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Impact of a IFRS Based on Full Fair Value: Views of Leading International Insurance Companies

Gerry Dickinson

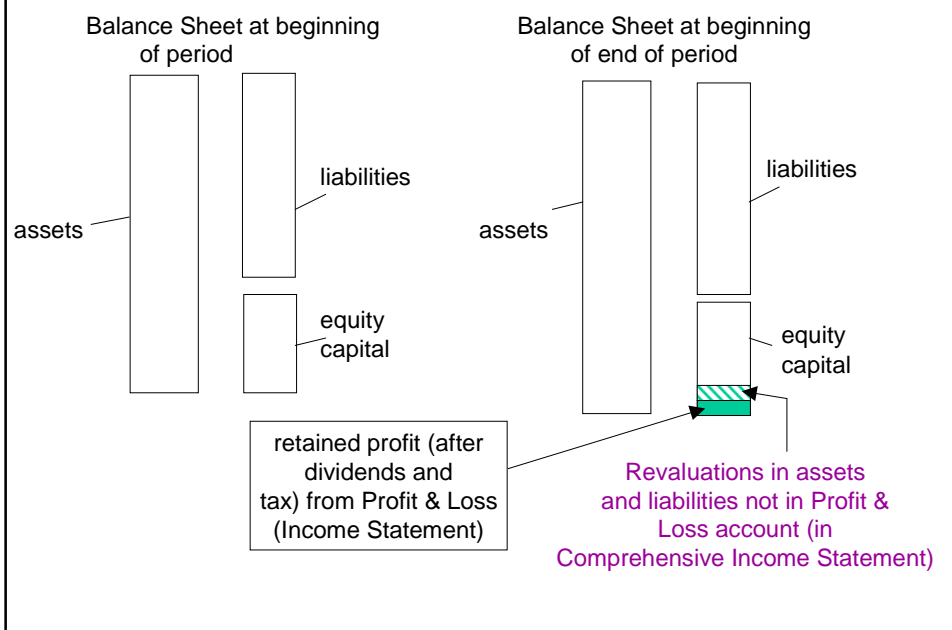
Aims of Survey

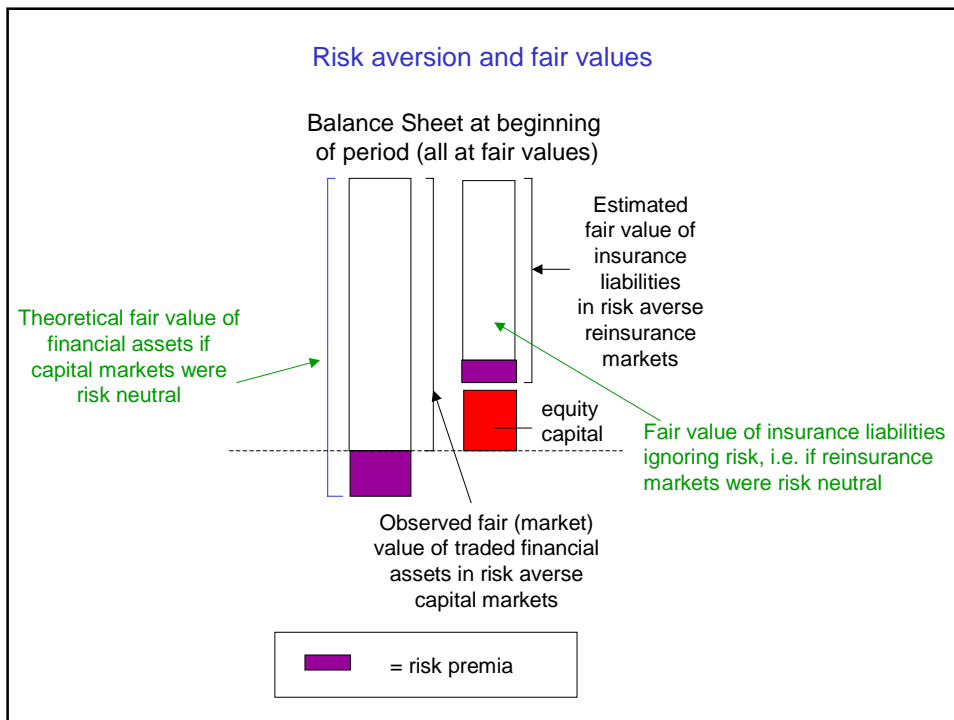
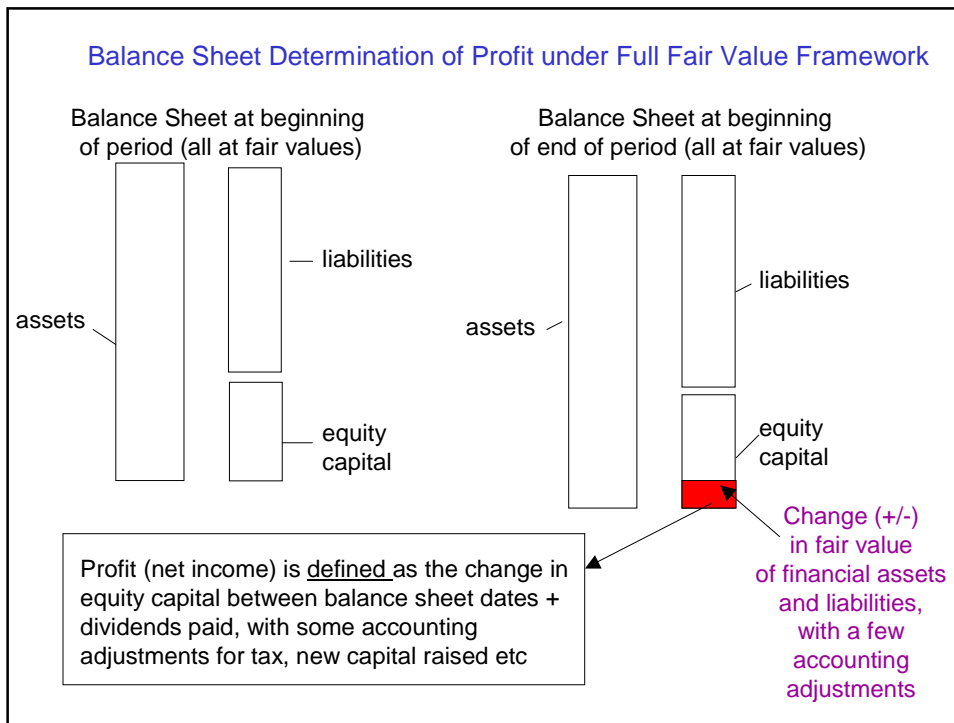
- To ascertain views of senior management in a large sample of leading international insurers on the likely impact of a full fair value reporting system on their business models and corporate policies.
- To obtain opinions on set of wider issues, i.e. increased transparency of fair value reporting, the cost of capital, and risk absorption role of insurance in the wider economy.
- Paul Volker, chairman of the Trustees of the IASC Foundation, stated late 2003 that international reporting standards should not undermine the economic role of commercial banks and insurers.

