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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

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What Users Want from the Financial Statements of Insurance Companies: The Geneva Association – Mercer Oliver Wyman Survey

Gerry Dickinson and Anthony Stevens

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2. Summary I – Views on current reporting
3. Summary II – Potential areas for improvement
4. Conclusions and next steps

Section 1

Background

Research of the accountancy task force of the Geneva Association

- **'The Search for an International Accounting Standard for Insurance' (February 2003)**
- **'Impact of a Fair Value Financial Reporting System on Insurance Companies: A Survey' (June 2004)**
- **'Insurance Sector Financial Reporting and Disclosure – User Needs Survey'**
 - Based on the Survey by The Geneva Association and Mercer Oliver Wyman

Primary goal of financial reporting is pragmatic provision of information to help users, particularly investors/creditors, in making decisions

- **There is no agreement, nor likely to be, on what is a correct theoretical foundation for preparing financial statements, and the information that they should contain**
 - ‘Accountants have adopted a decision-usefulness approach to financial reporting as a reaction to the impossibility of preparing theoretically correct financial statements’, W.R Scott (University of Waterloo, Canada) ‘Financial Accounting Theory’, 2003
- **The current conceptual frameworks of the IASB, and the FASB and other national standard setters, state that the primary aim of financial reporting is their value to users in their decision-making, with a emphasis on investors and creditors and those that advise them**
 - ‘The FASB’s goal in setting standards is to enhance the usefulness to investors and creditors of the information entities report in financial statements and other financial reporting’, L. Todd Johnson ‘Relevance and Reliability’, FASB Report, Feb 28, 2005

The challenge is to assess ‘What users want’

- **It is difficult for accounting standards setters to assess users needs systematically. Instead standards have been predicated on the following characteristics of information:**
 - Relevance, reliability, comparability and understandability, within an overarching requirement of a high level of transparency
- **Reliability and comparability can be mainly assessed *a priori*. But relevance depends on what users consider as beneficial and on what ‘markets’ judge as significant in forming, and revising, expectations on corporate performance**
 - What users consider as beneficial can be assessed by seeking their views (viz. extensive surveys and interviews) and by understanding their decision-making processes
 - What ‘markets’ consider as useful is harder to assess, since it can only be inferred from empirical models on how markets react to new accounting information

User needs survey aims to assist the development of IFRS's

Background

- The Geneva Association, in collaboration with Mercer Oliver Wyman, has been carrying out a pioneering 'user needs' survey of financial reporting and disclosure.
 - Part of ongoing Research Programme on Insurance and Finance
 - An extension to the work of the Insurance Accountancy Task Force

Objectives

- The survey 'User Needs on International Accounting' aims at:
 - Highlighting the needs of users of financial reporting
 - Identifying prioritized regulatory development needs for the future

Process

- A survey has been mailed to over 220 recipients covering various types of users (e.g. institutional investors, equity analysts, rating agencies, regulators, etc)
- The response rate has been about 25%

Survey structure

- The survey is structured around three pillars
 - Objectives and uses of insurance company financial reporting and disclosure
 - Evaluation of current insurance company financial reporting and disclosure from the user perspective
 - Areas of potential improvement in insurance company financial reporting and disclosure that would assist users

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Section 2

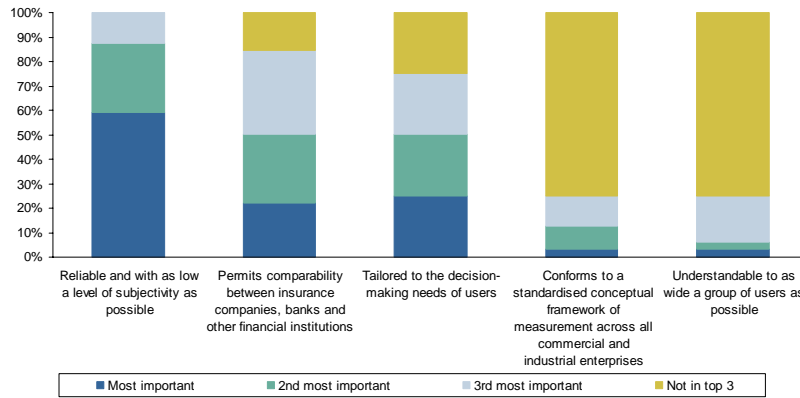
Summary I – Views on current reporting

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What do users want?

Which of the following characteristics of financial statements do you consider are the most important for insurance companies?

