

Panel on Accounting

Conference on Insurance Regulation and Supervision in Asia

Sponsored by the IAIS, OECD, and CIRC

Beijing, China

28-29 October, 2004



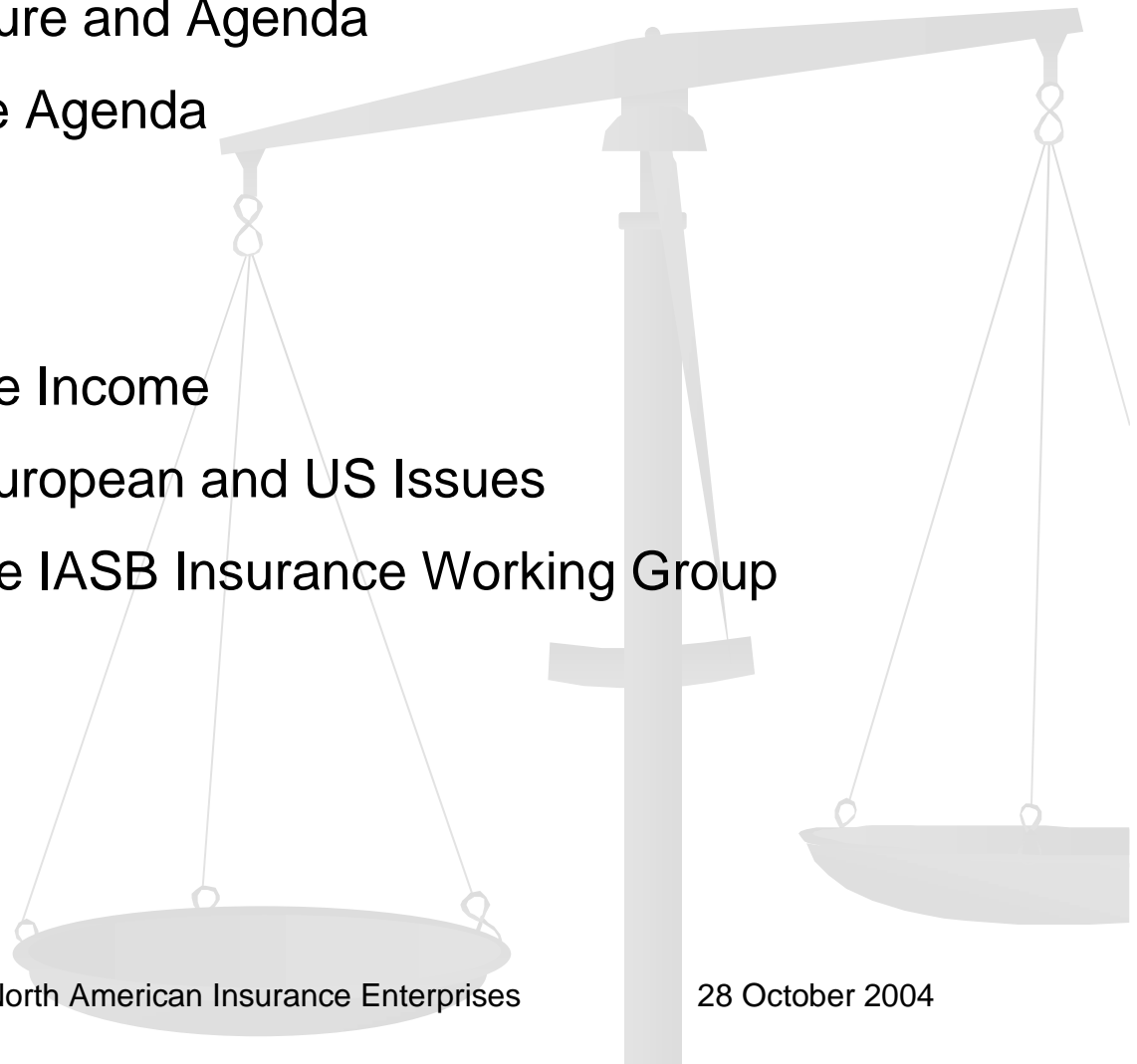
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Group of North American Insurance Enterprises
15 October 2004

Overview of Presentation

- Objectives and Activities of GNAIE
- IASB Background, Structure and Agenda
- FASB/IASB Convergence Agenda
- Insurance Contracts
- Revenue Recognition
- Reporting Comprehensive Income
- Financial Instruments - European and US Issues
- Due Process Issues of the IASB Insurance Working Group
- Predictions



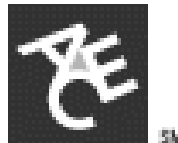
Group of North American Insurance Enterprises (GNAIE)



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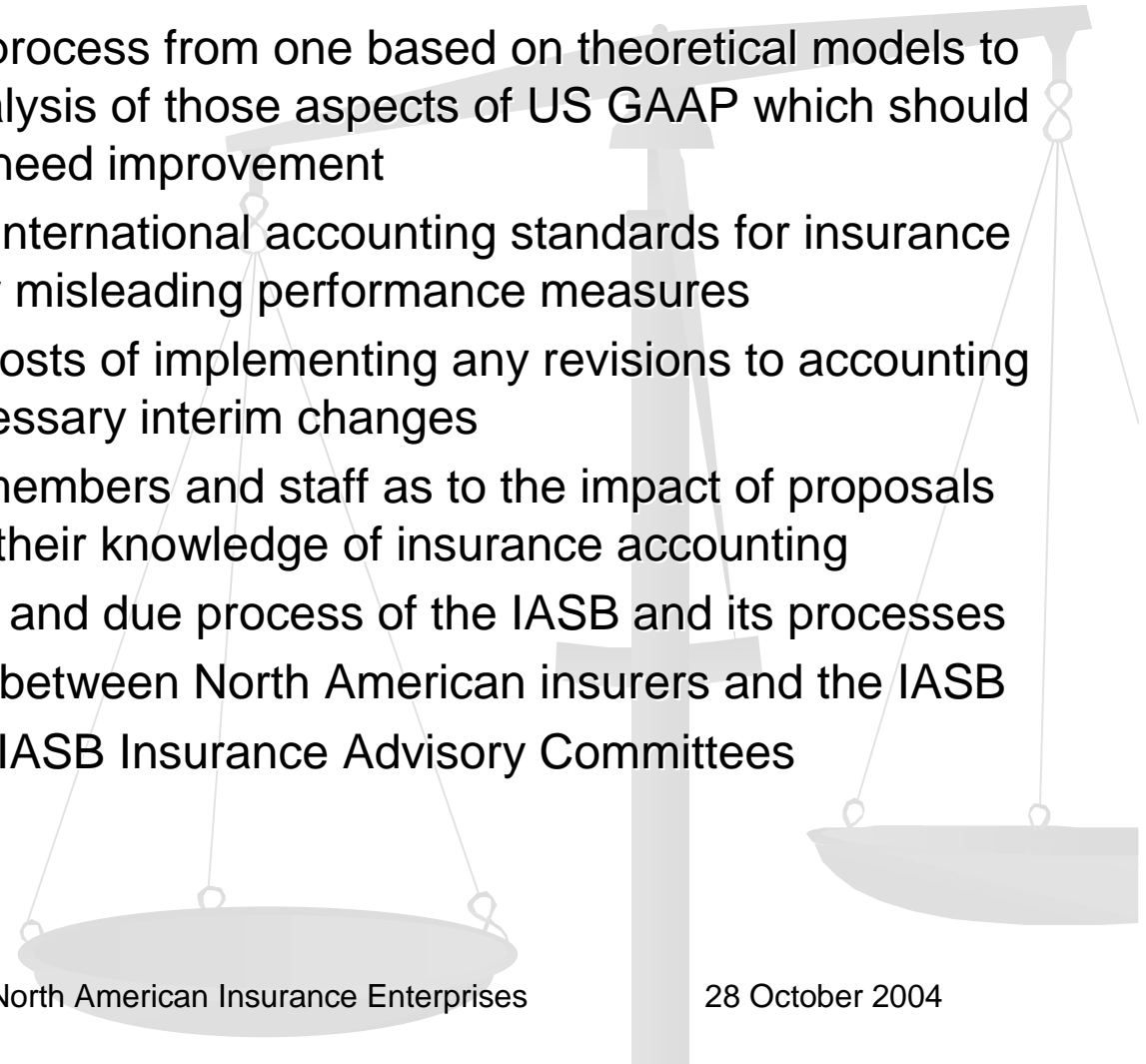
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Mission

To influence international accounting standards to ensure that they result in high quality, robust accounting standards for insurance companies.

