

Valuation of Technical Provisions

IAIS views



IAIS-ASSAL Training Seminar

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Shinichi Kishi – Principal Administrator

International Association of Insurance Supervisors (IAIS)



Outline

1. IASB Phase II Project on Insurance Accounting
2. IAIS views on IASB project
3. Development of IAIS Standard on the Valuation of Assets and Liabilities for Solvency Purposes



1. IASB Phase II Project on Insurance Accounting

Why is the IAIS interested in IASB standards?

- IAIS is concerned with regulatory reporting – why should it bother with the IASB
- “The IAIS believes that it is most desirable that the methodologies for calculating items in general purpose financial reports can be used for, or are substantially consistent with, the methodologies used for regulatory reporting purposes, with as few changes as possible to satisfy regulatory reporting requirements”



1. IASB Phase II Project on Insurance Accounting

What is IFRS?

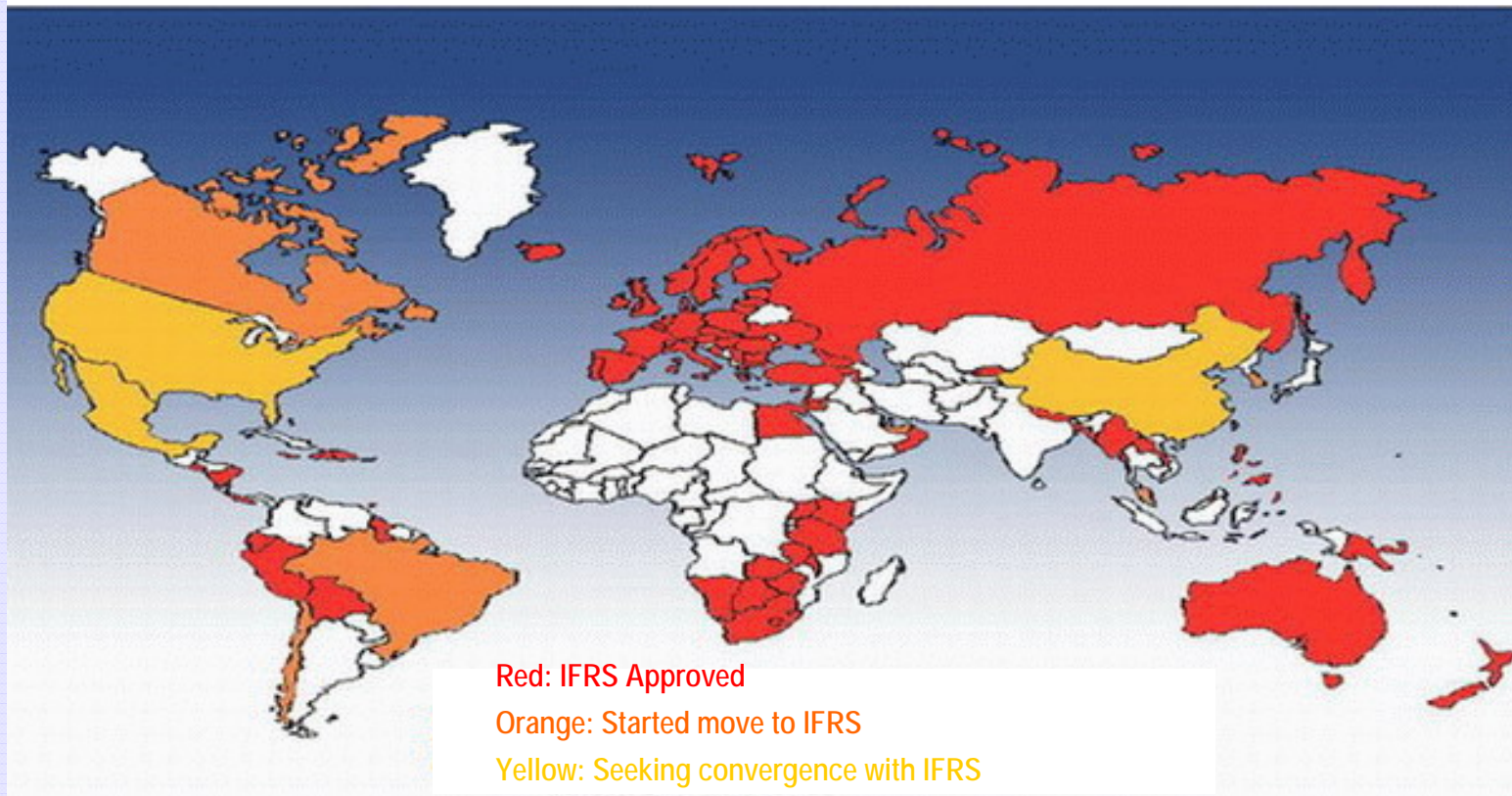
- IFRSs are a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements
- IASB (International Accounting Standards Board) has been committed to developing IFRSs



1. IASB Phase II Project on Insurance Accounting

Wide spread IFRS

- More than 100 countries now require or permit the use of IFRSs or are converging with IFRSs





1. IASB Phase II Project on Insurance Accounting

Who develops IFRSs?