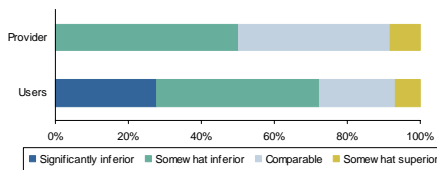


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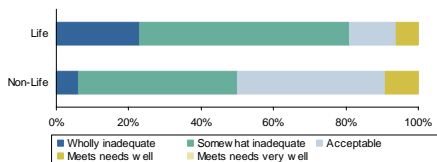
Current situation – major difference in views between insurers and users concerning the adequacy and quality of financial disclosure

Quality of insurance disclosure compared to banks



Users are unhappy with current financial reporting by life insurers, but less so for non-life insurers

Users' views on adequacy of current information provided in financial statements of providers

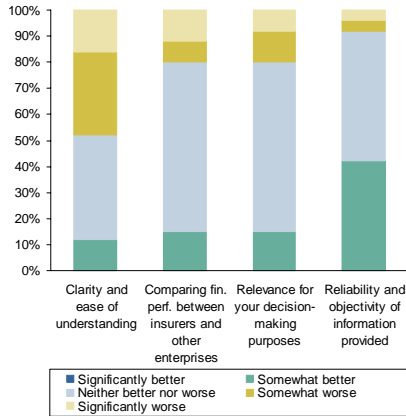


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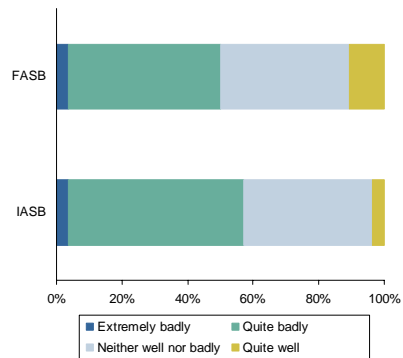
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While new accounting standards have increased objectivity, they have reduced clarity

Improvement in relative usefulness of financial statements through IFRS4 and IAS39



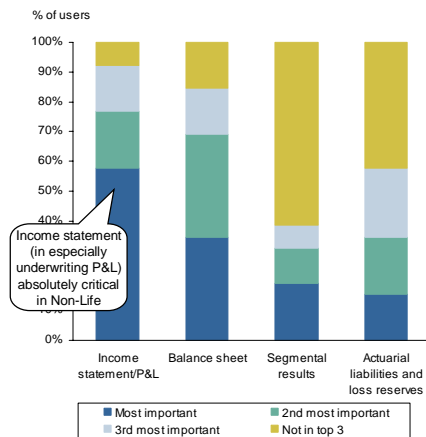
Success of incorporating user needs¹ when developing financial reporting standards



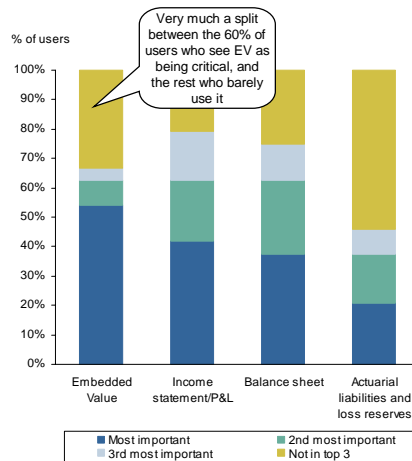
¹For decision-making needs
 Note: Chart displays which items were ranked as most important by providers and users respectively
 Source: User Need Survey on International Accounting
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Which components of financial statements/disclosures are most key to users' decisions?

Non-Life



Life

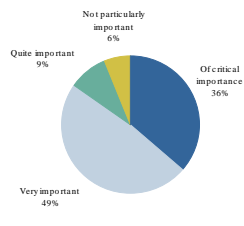


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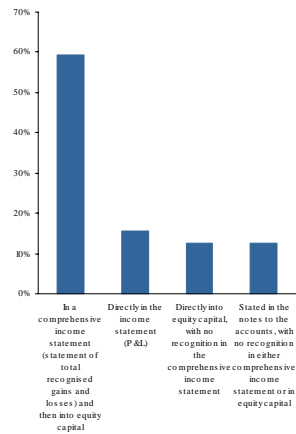
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While market value/fair value disclosures are important, users prefer to see the impact of market value changes in a comprehensive income statement than directly in P&L or in Equity .

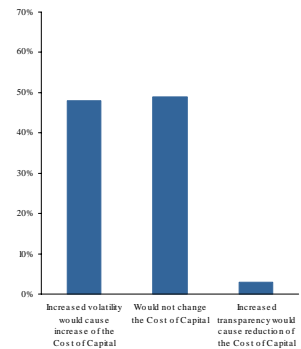
Importance of market value disclosure of all financial assets/liabilities



Where should changes in market value of unrealised gains/losses be reported?