Objectives of GNAIE

- 
- To reverse the current IASB process from one based on theoretical models to one which begins with an analysis of those aspects of US GAAP which should be retained and those which need improvement
 - To avoid any changes to the international accounting standards for insurance which would create volatile or misleading performance measures
 - To minimize the transaction costs of implementing any revisions to accounting standards by avoiding unnecessary interim changes
 - To educate the IASB Board members and staff as to the impact of proposals on insurance and to improve their knowledge of insurance accounting
 - To increase the transparency and due process of the IASB and its processes
 - To increase communications between North American insurers and the IASB
 - To strengthen the FASB and IASB Insurance Advisory Committees

Committees of GNAIE

- **Research Committee**
 - Focused on developing models which quantify the difference between US GAAP and Certain Fair Value Models
 - First a Study on Non-Life Insurance
 - Second, A Model for Life products
- **Accounting Convergence Committee**
 - Review insurance industry issues on IASB or FASB Agenda
 - Revenue Recognition (FASB/IASB joint project)
 - Reporting Financial Performance (FASB/IASB joint project)
 - Disclosure of Financial Risk (IASB project)
 - Insurance Contracts (IASB project)

Activities of GNAIE

- Letter to IASB re: ED7, Financial Instruments - Disclosure (Credit Risk)
- Letter to IASB re: Proposed Amendments to IAS 39 Financial Guarantee Contracts and Credit Insurance
- Letter to FASB on FSP 03-1-b, deferral of paragraph 1, September 29, 2004
- Letter to FASB on the FV Measurement Exposure Draft, September 7, 2004
- Letter to FASB regarding implementation of EITF 03-1, "other than temporary impairments", September 1, 2004
- Letter to NAIC IASWG on participation on the IAIS Accounting Subcommittee's Future Valuation Project, July 27, 2004
- Letter to IASB on the IAS 30 Improvements Project, June 7, 2004
- Letter to IASB on the development of insurance accounting standards June 11, 2003

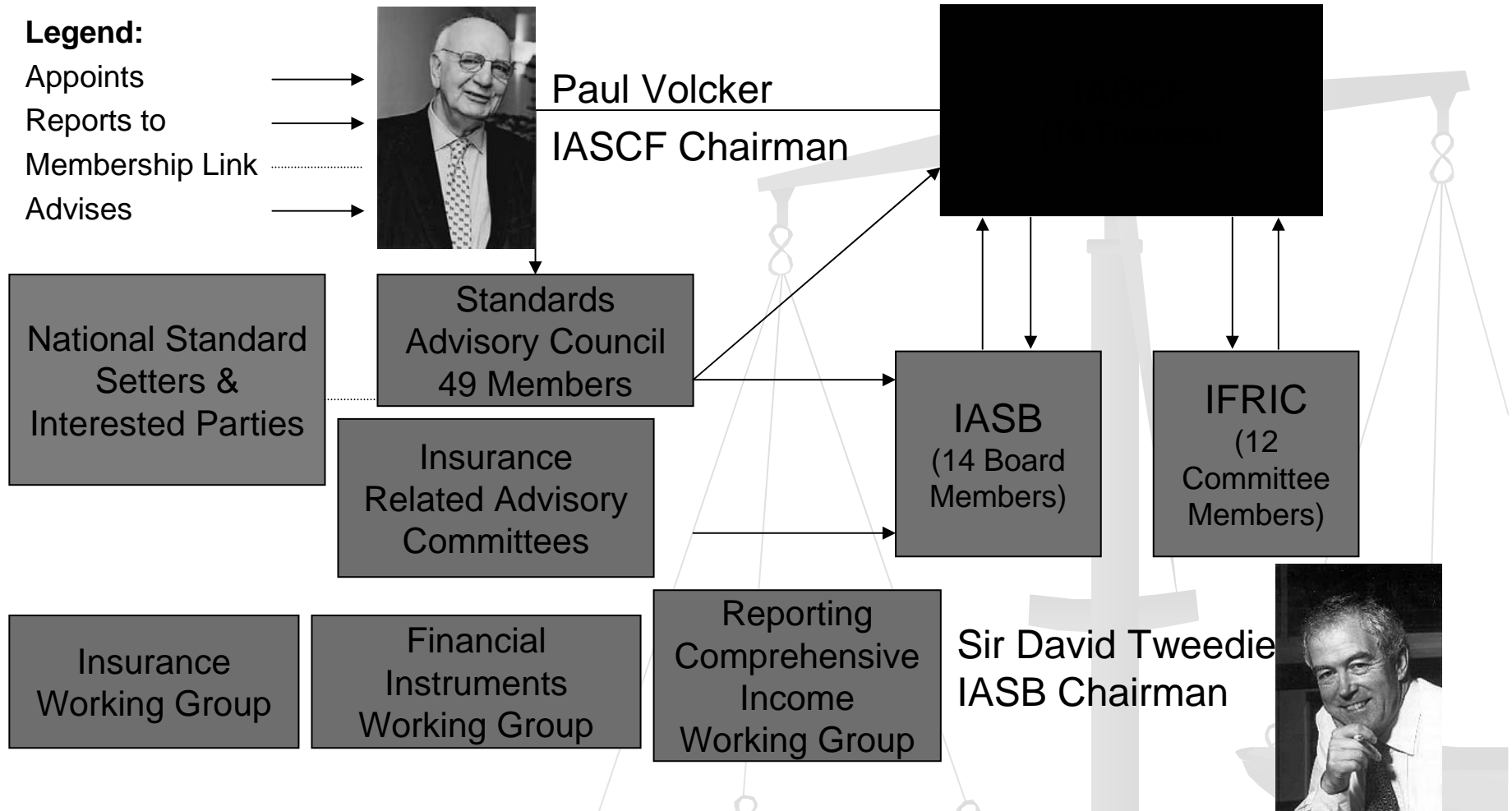
IASB Background

- IASC: International Accounting Standards Committee
 - From 1973 until a comprehensive reorganization in 2000, the structure for setting International Accounting Standards
- IASCF: International Accounting Standards Committee Foundation
 - Parent foundation, created as part of the reorganization in 2000 to oversee the IASB
- IASB: International Accounting Standards Board
 - Objectives of the IASB are:
 - to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;
 - to promote the use and rigorous application of those standards; and
 - to bring about convergence of national accounting standards and International Accounting Standards to high quality solutions.