- IASB Board Members



D. Tweedie
UK
Chair



T. Jones
USA
Vice Chair



M. Barth
USA



S. Cooper
UK



P. Danjou
France



J. Engström
Sweden



R. Garnett
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France



P. Kalavacherla
India



J. Leisenring
USA



W. McGregor
Australia



J. Smith
USA



Z. Wei-Guo
China



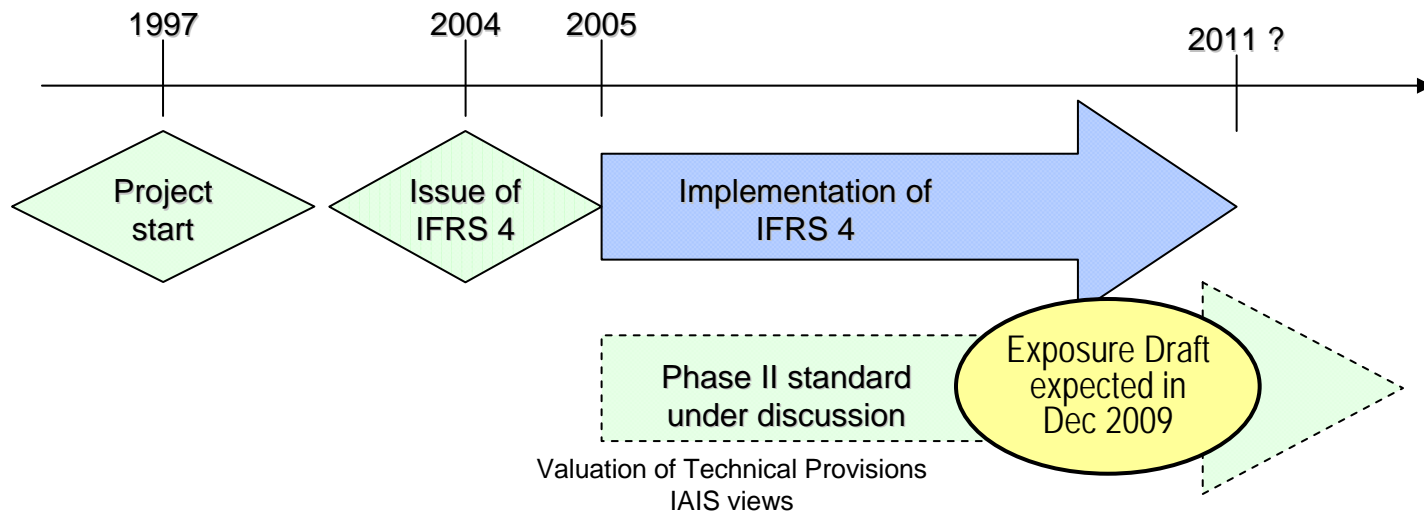
T. Yamada
Japan



1. IASB Phase II Project on Insurance Accounting

How does IASB develop IFRSs for insurance?

- IASB Insurance Contract Project
 - Started in 1997
 - IFRS 4 Insurance Contract (phase I), which does not alter insurance accounting significantly, was issued in 2004
 - Discussion Paper (DP) on phase II, which deals with the valuation of insurance liabilities, was issued in May 2007





1. IASB Phase II Project on Insurance Accounting

Main proposals in Discussion Paper (DP)

- Insurance contract attributes “Current Exit Value” or CEV
- CEV is defined as the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations to another entity
- CEV very rarely observable, so a proxy methodology using 3 building blocks used instead consisting of expected cash flows, a discount for time value of money, and a margin that would be demanded by a market participant



1. IASB Phase II Project on Insurance Accounting

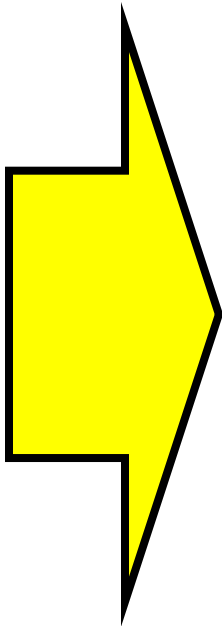
DP proposal – three building blocks

- Explicit, unbiased, market-consistent, probability-weighted and current estimates of the contractual cash flows,
- Current market discount rates that adjust the estimated future cash flows for the time value of money, and
- An explicit and unbiased estimate of the margin that market participants require for bearing risk (a risk margin) and for providing other services, if any (a service margin)



