2 November 2010

International Financial Reporting Standards

Determining the appropriate discount rate for insurance liabilities

ARG Meeting

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation

Agenda

- What is the appropriate discount rate?
- The ED proposals
- Open issues
- A simple example
- Questions

What is the appropriate discount rate?

- Question is threefold:
  - What is the **objective** of the discount rate for insurance liabilities?
  - What are the **factors** to include in the discount rate?
  - How to **build** the factors into the discount rate?

Discounting insurance liabilities: The ED proposals

- Building block approach
- Time value of money
- Objective: Reflecting characteristics of the insurance contract
  - Non-participating: risk-free plus adjustment for illiquidity
  - Participating: consider performance of assets
- Excluded: non-performance risk (own credit risk)

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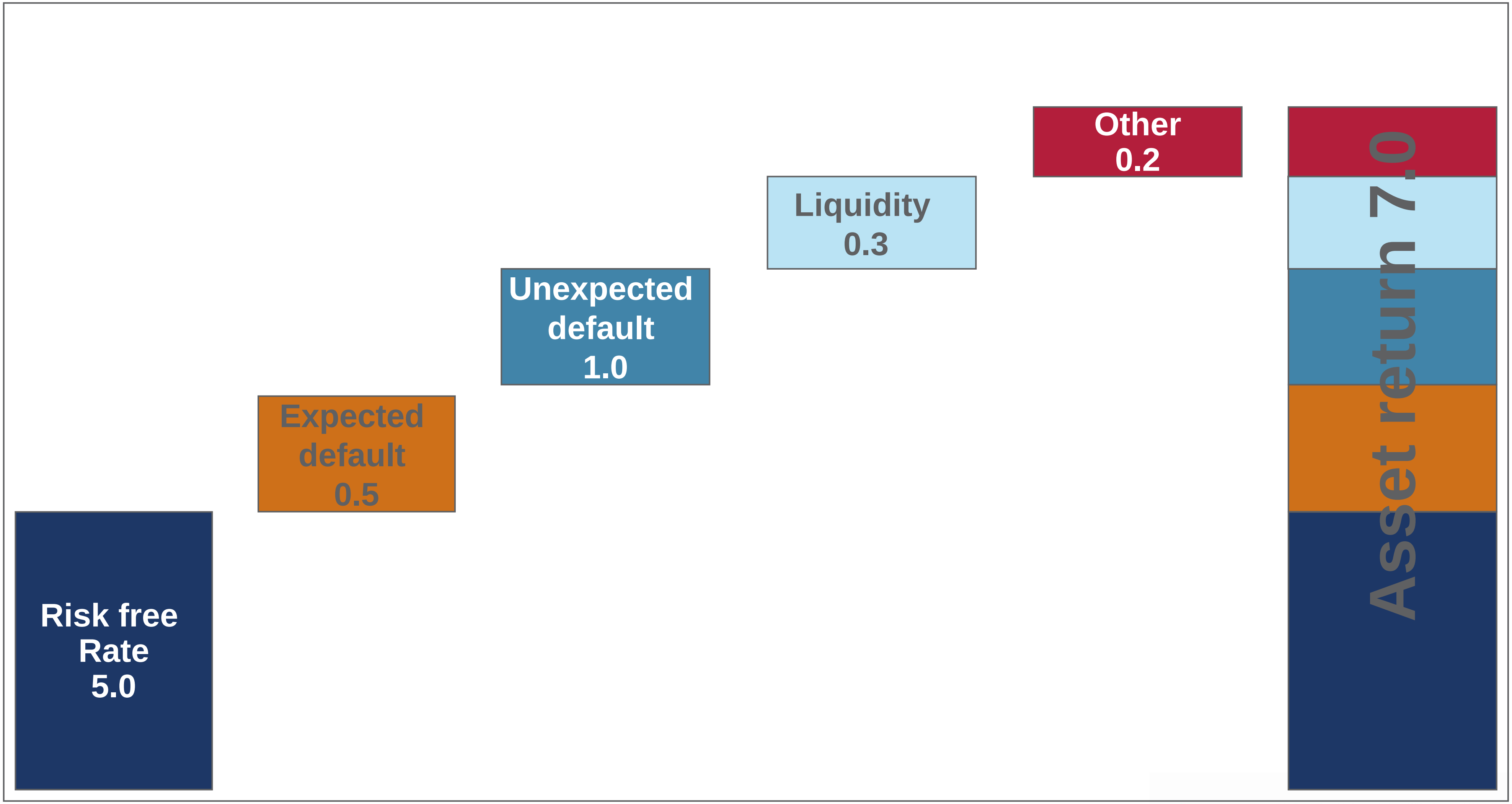
Discounting insurance liabilities: Open issues

- Some argue that, in some cases, the ED proposals for the discount rate do not reflect the insurer's business model which results in:
  – volatility
  – day-one losses
- What characteristics should a discount rate reflect then?