IASB Structure

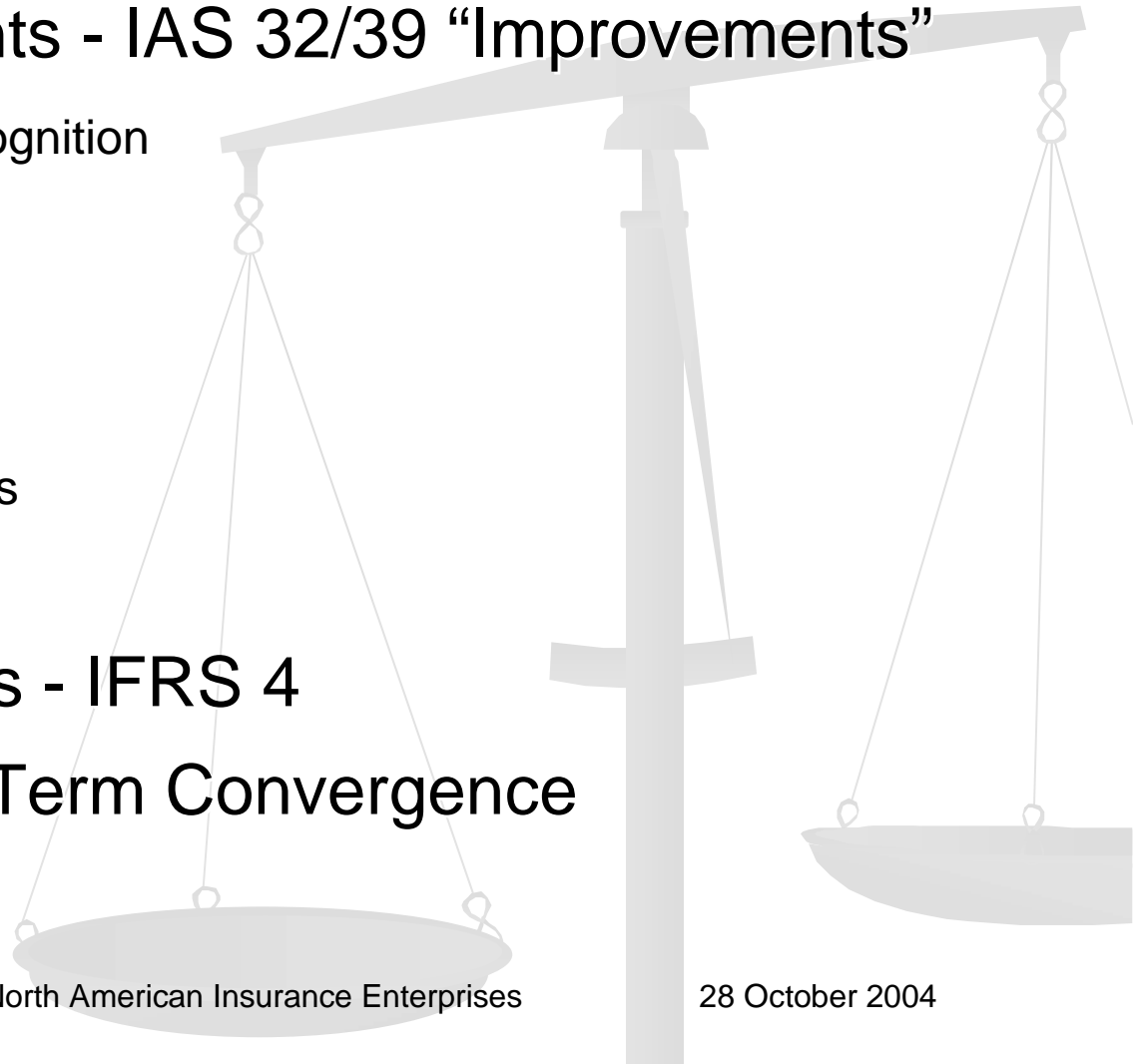
Legend:

- Appoints →
- Reports to →
- Membership Link ·····
- Advises →



Early IASB Actions

- General Improvements
- Financial Instruments - IAS 32/39 “Improvements”
 - Measurement and Recognition
 - Control
 - Risk/Reward
 - Sticky Fingers
 - Fair Value of Derivatives
 - Macro hedging
- Insurance Contracts - IFRS 4
- IASB/FASB: Short Term Convergence



Proposed Convergence Agenda

- Reporting Financial Performance
- Liabilities and Equity
- Measurement of Risk
- Disclosure Framework
- Revenue Recognition
- Leases
- Disclosure of Financial Risk
- Insurance Contracts



**International
Accounting Standards
Board®**



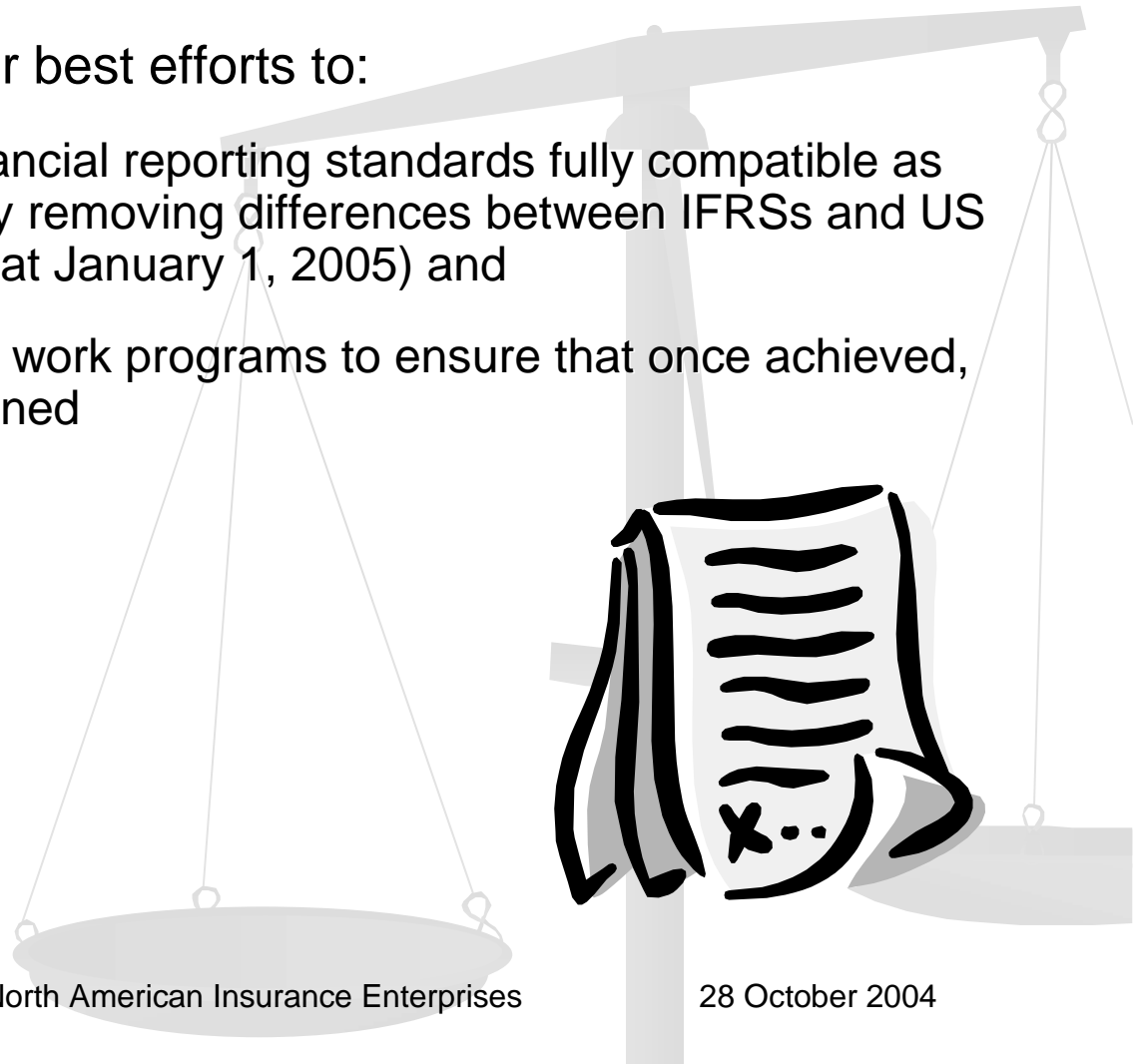
FINANCIAL ACCOUNTING STANDARDS BOARD

Serving the investing public through transparent information resulting from high-quality financial reporting standards, developed in an independent, private-sector, open due process.

