



International Association for the
Study of Insurance Economics

Études et Dossiers

Extract from

Études et Dossiers No. 340

**4th International Insurance and Finance
Seminar of The Geneva Association**

6-7 December 2007
London

February 2008

**Working Paper Series of
The Geneva Association**

© Association Internationale pour l'Etude de l'Economie de l'Assurance

The Geneva Association - General Secretariat - 53, route de Malagnou - CH-1208 Geneva
Tel.: +41-22-707 66 00 - Fax: +41-22-736 75 36 - secretariat@genevaassociation.org - www.genevaassociation.org

The Geneva Association Working Paper Series “Études et Dossiers” appear at irregular intervals about 10 - 12 times per year. Distribution is limited.

The “Études et Dossiers” are the working paper series of The Geneva Association. These documents present intermediary or final results of conference proceedings, special reports and research done by The Geneva Association. Where they contain work in progress or summaries of conference presentations, the material must not be cited without the express consent of the author in question.

Layout & Distribution: Valéria Kozakova

Insurance Contracts: Opening the Black Box

Peter Clark

Before we start



International Accounting
Standards Board

- I will talk about what I've heard in discussions with various people over the last few months.
- Comment letters are still coming in and we are beginning our analysis.
- I will give you my own personal comments. I have not discussed them with the Board.

Overview



International Accounting
Standards Board

- **Basic model:**
 - ★ *Three building blocks, measurement attribute, what have we heard so far?*
- **Challenges**
 - ★ *Future premiums, policyholder participation, performance*
- **Timing, other projects and US GAAP**

2

December 2007

The basic model: three building blocks



International Accounting
Standards Board

- **Estimates of future cash flows**
- **Time value of money**
- **A margin**

3

December 2007

The basic model: advantages



International Accounting
Standards Board

- Information on cash flows:
 - ★ *amount, timing and uncertainty*
- Explicit margins (release from risk)
- Consistent approach to estimates
- Embedded options and guarantees
- Coherent way to resolve new issues
- Clear reporting of economic mismatches

4

December 2007

What have I heard?



International Accounting
Standards Board

- Fair support for direction, concerns on:
 - ★ *Day 1 profit*
 - ★ *Risk margins*
 - ★ *Service margin*
 - ★ *Entity-specific expenses*
 - ★ *Non-life discounting (mainly US, Bermuda)*
 - ★ *Credit characteristics*

5

December 2007

Non-life issues



International Accounting
Standards Board

Pre-claims period

- UPR as an estimate of exit value?
- UPR as a proxy? (When?)

Claims period

- Is discounting feasible?
- Costs v benefits
- Financial reinsurance

6

December 2007

Putting the building blocks together



International Accounting
Standards Board

Possible measurement attributes:

- Current exit value (DP proposal)
- Current entry value
- Settlement value
- Something else?

7

December 2007

Measurement attribute: what's it for?



International Accounting
Standards Board

- An informative, concise label to help communicate with users
- A guiding light to resolve emerging issues

8

December 2007

Measurement attribute: key questions



International Accounting
Standards Board

- How is it defined?
- What does the margin represent?

9

December 2007

Current exit value



International Accounting
Standards Board

- Transferee would consider cash flows etc
- Relevant and reliable information to help users with economic decisions
- Does not imply that an insurer can, will or should actually transfer the liability to a third party
- In most cases, insurers cannot transfer the liabilities and do not want to do so

10

December 2007

Future premiums: guaranteed insurability



International Accounting
Standards Board

- Is it too narrow?
 - ★ *Asymmetry (inflows v outflows)*
 - ★ *Flexible contracts*
- Is it too wide?
 - ★ *Health insurance*

11

December 2007

Future premiums



International Accounting
Standards Board

Measure 'the whole contract'?

- Where does the contract end?
 - ★ *Health insurance*
 - ★ *Group contracts*
 - ★ *Semi-automatic renewals*
 - ★ *Analogies in other sectors*

12

December 2007

Policyholder participation



International Accounting
Standards Board

- Is there a legal or constructive obligation?
- Measure the whole contract?
 - ★ *The convertible debt analogy*
 - ★ *Will mutuals have any equity?*

13

December 2007

Reporting performance



International Accounting
Standards Board

- Insurance premiums: revenue or deposits?
- Release from risk
- Changes in estimates
- Market changes

14

December 2007

Phase II timetable



International Accounting
Standards Board

Comments due	16 November 2007
FASB agenda decision	2008
Exposure draft	2009?
Standard	2010?
Implementation	?

15

December 2007