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FINANCIAL REPORTING FOR LIFE ASSURANCE

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A ONE-DAY Seminar was held at Staple Inn Hall jointly by the Institute of Actuaries and the Faculty of Actuaries, on 'Financial Reporting for Life Assurance'. The seminar was aimed at actuaries in senior and middle management positions as well as both actuaries and accountants working in the financial reporting area. The total number of participants was 146, comprising 112 members of the Institute, 8 members of the Faculty, 2 overseas guests from Norway and 24 non-members.

In opening the seminar the Chairman of the morning session, Mr S. P. Taylor-Gooby noted that financial reporting consisted of much more than simply the annual accounts, and that requirements of regulators, current and prospective policyholders, the Inland Revenue, company management and shareholders all needed to be considered. The day's proceedings would concentrate on requirements of policyholders, regulators and shareholders. Particular issues to be raised included the balance to be drawn for policyholders, between the extremes of '*caveat emptor*' and 'assistance and protection'. For regulators there was a need to reconsider the standard use of 'conservative' reserves as opposed to 'best estimate' reserves combined with additional, risk-related capital requirements. Finally, for shareholders discussions were continuing on reducing large amounts of information to a few key numbers together with an element of corresponding disclosure.

In the first session on financial information for regulators, Mr D. O. Forfar and Mr R. W. M. Baxter presented the results of investigations into the impact of the current valuation regulations on solvency and policy results. The investigations modelled the performance of a portfolio of traditional with-profits contracts over a long period, with pay-outs being based on asset shares (or guaranteed benefits if larger) and a mix of reversionary and terminal bonus that broadly reflected current practice. With a fixed investment policy including a high level of equities, repeated simulations disclosed a very high level of technical insolvency at some future time. If allowed to continue to trade, however, virtually all simulations demonstrated an ability to return to a solvent position. A flexible investment policy, increasing the element of fixed-interest investment as asset cover declined, reduced the number of technical insolvencies, but the cost, in terms of reduced returns to policyholders, was significant. Several possible solutions had been considered, including changes to the mix of reversionary and terminal bonus and reduced levels of new business growth. None had been found that was felt to be both effective and acceptable.

The discussion on this subject indicated that similar results had been achieved with other asset models, and that the results of the investigations should not be a surprise, given the similarities between this work and research during the 1970s on the cost of maturity guarantees for unit-linked policies. The joint Institute and Faculty Valuation Regulations Working Party has been considering these issues for some time, and will be reporting in the middle of 1992 on their conclusions.

The second element of the session was a presentation by Mr M. A. Pickford, identifying deficiencies in the annual returns produced by insurance companies for regulatory purposes, and considering the potential effects of the forthcoming European Life Framework Directive on the regulatory approach used in the U.K. The returns include a significant amount of information on the valuation of the liabilities, but far less is available on the assets and on the matching of those assets to the liabilities. Examples include the lack of information on the spread and potential risks associated with equity investment and the nature and term of loans. Also, there is usually inadequate information provided on reserving standards used when testing for resilience.

Turning to the Life Directive, a series of technical issues arise, given differences between regulation in the U.K. and in the rest of Europe. Indeed, the whole approach to regulation differs markedly, in that in the bulk of EC countries the supervisory authorities specify the reserving basis to be used. In contrast, the U.K., Ireland and Holland adopt a monitoring approach by specifying minimum requirements, but leaving the choice of reserving basis to the companies concerned. The extent to which these two contrasting approaches can continue is as yet uncertain.

The next session was led by a guest, Mr M. Renshall, the Deputy Chairman of the Financial Reporting Review Panel. He described current developments in U.K. financial reporting, and in particular, the new framework for the establishment and interpretation of accounting standards. The structure now in place consists of a Financial Reporting Council, an Accounting Standards Board (ASB), a Financial Reporting Review Panel and an Urgent Issues Task Force.