Norwalk Agreement – Sept 2002

■ FASB/IASB Coordination of Agendas

- Both pledged to use their best efforts to:
 - Make their existing financial reporting standards fully compatible as soon as practicable (by removing differences between IFRSs and US GAAP that will remain at January 1, 2005) and
 - Coordinate their future work programs to ensure that once achieved, compatibility is maintained



IASB/FASB Joint Board Meetings

■ Toronto - October 2003

- Created a Joint Task Force on a Common Agenda
- From 2004, two joint meetings per year
- Similar priorities, agenda papers
- Increased priority on convergence items

■ London - April 2004

- Creation of the Convergence Agenda

■ Norwalk - October 2004

- Continuation of the Convergence Agenda

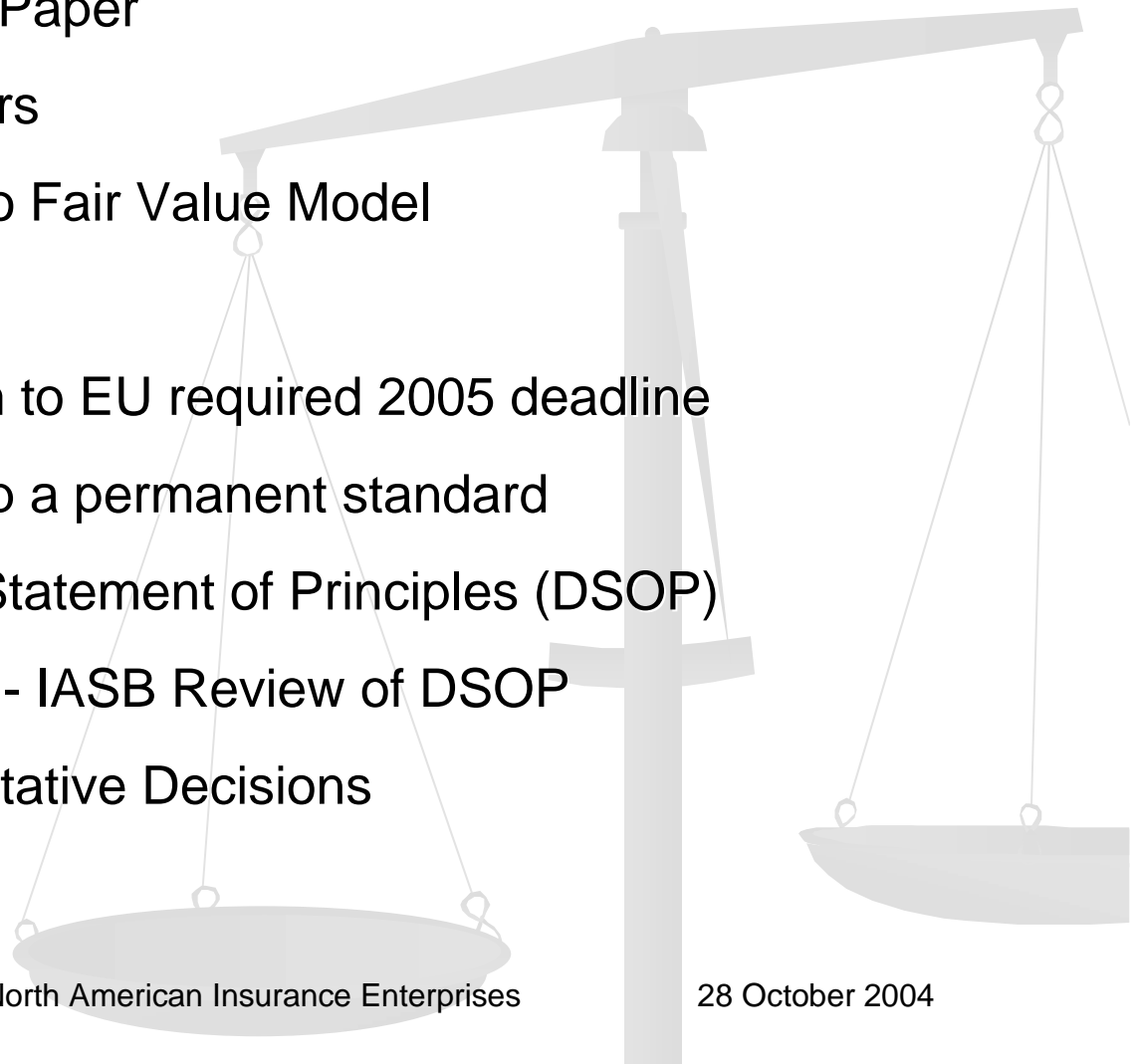


Japan Convergence

- 12th Oct 2004 IASB and Accounting Standards Board of Japan start talks about a joint project for convergence
- The International Accounting Standards Board (IASB) and the Accounting Standards Board of Japan (ASBJ) today started talks about a joint project to minimize differences between International Financial Reporting Standards (IFRSs) and Japanese accounting standards towards a final goal of convergence of their standards. Both boards believe that this effort is the first step in promoting further international convergence to high quality accounting standards and will contribute to the development of global capital markets

History of IASB for Insurance Contracts

- Project Starts - 1997
- December 1999 - Issues Paper
 - 150+ Comment Letters
 - Generally Opposed to Fair Value Model
- May 2002 - Two Phases
 - Phase I – To conform to EU required 2005 deadline
 - Phase II – To develop a permanent standard
- September 2002 - Draft Statement of Principles (DSOP)
- October-December 2002 - IASB Review of DSOP
- January 2003 - IASB Tentative Decisions