1. IASB Phase II Project on Insurance Accounting

Potential impacts brought by Insurance IFRS



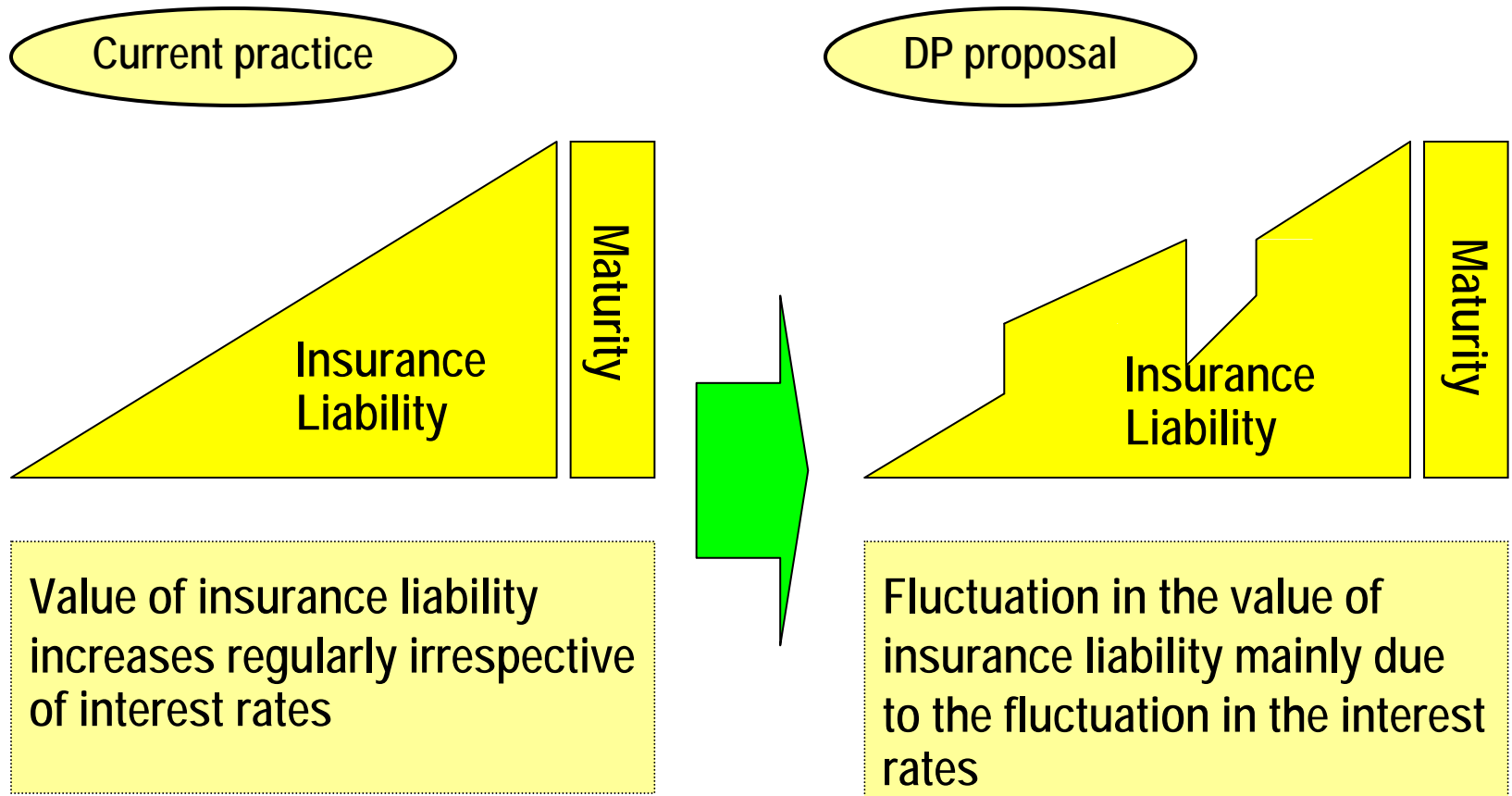
1. Constant fluctuation in the value of insurance liability mainly due to the fluctuation in interest rates