The ASB is the body responsible for issuing accounting standards and, in contrast to previous regimes, is operationally independent of the professional accounting bodies. The Urgent Issues Task Force, working under the ASB, is intended to speed up the clarification of issues that emerge that do not need, or cannot wait for, a new accounting standard to be issued. Finally, the Financial Reporting Review Panel is the body that has responsibility for examining departures from the Act and from standards, and has the power (indirectly via a Court Order) to require corrected accounts to be issued if deemed appropriate. This power has not yet, at April 1992, been invoked. However, several companies are now being publicly identified for particular instances of non-compliance. The overall message was that the new framework should speed up the development and interpretation of accounting standards in future, and should provide a more effective level of policing of adherence to those standards.

The afternoon sessions, chaired by Mr A. Neill, President of the Faculty of Actuaries, considered the financial information requirements of policyholders and shareholders.

In reviewing the current situation regarding information for policyholders, Mr M. H. Field noted that purchasers of, for example, manufactured goods enjoy a considerable degree of protection and product disclosure. Although this is a difficult area for life assurance, it should be the objective of the actuarial profession to help consumers to understand life assurance products. He considered that the latest Securities and Investments Board (SIB) proposals, which were due to be finalised around the end of May 1992, were broadly acceptable. In particular, the warnings on surrenders were worthwhile in bringing home the long-term nature of life assurance products when used as savings vehicles. In other areas improvements could perhaps be made, notably on expense disclosure and past investment returns, where there was a need for sufficient disclosure to enable comparisons to be made.

Continuing the theme, Mr R. H. Ranson considered that it was unfortunate that recent changes in disclosure had not been introduced voluntarily. This had resulted in the insurance industry facing a hostile environment in which critics from the consumer movement and the press were inclined to identify problems whilst overlooking positive aspects. He then outlined SIB's latest disclosure proposals, and noted concern over the size of the proposed reduction in maturity proceeds figures that are to be used to illustrate the effect of charges, in addition to the reduction in yield calculation. Finally, he identified a lack of information on with-profits business. Confusion arising from with-profits pay-outs from different offices moving in opposite directions was compounded by the lack of real explanation of bonus philosophy that might explain the moves. Without this information crude measures of financial strength will continue to be given prominence by independent financial advisers.

A wide-ranging discussion on the session noted particularly a failure to tell policyholders precisely how much of each premium was going to be invested and in what. This, together with a lack of differentiation between offices regarding anticipated future returns, led to a potentially excessive concentration on expenses and expense comparisons.

The final session of the day on financial information for shareholders, again had two speakers. Mr R. W. Whewell, the Chairman of the Insurance Industry Committee of the Institute of Chartered Accountants, spoke on the impact of the EC Insurance Accounts Directive. He believed that the formats specified in the Directive for the presentation of accounts would not, in themselves, affect the fundamental accounting treatments with the exception of the requirement to defer acquisition costs, subject to recoverability, unless this is prohibited by the National Authority. There continues to be an overriding 'true and fair' requirement for profit reporting and, in his view, for unit-linked business the deferral of acquisition costs and amortisation of those costs against margins should go a long way towards meeting this requirement. For traditional with-profits business, deferral of acquisition costs will not in itself result in a true and fair profit, as the profits are related to the size of bonus declarations and, over short periods at least, they could move in the opposite direction to the underlying net asset position, a situation which could hardly be regarded as true and fair. The use of a systematic basis for transfers from investment reserve and apportioning the estate to identify amounts held as provisions for policyholder bonuses are two elements that are likely to be needed to demonstrate a true and fair profit.

To conclude the session, Mr W. M. Abbott reported on the practical issues that his company had faced in addressing the perceived need to provide additional information for shareholders. In deriving figures for presenting in the company's report and accounts, the key issue had been to fully describe the mechanics of the transactions underlying the with-profits and 'other than with-profits' elements of the life fund together with the shareholders' interest in those transactions. The choice of an accruals method or an embedded value approach in deriving the published figures was to some extent a secondary issue.

In closing the Seminar, Mr Taylor-Gooby noted a close relationship in the information requirements for various purposes, with the lack of exposition of bonus philosophy and operation of with-profits funds being a consistent factor. He concluded a useful Seminar with the observation that the life assurance industry will almost certainly suffer ever more onerous disclosure requirements unless it voluntarily becomes more forthcoming.

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