Expected effects on the cost of capital of increased earnings volatility



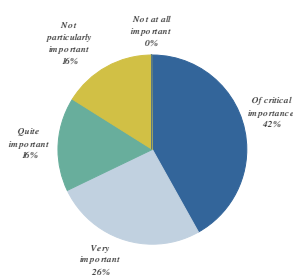
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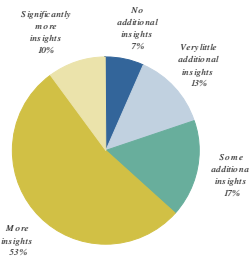
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... while separate disclosure of (European) Embedded Value appears to be seen as a major improvement

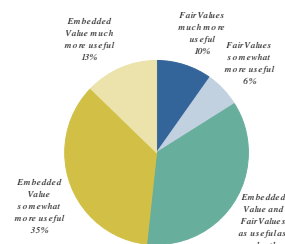
How important is the disclosure of (European) Embedded Values?



How much additional insight do European Embedded Values provide compared to traditional EV?



How useful are (European) Embedded Values compared to Fair Valuation of Assets/Liabilities?



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Section 3

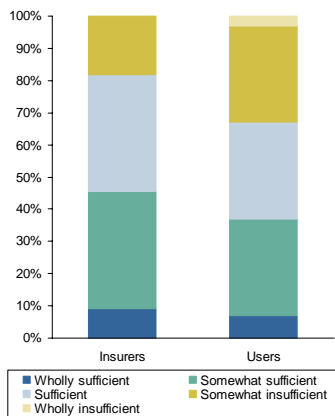
Summary II – Potential areas for improvement

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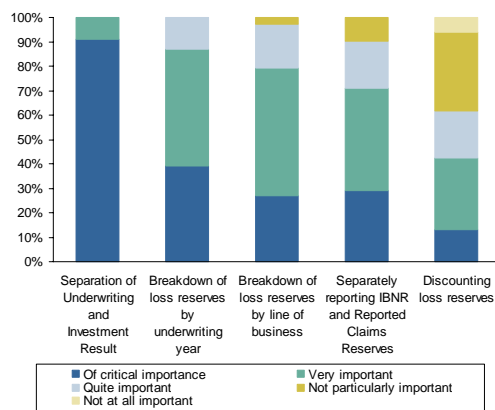
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Non-Life – Current framework broadly adequate, but greater granularity required in disclosure of loss reserves

Current deferral/matching for Underwriting P&L approach broadly adequate



Importance of different components of Non-Life P&L and Balance Sheet



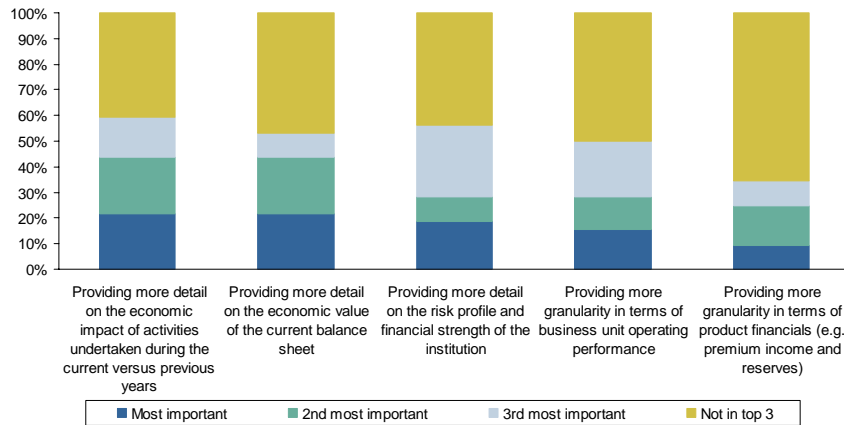
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Life – Users want greater transparency in economic values . . . both of current balance sheet, and of economic value of new business

Where is it most important that the current information in the financial statements of life insurers is improved?



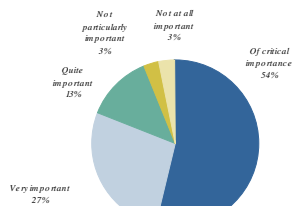
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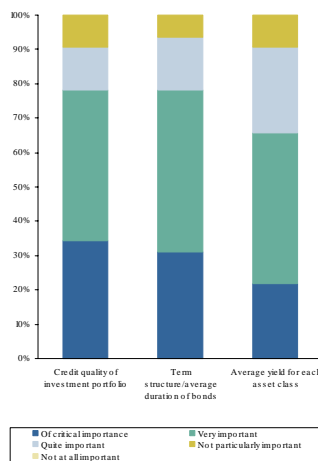
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Life (cont'd) – Enhanced disclosure of new business versus in-force performance and asset-liability profile particularly important

