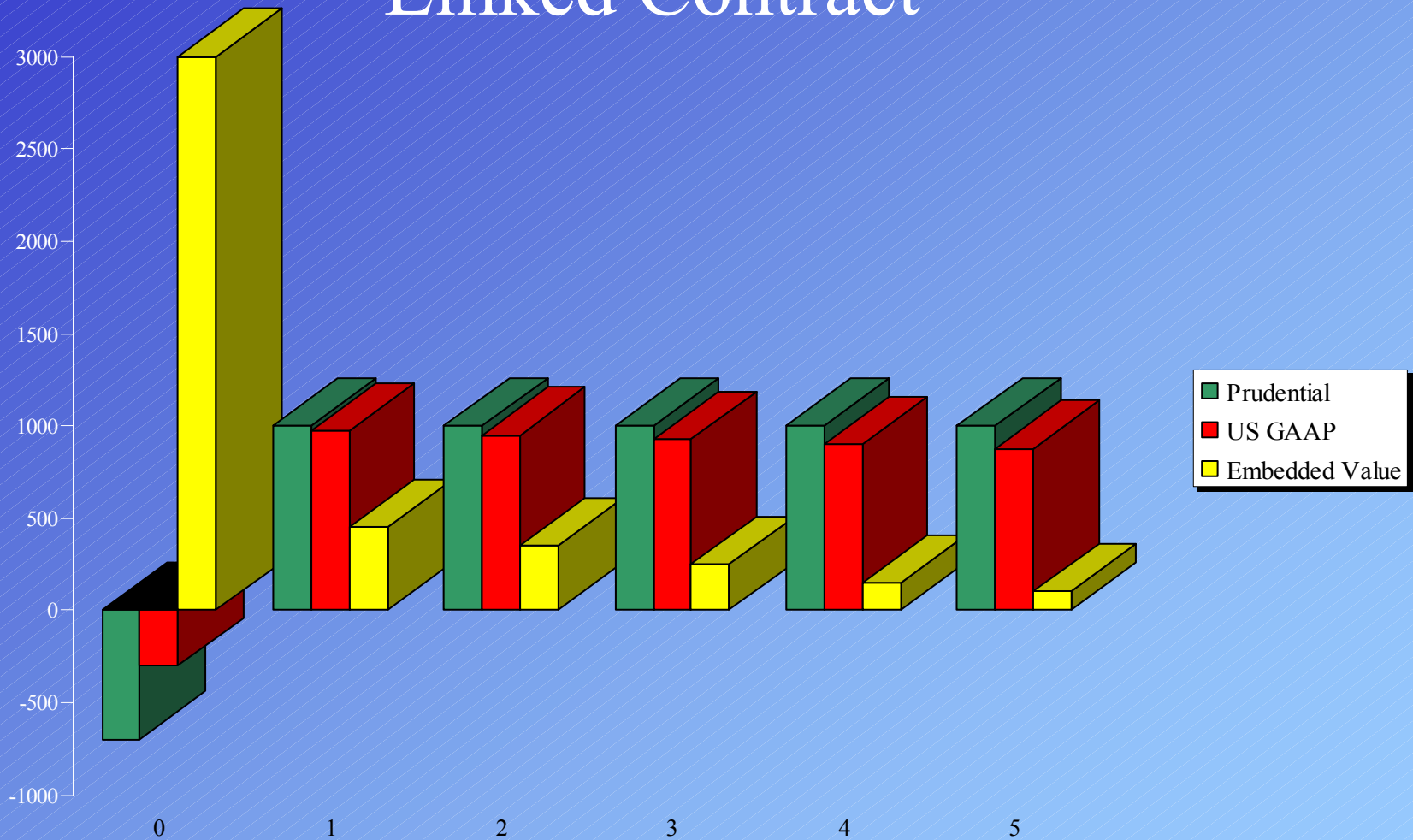
- Profit = Achieved Profit = Change in Embedded Value
 - = Investment Earnings on Net Worth
 - + Unwind of In-force
 - + New Business Value Added
 - + Difference in Actual Experience versus Expected
 - + Change in Value due to change in Assumptions