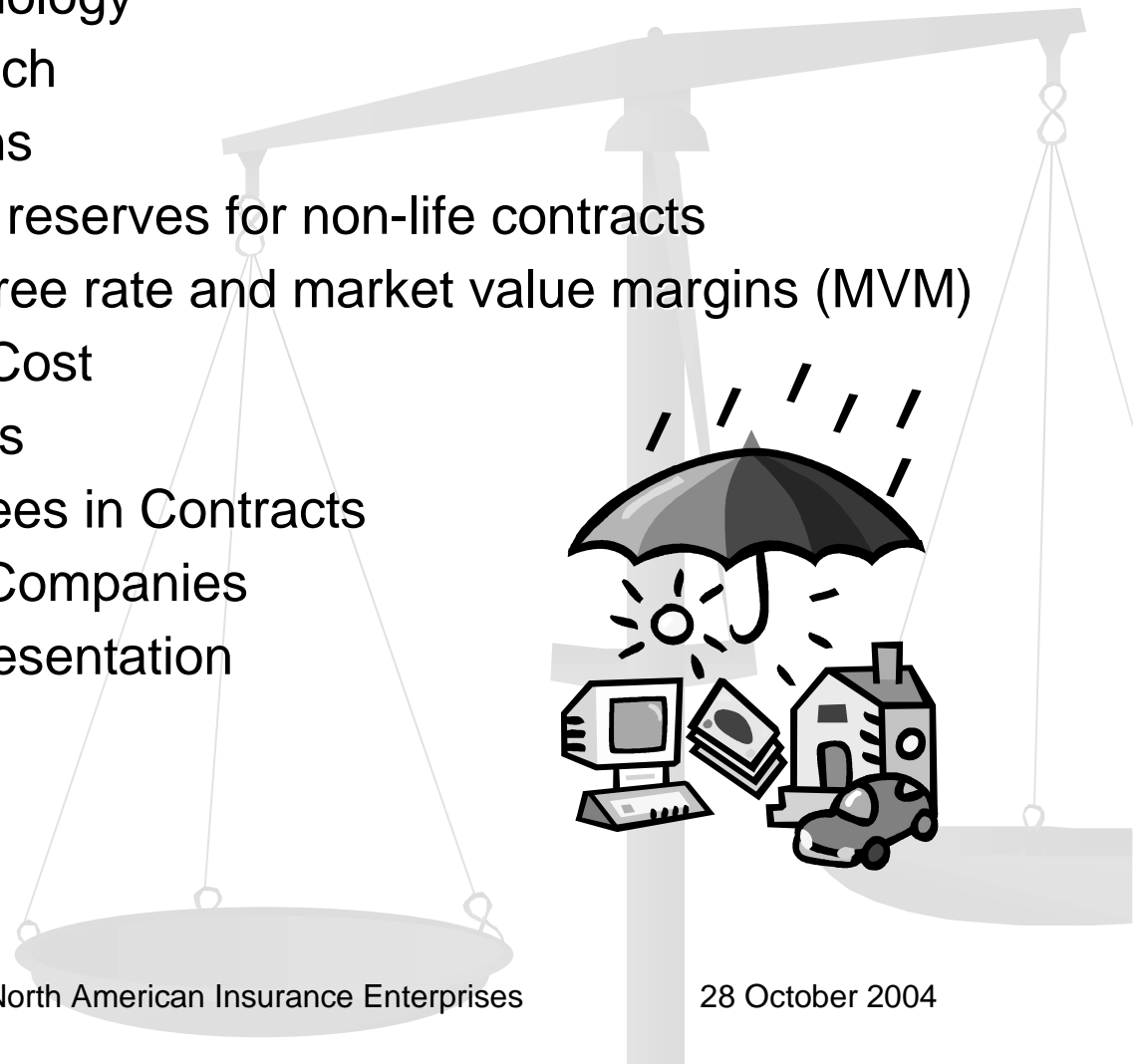
Insurance Contracts – Phase I (ED 5)

- ┌ Definition of Insurance Contract - Determination of Significant Risk
- ┌ Continue current measurement and recognition method by country
- ┌ Bifurcate and fair value embedded derivatives
- ┌ Unbundle certain contracts
- ┌ Prohibit certain provisions:
 - ┌ Catastrophe provision
 - ┌ Equalization provision
- ┌ Remove flexibility of reporting for participating contracts
- ┌ Increased disclosure of variable annuity contracts



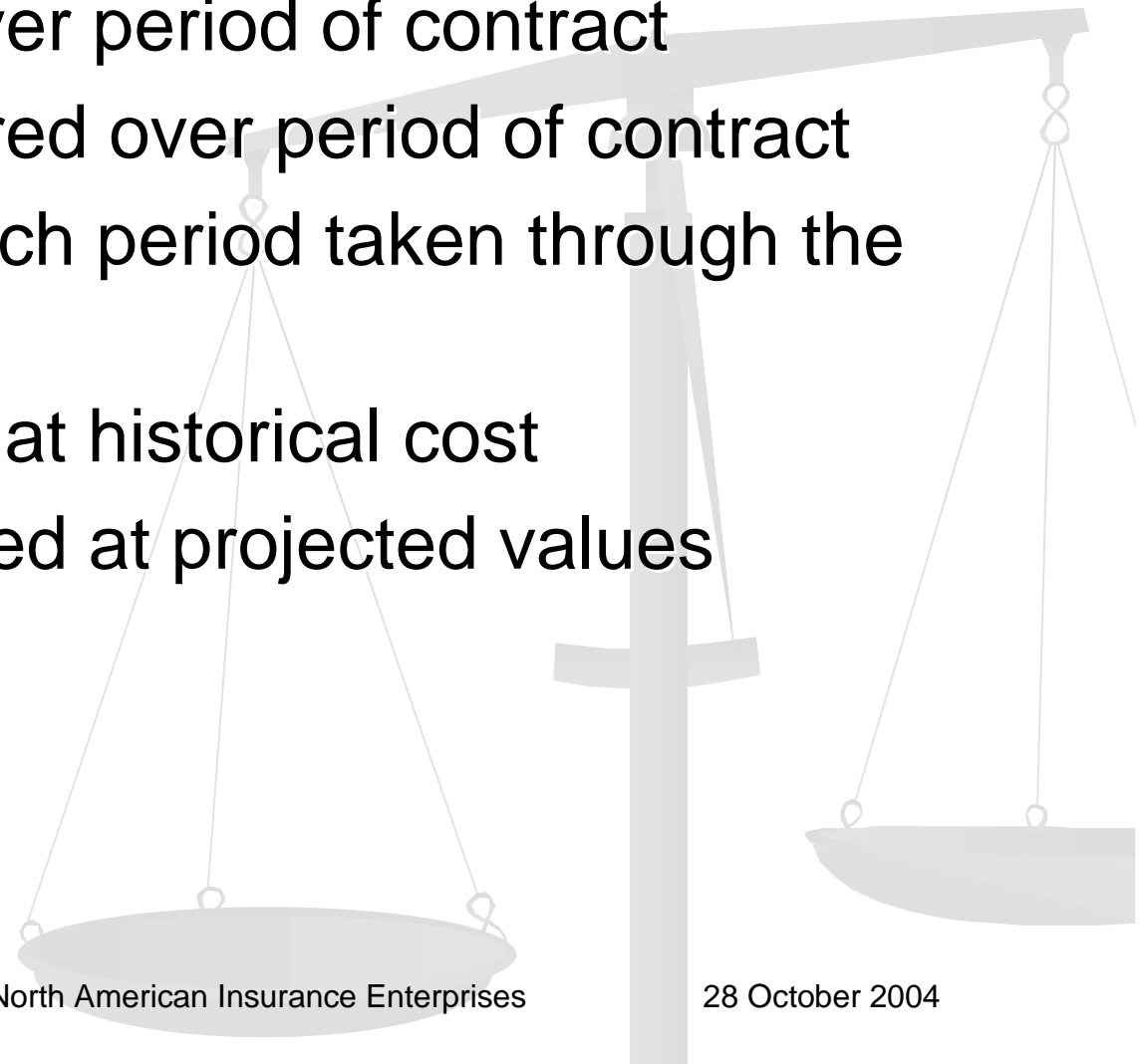
Insurance Contracts – Phase II

- Key Issues:
 - Measurement methodology
 - Asset/Liability Mismatch
 - Lock-in of assumptions
 - Discounting of claims reserves for non-life contracts
 - Development of risk-free rate and market value margins (MVM)
 - Deferred Acquisition Cost
 - Participating Contracts
 - Options and Guarantees in Contracts
 - Treatment of Mutual Companies
 - Income Statement Presentation
 - Disclosure
 - Transition