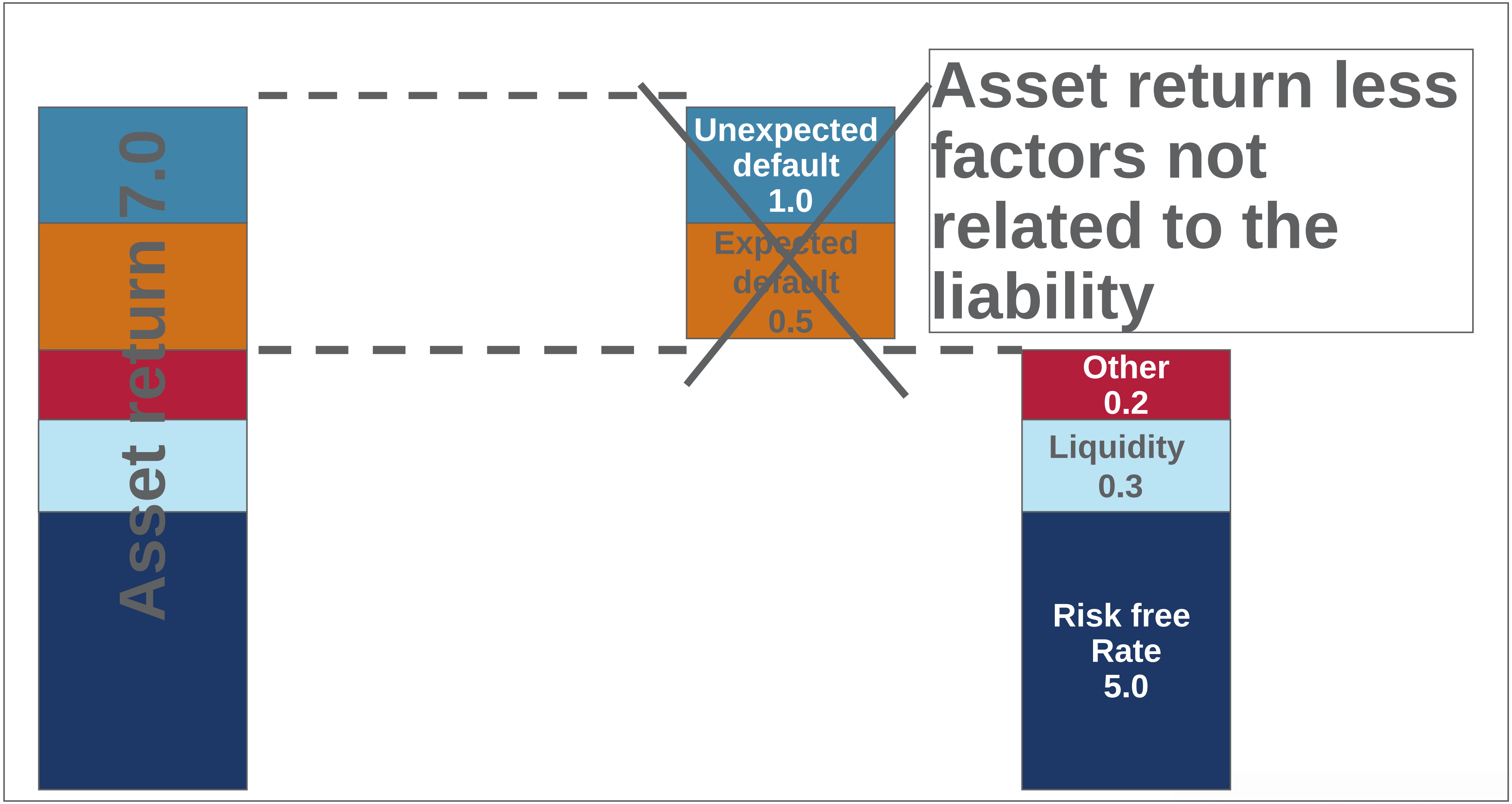
What factors can the discount rate include?

- Risk-free rate
- Credit spread
  - Expected default
  - Unexpected default (market-based or historical data-based)
- Liquidity
- Currency risk
- Other ?

