

*The Insurance Industry and IAS
Challenge and Opportunities
Live Forum Summary
9 and 10 October, 2001*

The former IASC Board started a project on Insurance Accounting in 1997. An Insurance Steering Committee was set up and an Issues Paper on Insurance was published in December 1999, with comment letters received. In April 2001, a new International Accounting Standards Board (IASB) was appointed to replace the former IASC Board. The Board decided to allow the Insurance Steering Committee to complete its work on the Insurance Draft Statement of Principles (DSOP). In June 2001, the Insurance Steering Committee met in Paris and discussed the last draft of the DSOP. At the September 2001 IASB meeting, the IASB agreed in principle to the Insurance Steering Committee's proposal to carry out field visits with insurance companies, but at this stage the IASB has not yet discussed any of the Insurance Steering Committee's proposals. These proposals are based on the draft Insurance DSOP, which currently is not a public document and has not been officially published by the Insurance Steering Committee, but is widely discussed within the insurance industry as a working document.

The new IASB is in the process of studying proposals that could have a substantial effect on financial reporting by insurance companies, with projects on financial instruments, insurance contracts, measurement and financial performance reporting. The key features of the draft Insurance DSOP are that it deals with insurance contracts only. It states that insurance risk must be present in order for a product to qualify as an insurance contract and it promotes an asset and liability approach as opposed to the traditional deferral and matching method. The approach has revolutionary consequences for financial communication as a whole.

In this context, insurers (namely Allianz, AXA, CGNU, Munich Re, Swiss Re, Zurich Financial Services, with the assistance of Deloitte Touche Tohmatsu) decided it was necessary to bring together CEOs and CFOs of major insurance companies, investors, analysts, standard-setters, including representatives from the IASB, regulators, actuaries and auditors in order to provide an arena for discussion and debate surrounding financial reporting by insurance groups, particularly on the accounting for insurance contracts and performance reporting. Such a forum, entitled "The Insurance Industry and IAS: Challenges and Opportunities", took place in Paris on 9 and 10 October 2001.

Approximately 200 people, representing 16 countries across all continents attended the forum. There were 26 speakers and panelists from the IASB, the insurance industry, FSI supervisors and regulators, financial analysts and investors, auditors and actuaries. The atmosphere over the 2 days was one of genuine interest in the topic. All participants remained extremely focused throughout the entire forum and listened intently to the presentations. They all welcomed this unique opportunity to express their views and participate in lively debate with people from different organizations and countries, both during the forum and gala dinner.

The overall flavor of the forum was that there is a clear need for harmonization. Change will happen. Even if it is clear that change will not satisfy everyone, for change to have substance and to be endorsed, all interested parties must have continuous active involvement in the debate. IAS are being used increasingly around the world and the European Union is proposing a requirement for listed companies to report under IAS by 2005. Currently there is no IAS for insurance, so the burning question was could this goal be achieved within this tight timeframe. Most insurers would like to have an IAS on Insurance Contracts finalized by the end of 2002, or mid 2003 at the very latest, to enable implementation of the standard for the 2005 deadline imposed by the European Commission. Caution was suggested, mainly by insurers and regulatory bodies against any rush to a revolutionary standard. Furthermore, for insurers, there was a sense of

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apprehension about being the industry at the forefront of this issue. An idea expressed by some was that by 2005 we don't have to change the world, but we do want one common standard, which it is now accepted, may not be perfect.

US pronouncements were closely scrutinized and the general feeling was that US standards alone, are not the best way to achieve international comparability and transparency, as they do not address all situations relevant to the rest of the world. There was also consensus for convergence between the US standards and IAS and much more consultation between the two standard-setting bodies.

There is a clear desire by the IASB to remove the distortions and arbitrary nature of current insurance accounting. In their view, the proposal to adopt an asset and liability approach to measuring insurance liabilities is directly linked to the desire to closely align future standards with the conceptual framework developed by the IASB. There were mixed reactions about this approach, i.e. valuing assets and liabilities completely independently. In particular most insurers argued that the liabilities are in fact dependent on the investment returns of the assets supporting them. Asset and liability management is a core part of the business and valuing liabilities independently of the investment returns of the assets could lead to misleading information.

There was a feeling expressed by insurers and European analysts that the accounts of an insurer should not 'effect' the way a business operates, but rather 'reflect' the way the business operates. Some investors consider the accounts as only one component in the evaluation of a company and are much more interested in taking a strategic view of the company's operations as a whole. Insurers and European analysts raised doubts as to whether the proposed approach to valuing insurance business would reflect management practices in the industry, or whether it would push the industry to change their management style to counter-effect unwanted volatility. Insurers stated that they are not only managing assets and liabilities, but insurers provide services to customers using the whole balance sheet as one tool. They express concern for the potential for large misalignment between internal reporting and external reporting if synergies are not found.

Overall there was a general consensus that fair value is a theoretically appealing concept. However views were then divided between fair value and entity-specific value as a concept, and which model provided more useful and relevant information, and to whom. Analysts and investors, specifically U.S analysts were in favour of a fair value model as they thought it to be more comparable. Others, mainly European analysts were in favour of entity-specific value as it is a more predictive model, and gives more information about management's operations and decisions made. Nevertheless, in both cases reliability was clearly addressed. There were concerns raised by regulators and auditors that the level of subjectivity will increase, which will in turn effect the ability of auditors to validate the numbers in the accounts.

Whatever model is used, the question was asked and actively debated as to whether those values need to impact the balance sheet and income statement, thus introduce more volatility, or whether it is preferable to have them only as note disclosure. Views were strongly divided on this point. Analysts and investors argued that volatility is not a new concept, and if fair value accounting brings such volatility to light, then this may be acceptable if proper disclosure is given and movements clearly explained. It was felt that volatility is very much related to performance reporting and that this project must be resolved concurrently with insurance to prevent inconsistent treatment with other financial instruments. On the other side, it was argued mainly by insurers, that such volatility does

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not reflect the true underlying business of insurance and is too short-term focused. Most insurers believe it would only scare certain readers of the accounts, including policyholders. However they believe that such a valuation could be very useful in assessing capital and risk.

Everyone agreed that this is only the beginning of the process and there is still a long way to go. Whatever the final decision, it was agreed by all that disclosure is key, more guidance is needed and that there needs to be a strong desire of participants to be actively involved in this debate.