2. Profit on Inception (POI) would possibly arise, which might result in insufficient reserve



1. IASB Phase II Project on Insurance Accounting

Constant fluctuation in insurance liabilities

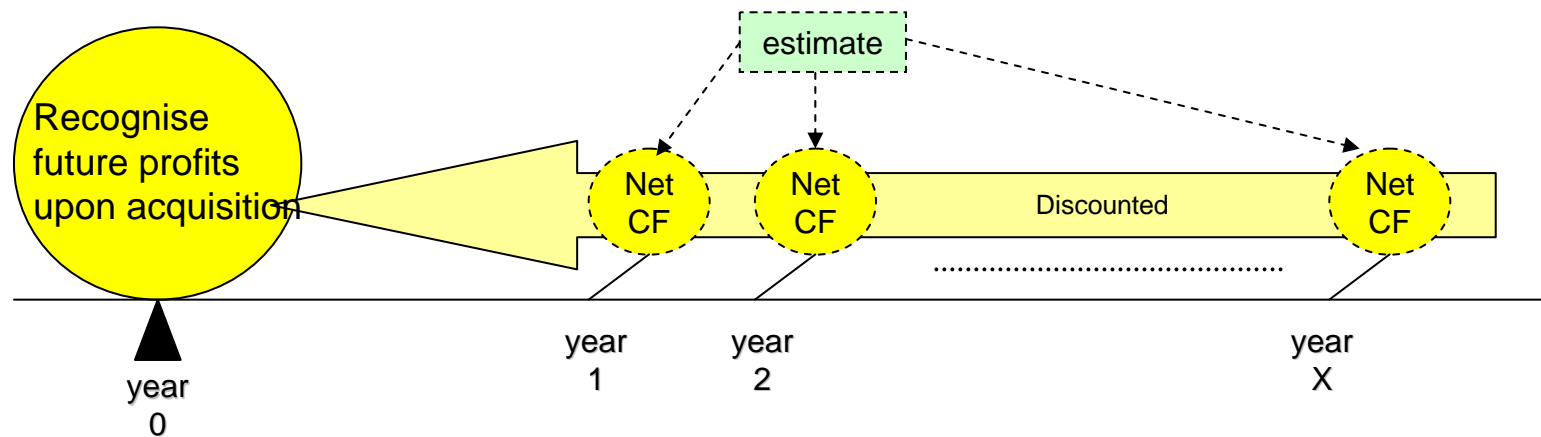


(*) In the case of endowment insurance



1. IASB Phase II Project on Insurance Accounting

Profit on Inception (POI)



- Where is market consistent information?
 - *There is no deep liquid secondary market which would provide observable market values for insurance liabilities.*



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2. IAIS views on IASB project

IAIS Views – General

- Future cash flows relating to full settlement with the claimant/beneficiary should be the basis for measuring insurance liabilities
- An approach which uses observable inputs from deep and liquid markets to the fullest extent possible is appropriate in insurance liability valuation
- Similar obligations with similar risk profiles should result in similar liabilities
- Probabilities which reflect likely policyholder behaviour are needed to achieve meaningful results
- Including adjustments for credit standing in the measurement of insurance liabilities would be misleading



2. IAIS views on IASB project

IAIS views – Recognition & measurement

- Recognition & IAS39: a theoretically pure approach to recognition along the lines of IAS39 *probably* not worth it from a cost/benefit standpoint.
- A practical approach to market assumptions and a company's own experience with a particular portfolio.



2. IAIS views on IASB project

IAIS views – Margin & Profit on Inception

- "An exit model is preferable but profit on inception should be recognised only where an appropriate and sufficiently reliable risk margin has been provided for in the value of liabilities."
- While IAIS Members are unanimous that losses on inception should be recognised immediately, they differ regarding situations where a profit on inception might possibly arise.



2. IAIS views on IASB project

IAIS views – Transfer VS Settlement

- Exit (transfer) value vs. settlement value debate – potentially very relevant
- “Transfers would need to be made to an entity capable of accepting the transfer which implies that the transferee would also need to be regulated and capable of **settling** the obligation to the claimant/beneficiary. Any transfer notion would be strongly influenced by the **settlement** obligations that the transferee would undertake”