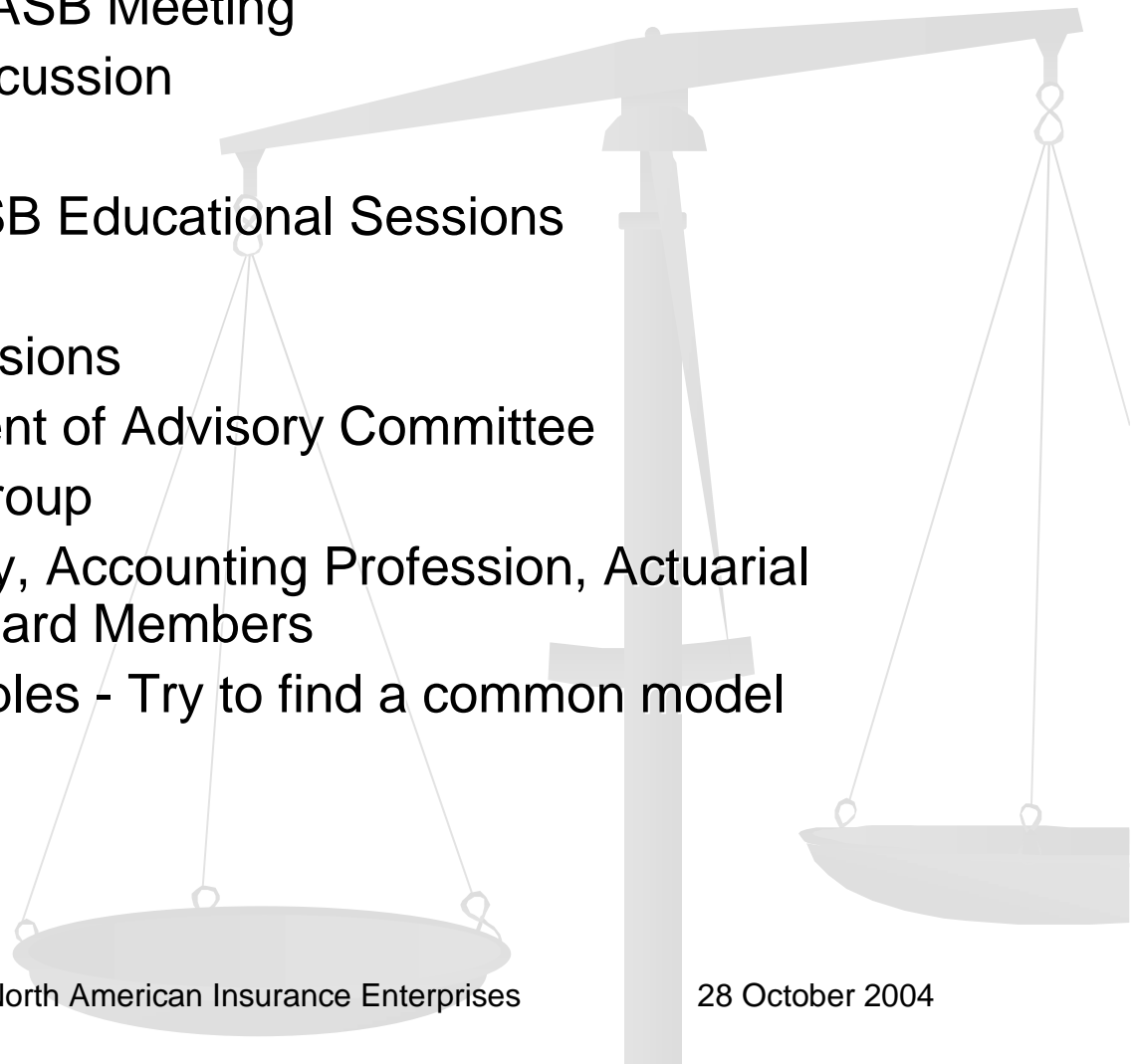
US View - Insurance Contract Accounting

- Income earned over period of contract
- Expenses measured over period of contract
- Net income for each period taken through the income statement
- Assets measured at historical cost
- Liabilities measured at projected values

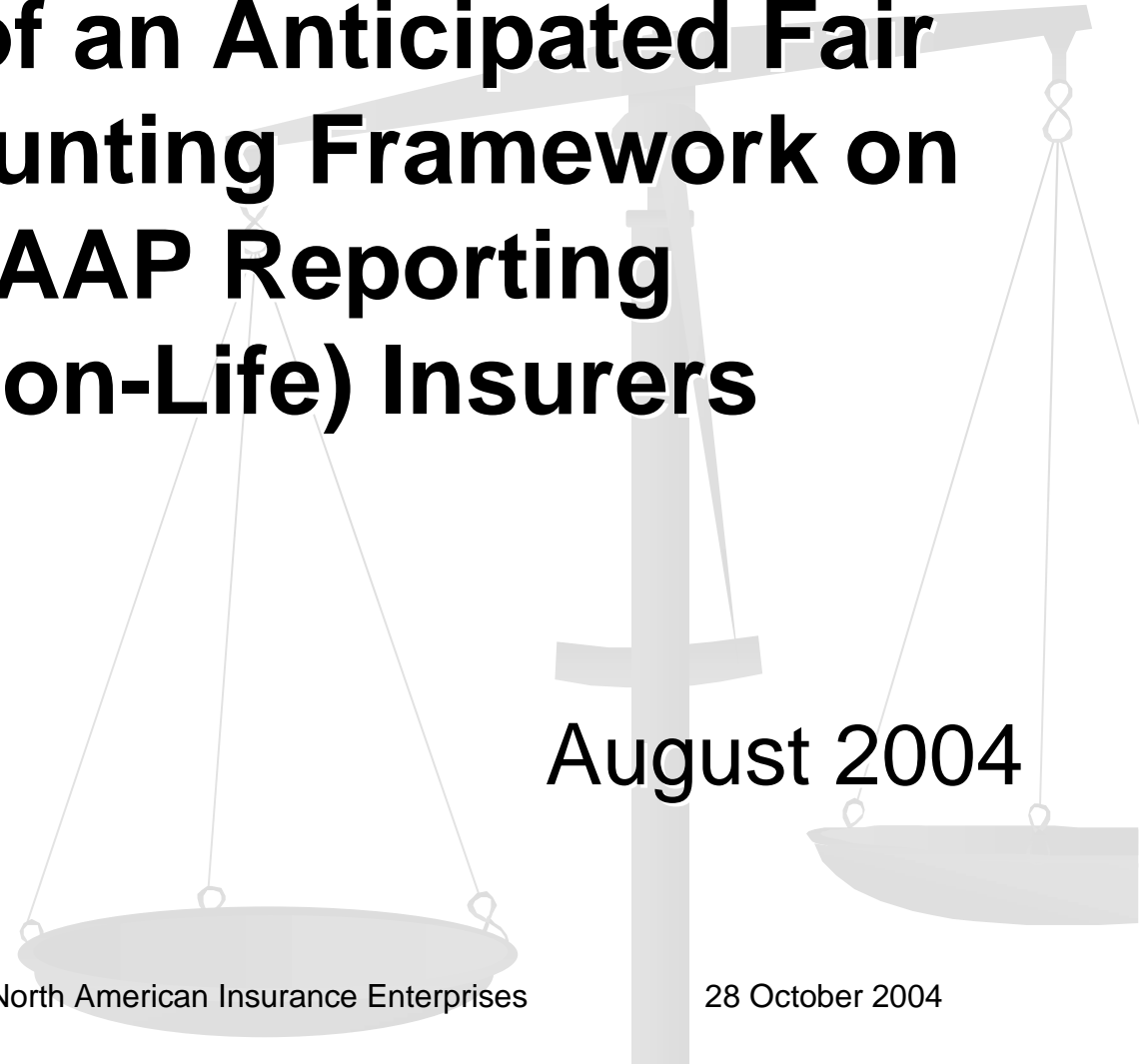


Phase II IASB Progress

- April 2004 - Joint FASB/IASB Meeting
 - Insurance Project Discussion
 - Modified Joint Project
- July/September 2004 IASB Educational Sessions
 - 2004 IASB Meetings
 - Other Information sessions
- August 2004 - Appointment of Advisory Committee
 - Insurance Working Group
 - Meetings with Industry, Accounting Profession, Actuarial Profession, Users, Board Members
- Start with National Principles - Try to find a common model



The Impact of an Anticipated Fair Value Accounting Framework on US GAAP Reporting P&C (Non-Life) Insurers