A simple example

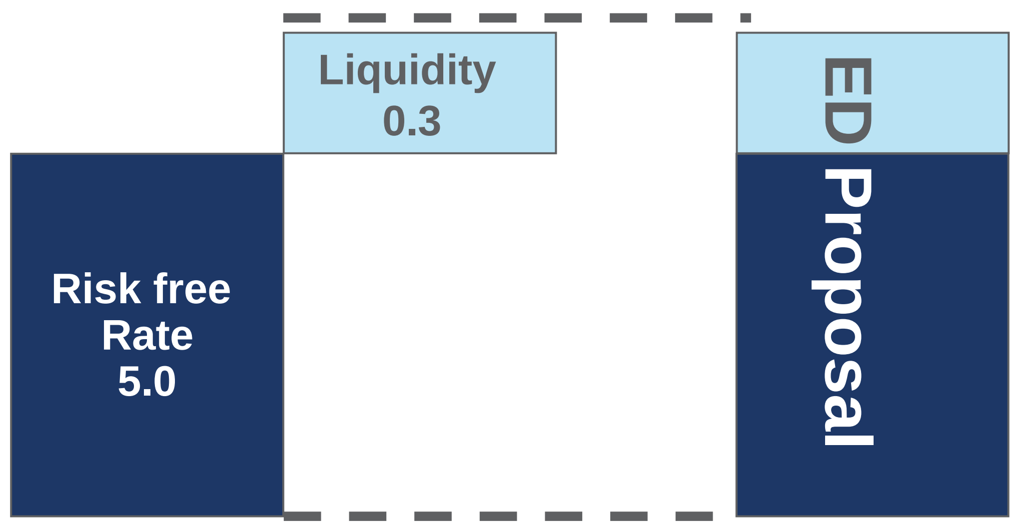


Discount rate based on the return on assets



Building up the discount rate

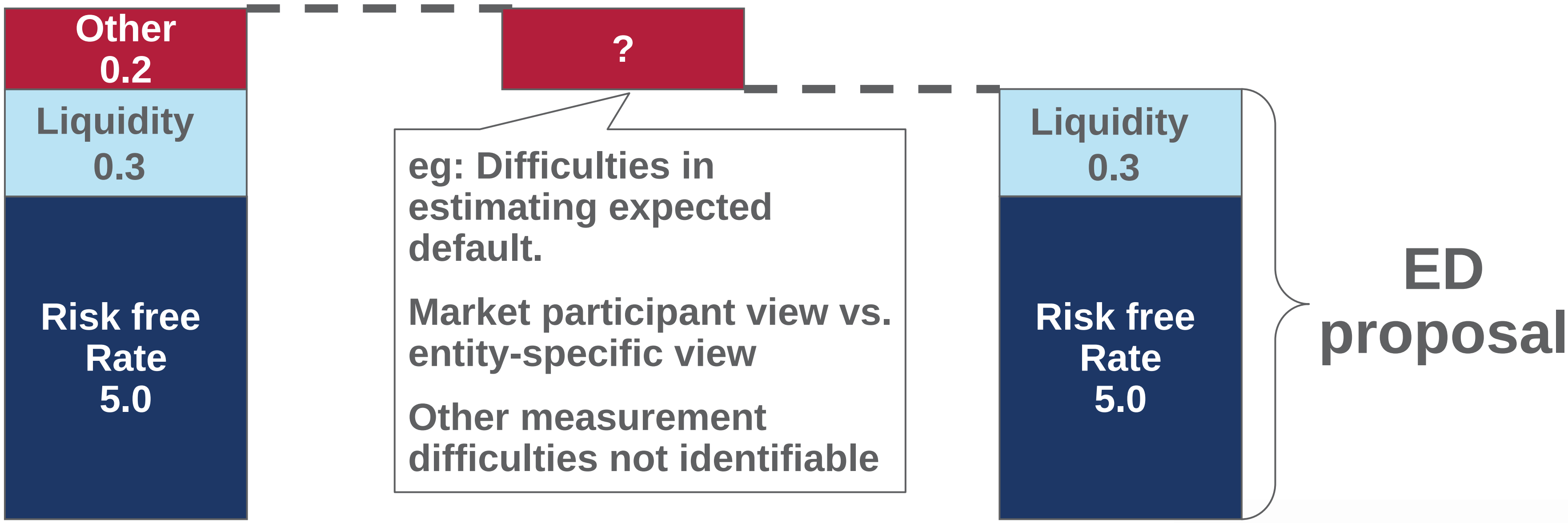
Discount rate built up based on the characteristics of the liability



What is the difference between the two approaches?

Asset return less factors not related to the liability

Discount rate built up based on the characteristics of the liability



Questions

- Are there any other factors that contribute to the difference between an asset return less factors not related to the liability and the discount rate built up based on the characteristics of the liability?
- Are these factors related to the characteristics of the asset or the liability?

Questions or comments?

Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.