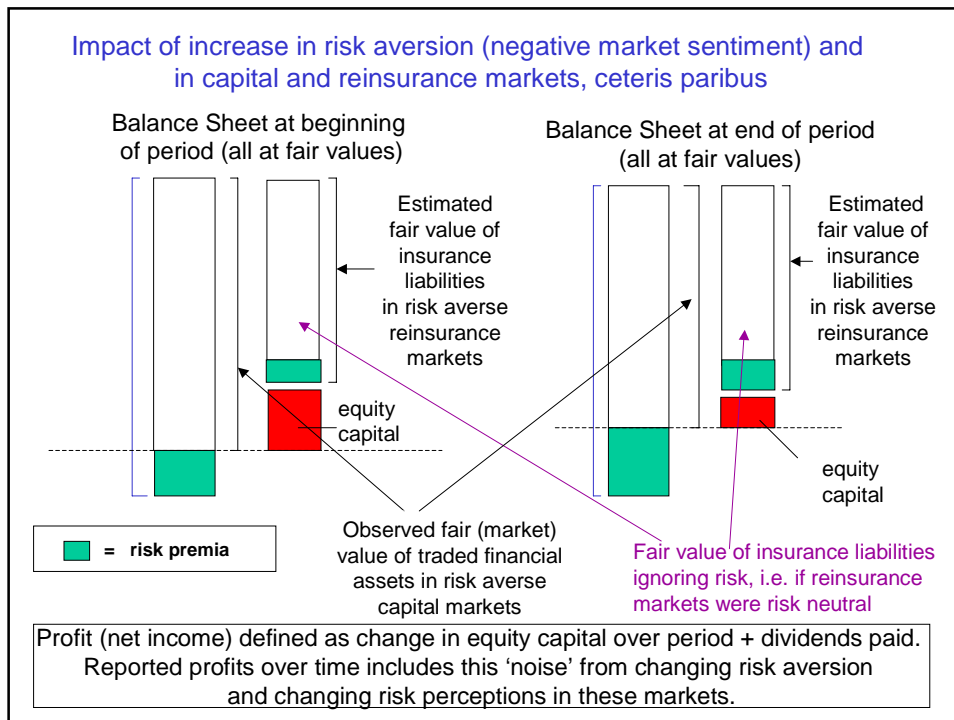
Main features of a full fair value (i.e. mark-to market) reporting system

- All financial assets and liabilities would be stated in primary balance sheets at 'fair' values (i.e. market value or estimated market value)
- All of the changes in the fair values of financial assets and liabilities between accounting periods would be recorded directly into Income Statements (Profit and Loss Accounts)
- All equalization and catastrophe provisions would not be considered as accounting provisions, and deferred acquisition costs unearned premiums not recognised in the measurement system

Conventional Accounting Relationship







Key Findings of Geneva Association Survey

- None of the 40 leading insurers from 17 countries in the survey used full fair value as an internal accounting and financial system to run their businesses, nor would they voluntarily choose to do so.
- Management would be under some pressure over time to align their internal accounting and financial systems to any international financial reporting system.
- A full fair reporting system would significantly change business models, corporate policies and systems over time in a way that reduce their competitiveness, especially compared to banks
- A mark-to mark financial reporting system would tend to shorten business planning horizons and reduce the appetite for long term risk-taking. Existing 'myopia' in stock markets might be encouraged

- Significant impact on product offerings. A move away from life and annuity policies with guarantees. Liability insurances, workmen compensation and longer tail non-life insurances would be less attractive to supply
- Investment policies would change, with a shift from stocks to bonds, a move to less price volatile investments, and a closer matching of assets and liabilities
- A high consensus that the volatility of reported profits (earnings) would increase the cost of capital and make earnings forecasts impossible.
- Preferred internal planning and control systems are broadly consistent with deferral and matching systems or in life insurance with supplementary accounting systems, such as embedded values/achieved profit models.
- A mark-to-market accounting system would be inconsistent as it is too short term, especially with quarterly reporting

- Asset-liability management models in insurance, especially life insurance, are concerned with independency of assets and liabilities and measuring and managing risk over time.
 - Fair value accounting ignores asset-liability linkages
 - Fair Value is only concerned with short term market risk.
- A broad consensus that it would have a major adverse impact on the economic roles of the industry in risk transfer and savings mobilisation. There might be some benefits by encouraging more economic pricing, especially for embedded options and guarantees in the life insurance, but the effect is not clear.