August 2004

Ernst & Young Conclusions

- Equity Will Likely Increase
- The Revaluation of Discounted Loss Reserves Causes Volatility in Underwriting Income
- Changes in the Market Value of Assets Cause Volatility in Net Income
- Changes in the Expected Payment Pattern Cause Volatility In Underwriting Income
- Changes in the Market Value Margins Cause Volatility in Underwriting Income
- The Provision for Insurer's Own Credit Standing Will Impact Underwriting Income

Judgment and Estimates Increase

- **Fair Value Requires Increased Use of Management Judgment and Subjective Estimates.**

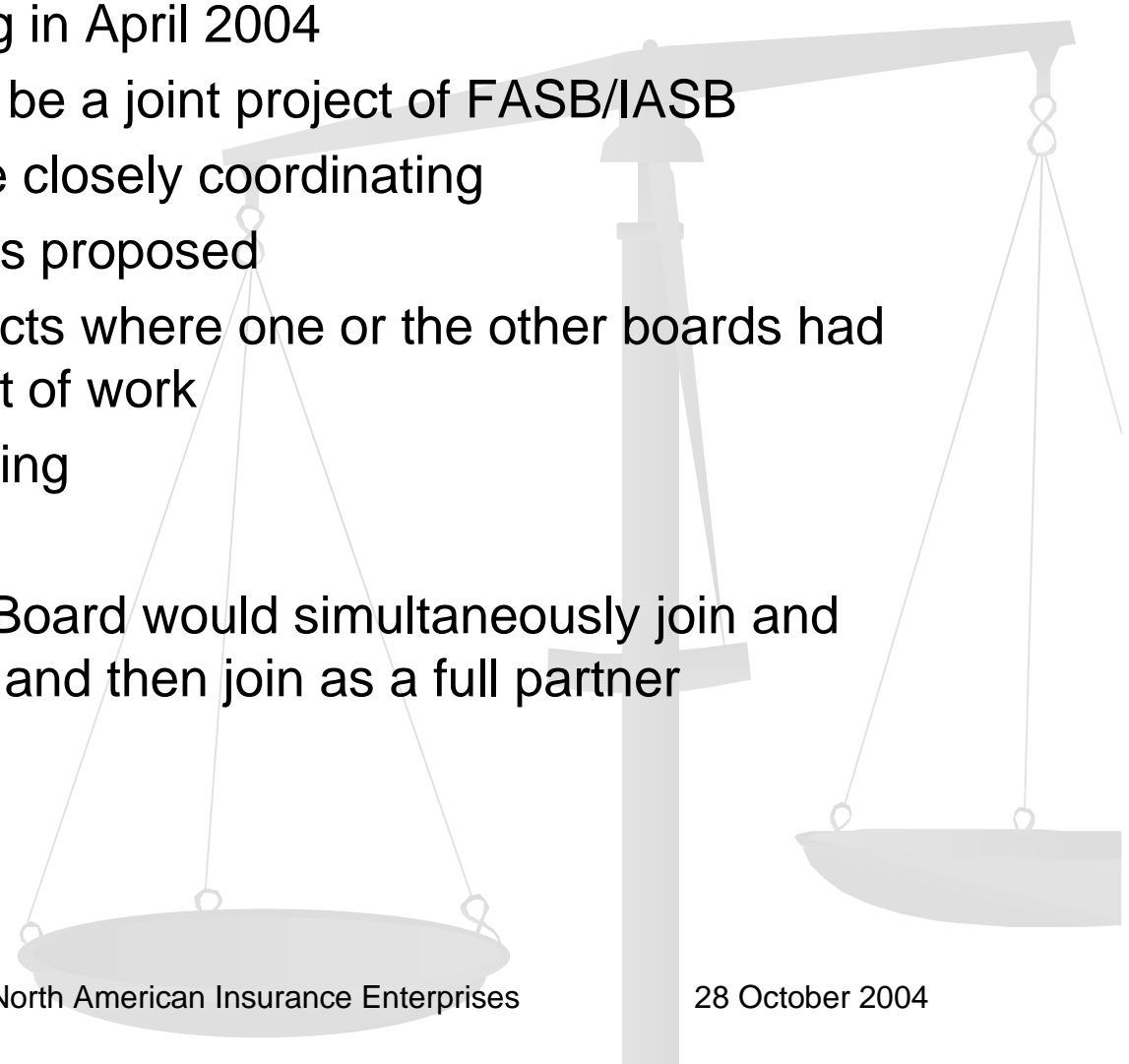
These include:

- The approach and quantification of the Market Value Margin.
 - The expected profit associated with US GAAP unearned premium.
 - Explicit provisions for the amount and timing of claim and expense payments (payout pattern).
 - Future interest rates.
- **Changes in Fair Value Judgments May Produce Trends in Reported Fair Value Results that are Inconsistent with US GAAP**

Insurance Contracts

Modified Joint Project of IASB/FASB

- Joint FASB/IASB meeting in April 2004
- Any major project should be a joint project of FASB/IASB
- Discussed plans for more closely coordinating
- Modified Joint Project was proposed
- One of a number of projects where one or the other boards had done a significant amount of work
- Single leader, staff following
- Perhaps team members
- At some point, the other Board would simultaneously join and expose the projects draft and then join as a full partner
- Administrative Issues