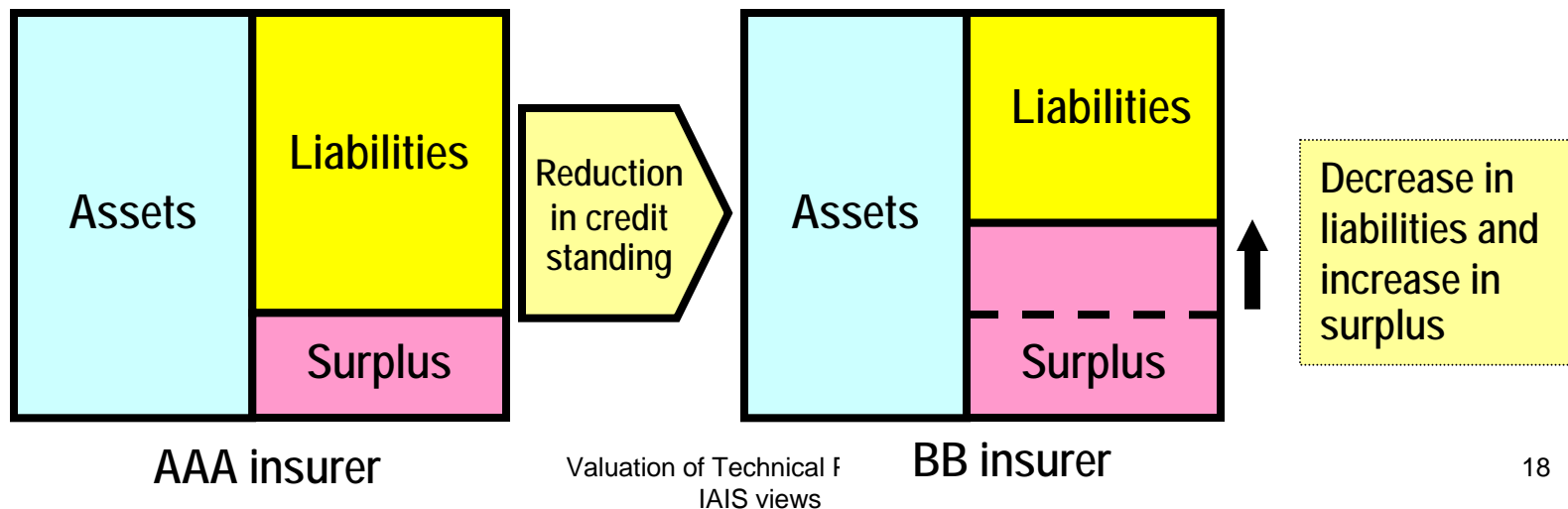


2. IAIS views on IASB project

IAIS views – Own Credit Standing

DP proposed to include insurers' own credit standings in the valuation of insurance liabilities

➡ Do we support a reduction in liabilities for a reduction in credit standing of the insurer?





2. IAIS views on IASB project

IASB's new proposal (February 2009)

Approach	Current exit value (Candidate 1)	Current fulfilment value (Candidates 2-4)
Concept	The expected payment required to transfer the remaining contractual rights and obligations immediately to another entity	The expected present value of the cost of fulfilling the obligation to the policyholder over time
Margins	The compensation required by market participants for bearing risk	The cost of bearing risk , measured from an entity's perspective
Profit or loss on inception	Profit or loss on inception	Profit or loss at inception (2) No profit on inception, loss possible (3,4)
Own credit standing	Yes	No



2. IAIS views on IASB project

Next steps?

- IASB will move ahead with the project
 - Exposure draft: Expected in December 2009
 - Finalisation of phase II standard: 2011?
- IAIS will continue to monitor and provide comments to IASB
- IAIS is developing a standard and guidance paper on the valuation of assets and liabilities for solvency purposes



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3. Development of IAIS standard on valuation

IAIS Standard on the Valuation of Assets and Liabilities for Solvency Purposes

- Under development jointly by the Solvency and Insurance Contracts Subcommittees
- Focus on the supervisory purposes of valuation
- Characteristics of technical provisions are similar to those being considered by IASB
- Target: October 2010





3. Development of IAIS standard on valuation

Key requirements – provisional

- The valuation for solvency purposes of technical provisions should be an economic valuation which is undertaken on a market-consistent basis.
- The methodology for calculating technical provisions should be the same as, or substantially consistent with, the methodology used for calculating the equivalent item in general purpose financial reports



3. Development of IAIS standard on valuation

Key requirements – provisional (continued)

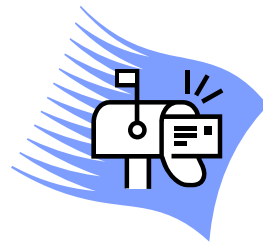
- Technical provisions should be valued in a prudent, reliable, objective and transparent manner to allow comparison across insurers worldwide.
- Technical provisions conceptually comprise two components – Current estimate and Margin over current estimate.
- The technical provisions should reflect all future cash flows that are expected to arise in fulfilling the insurance obligations.



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Muchas Gracias !

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shinichi.kishi@bis.org