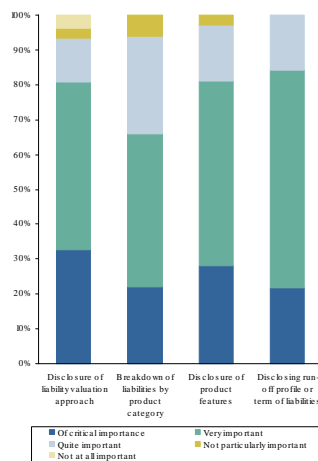
Differentiation between new and in-force business



Providing supplementary asset portfolio information



Disclosure of life technical provisions



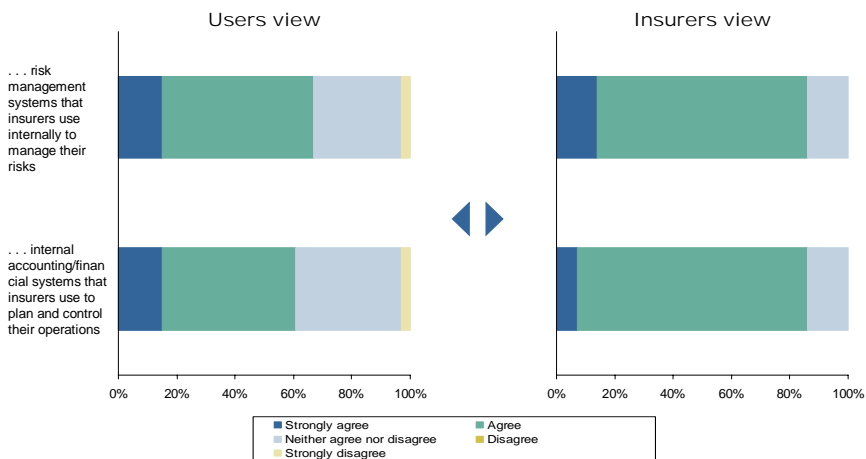
Source: User Need Survey on International Accounting

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Both users and insurers believe alignment of external financial statements with internal financial / accounting and risk management systems is important

Alignment of financial statements with . . .



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Section 4

Conclusions and next steps

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Conclusions (1/3)

- **Although the new IFRS regime, with the closer links with FASB, is seen as auguring well for the future, current financial reporting by insurance companies is far from optimal**
 - Investors believe IASB and FASB have not good job so far in incorporating decision-making needs of users in their standard setting processes
 - Users (European) find the new European Embedded Value supplementary reporting a major improvement
 - IFRS Phase I has improved comparability and objectivity, but users believe the introduction of IFRS4 and IAS39 has not changed the relative usefulness and clarity of financial statements very much
- **There is still a significant mismatch between reported and desired financial information in the insurance sector**
 - The perception of the quality of financial information differs significantly between the providers (insurance companies) and the users (especially investors, analysts, rating agencies) of this information
 - Disclosure on a more granular and transparent level than today is clearly desired

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Conclusions (cont'd) (2/3)

- **Investors, analysts and rating agencies in general use their own measurement metrics to assess and forecast performance and financial strength**
 - It is the information in financial statements that matters more than the structure of financial statements themselves
- **Users mainly want four things:**
 - Reliability of information in financial statements, a low level of subjectivity by preparers, and comparability
 - More detailed information (greater granularity). Users in the United States are not as dissatisfied as European and other users, as the SEC, market practice and statutory reporting ensures there is a good deal of supplementary disclosure
 - Financial statements that better reflect the underlying economics of the insurance business, and disclose the market value of both assets and liabilities and fair value if reliable.
 - However, users have a preference for accounting for any changes in market/fair values of assets and liabilities to be taken into a Comprehensive Income Statement, rather than directly into equity, directly into the Income Statement or in the notes. This has implications for IASB's future Performance Reporting Standard
 - Greater alignment between external financial statements and internal accounting / financial planning / risk management (ALM) systems within insurance companies

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Conclusions (cont'd) (3/3)

- **Users have some specific areas that wish to see improvements on for Non-Life and Life insurers:**
 - Non-Life
 - Current system of measuring underwriting profit (loss) based on deferral and matching is considered acceptable
 - Greater disclosure of loss reserves and valuation methods used, although discounting is not a key concern
 - Clear separation of underwriting performance from investment performance
 - Life
 - Less satisfaction with life accounting, especially in Europe
 - Among European users in particular, greater disclosure of embedded values, with clear separation of value of new business from value of in-force, and consistent measurement of assets and liabilities and these should on a market or market-related basis
 - Among US users, still relatively little interest in Embedded Value disclosure
 - General improvements in disclosure of asset-liability profile and structure of assets and liabilities

Next steps

- Comprehensive summary of all survey results in a report.
- Discussion of final survey report with our Accountancy Task Force.
- Publication of final report in early 2006.