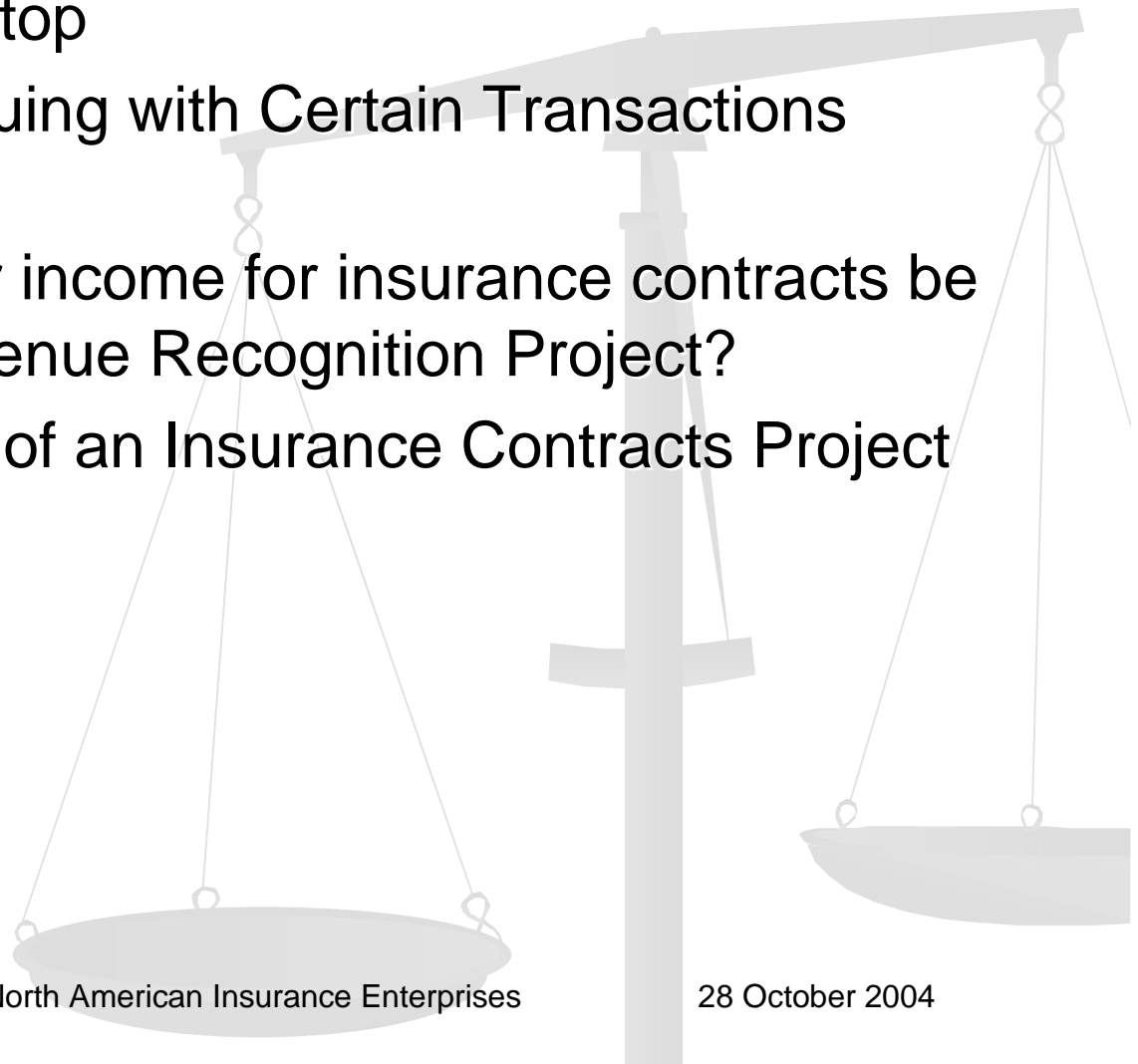


Revenue Recognition

- General Approach
 - FASB Project
 - IASB Project
 - Fair Value all Assets and Liabilities
 - Report Periodic Changes in Income Statement
- Insurance Issues
 - Revenue for insurance contracts-defined in US GAAP
 - IASB/FASB Projects do not consider
 - Scope Out Insurance Contracts or Include in Papers
 - Should be part of Insurance Contracts

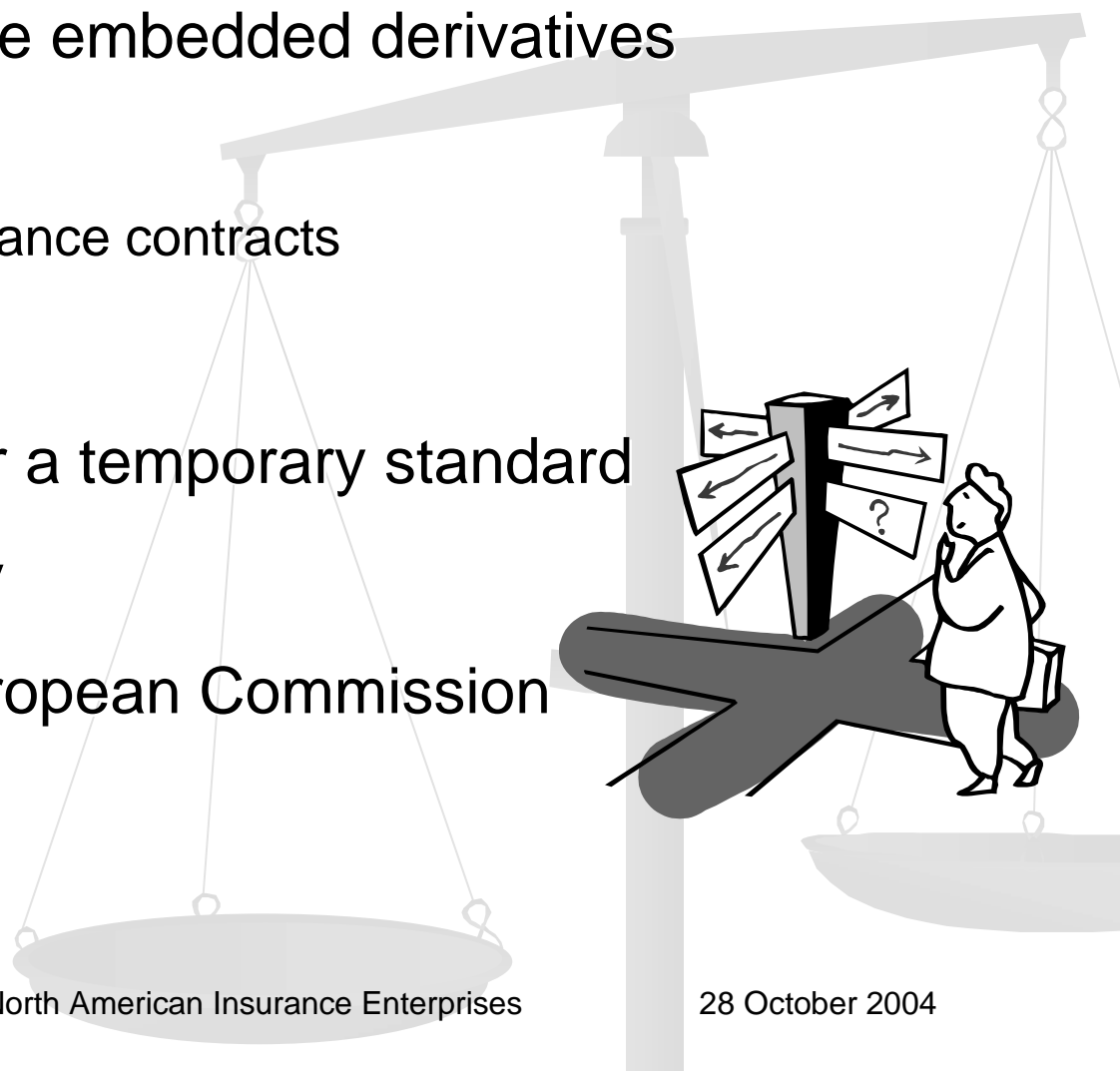
Reporting Comprehensive Income

- IASB Project – Full Stop
- FASB Project Continuing with Certain Transactions taken through equity
- But, will treatment for income for insurance contracts be a function of the Revenue Recognition Project?
- Should be a function of an Insurance Contracts Project
- Or Scope Out?



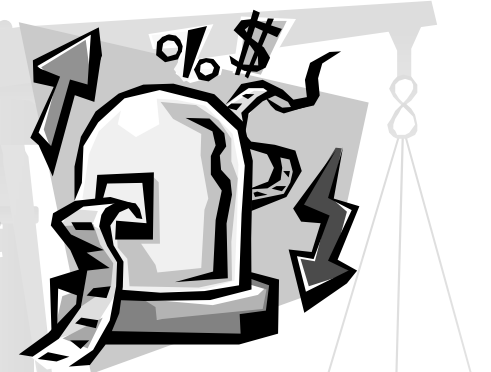
European Issues-Insurance and IAS 32/39

- Asset/Liability Mismatch
- Separate and fair value embedded derivatives
 - Creates confusion
 - How to distinguish insurance contracts
- Inadequate transition
- Too many changes for a temporary standard
- Inappropriate Volatility
- EFRAG to ARC to European Commission



Overview of IAS 32/39

- Modified FAS 115/133
- Categories of investments:
 - Trading - MTM - Income
 - Available for Sale (AFS) – MTM - Equity
 - Held to Maturity (HTM) – Amortized Cost
- Reporting Changes in fair value
 - Trading – Investment Income
 - AFS – “Other Comprehensive Income” (Equity)
- Majority of portfolio will be held in AFS and valued at Fair Value; liabilities will be held at cost creating a Mismatch in Balance Sheet and Income Statement



Financial Instruments

- Definitional Issues
 - Insurance Contracts
 - Everything Else
 - Where to draw the line?
 - Can it be drawn?
 - Is FAS 115/133 the International Answer?
- Financial Assets
 - Assets Backing Liabilities
 - Time to Review FAS 115?



What Does the Future Hold?

Possible Timing:

- Final IASB Insurance Contracts standard by 2007/2008
- Gradual Convergence with FAS with ultimate in 2009/2010



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