IAIS presentation to joint IASB/FASB meeting

London, 23 July 2009

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Agenda

Topics we will address today

- Timing of the Insurance Contracts project
- Acquisition costs
  - Long-term policies cash flow
  - Contract boundaries
- Day 2 / Day 366 – run-off of the margins
- Financial Instruments issues

Timing of the Insurance Contracts Project

- The project has taken 10+ years … and counting
- Today's timetable envisages a December ED and May 2011 standard
- Further delays are unacceptable – international consensus is beginning to break down as regions cannot wait
- IAIS aim is still to utilize IFRS/GAAP as input into insurance regulatory requirements

Acquisition costs

- Pricing at time zero immediately before issuance is the same as cash flow expectations plus a composite margin
- Acquisition costs become payable on day 1
- Acquisition costs can exceed first year's premium for long-term contracts
- Generally expect profitable long-term contracts
- Subsequent cash flow expectations are presumably unchanged by payment of acquisition costs
- Hence the cash flows for profitable long-term contracts imply an asset at time zero (margined out), and a bigger asset after payment of acquisition costs

Contract boundaries

- IAIS recommendation to the Boards:
- "The relevant cash flows are bounded by the earlier of the following, if they exist:
  - the contractual termination date as extended by any unilateral option available to the policyholder, or
  - the insurer having a unilateral right to cancel or freely re-underwrite the policy, or
  - both the insurer and policyholder being jointly involved in making a bilateral decision regarding continuation of the policy."

Day 2 / Day 366

- Run-off of margins almost entirely not discussed in the last 10 years
- It desperately needs to be solved before the ED
- The answer must be simple, understandable and auditable
- Following slides provide a deliberately simple example to illustrate the issues

Margin run-off example

- Non-life 1 year policy. Expected loss cash flows 80. Premium 100, therefore composite margin 20.
- If the first year is analogized to revenue recognition, the performance obligation is satisfied over the year. At the end of the year, there will be future expected losses
- Assume no claim payments have yet occurred and no reason to change the estimates of loss cash flows

Margin run-off example continued

- Day 366, building block one – expected probability weighted cash flows relating to claims incurred and IBNR are still 80.
- What is the margin?
- Is it still 20, as the future cash flows (and uncertainty) have not changed?
- Is it zero, as the risk underlying the policy has run-off, i.e. no further claims can in fact occur and it is merely loss estimation?
- Is it something in between?

Margin run-off example continued

- Do the margins run off based on release from risk – if so, and the risk is the underwriting risk, then this would argue for the 20 to run off in year one.
- Do the margins run off based on the expected cash flows, which could be analogized to FAS114 as a fixed percentage of the remaining cash flows relative to the originally assumed cash flows.
- Need the answers in time for the ED

Financial Instruments

- Two most significant parts of an insurer's balance sheet – insurance contracts and financial instruments
- Insurers are the largest purchasers of financial instruments in the world
- Need to have regard to consistency on asset and liability side of the balance sheet
- Asset/Liability management is vital to insurers

Financial Instruments, continued

- There needs to be coherence between asset and liability measures: timings of the projects problematical
- Fundamental institutional factors exist: banks and insurers are different, and while cross sectoral comparability is important, a bank solution may cause significant problems for insurers
- How will assumptions unlock and margins run off for liabilities – and will amortized cost “hedge” these liabilities?

Questions and Answers

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