US GAAP

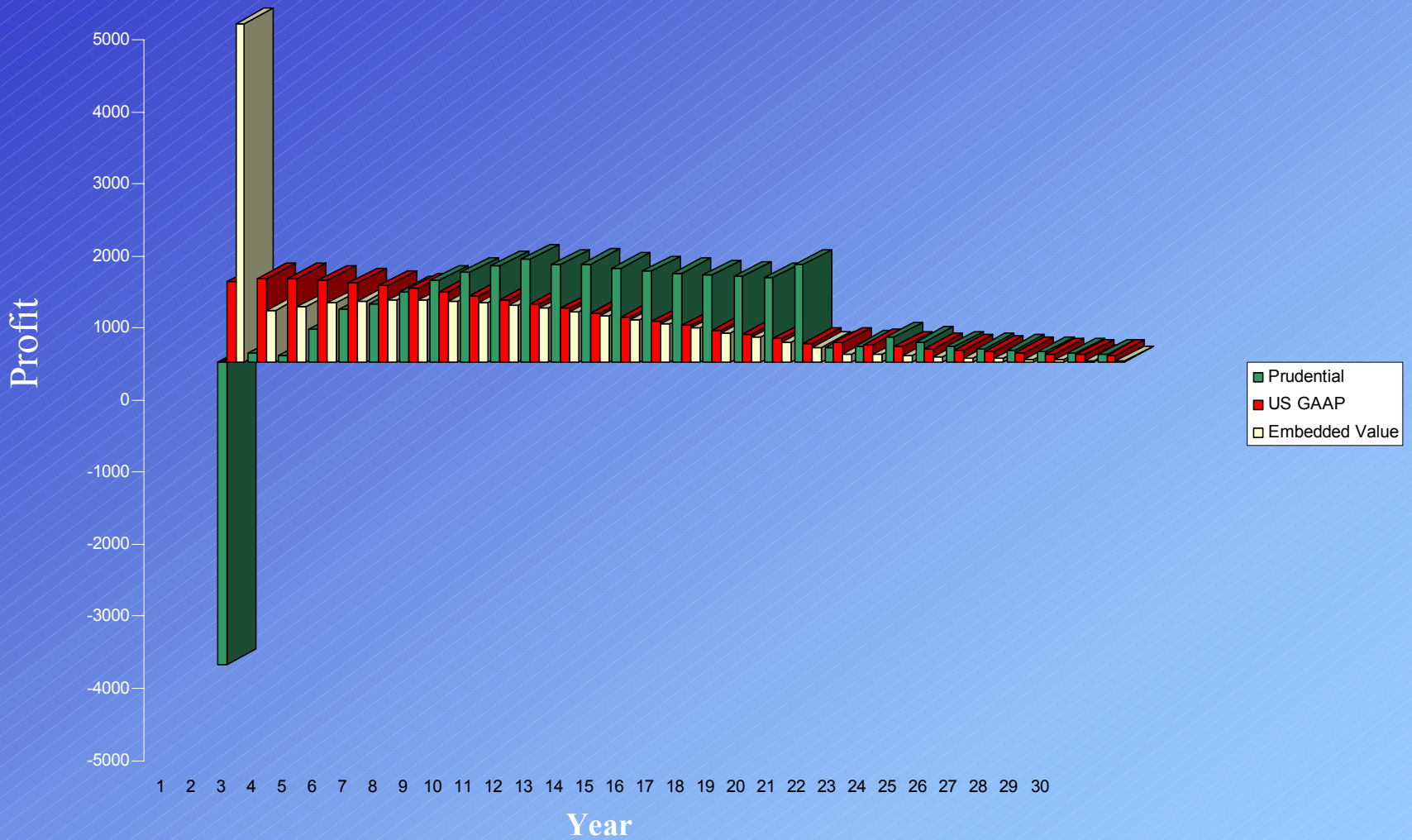
Compared with Embedded Value

	US GAAP	Embedded Value
Accounting Model	Deferral and Matching	Asset / Liability
Emergence of Earnings	<ul style="list-style-type: none"> • Smoother over Lifetime • Less Volatile 	<ul style="list-style-type: none"> • Up front Profit • Volatile
Lead Indicator	No	Yes
Helpful in Managing Business	Partially	Yes

Profit Signatures: Unit Linked Contract



Profit Signature - Term Insurance Contract



EV v FV

	Embedded Values	Fair Value
Assumptions	Best Estimate	Risk Adjusted
Discount Rate	Risk Adjusted	Risk-free
Cost of Capital	Direct Allowance	No Allowance
Value of Liabilities	Indirectly: VIF Adjustment	Directly

Conclusions

- Intent to converge accounting standards
- Phase II has long way to gobut
- Impact on US GAAP
- Begin to keep closer eye on developments