The Derek Newton slide: why accounting isn’t boring

- Shareholder perspective: Accounting does drive actions – in theory it shouldn’t, but:
  - Observers think “earnings” mean something
  - As shareholders, how much leeway do we wish to give to managers to “manage” up the numbers? They are supposed to be reporting to us on their stewardship of the company.
- Change accounting, change perceptions, improve understanding
- Least admired feedback from strategy WP questionnaire
- Self-deception is a form of dishonesty: make the accounting more honest and attract the more honest managers?
- Every practical step we can take to improve the integrity of accounts is worth the effort.

Agenda

- Where are we with Phase 1 of IASB’s insurance project?
  - Disclosure
- Some issues for Phase 2:
  - Read across to Solvency 2
  - You don’t hear about “fair value” much now
- How IASB makes decisions
  - Where to look for up to date information
  - Involvement of the profession
  - Ways to contribute
- Some predictions?
Agenda

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  - Ways to contribute (by way of penance, Derek Newton has just been volunteered)
- Some predictions?

IFRS

Some actuaries said IFRS would never happen ...

Phase I – IFRS 4

- Product Classification – is it insurance?
  - Finite Reinsurance
  - If it's not insurance, apply economic reality!
- Disclosure
  - Loss development tables
  - Sensitivity
  - Concentration of risk
- Liability adequacy test may bite in some places
  - e.g. Greece
- Guides available from many accounting firms
Phase II ➔ “It Must Happen”
- Already exists for M&As accounting:

“But when?”

Phase I

NOW

01.01.05 YE05 YE06 YE07 YE08 YE09 YE10

Phase II – But what should I do?

Actuarial Strategies
a) Rely on ISMIN update once a year till nearer the time
   ✓ Good strategy for most
b) Strategic Position
   If asked to implement a measure of uncertainty e.g. ICA; Solvency II, Reserve Ranges – ensure Phase II can be accommodated
   ✓ Good for most of the rest
c) Lobbying Strategy
   Max impact up to April 2006
   ✓ Good for a few in firms who want to influence

Aggregate Monitoring
Reinsurance
ICA
Solvency II
Reserve Ranges
Strategic Decisions Plans
External reporting Banks
Rating agencies
IFRS Disclosures

Risk measurement & quantification
ICA
Solvency II
Reserve Ranges
Strategic Decisions Plans
Aggregate Monitoring
External reporting Banks
Rating agencies
Accounts Disclosures
Reinsurance
Phase II Accounts
Aggregate Monitoring
Strategic Decisions Plans
External reporting Banks
Rating agencies
The Political Landscape

Discount?
Risk margin or zero?

Disclose mean value?
Permit profits on day one?

Drive risk margin from notional company (portfolio invariant) or from confidence levels?

Basic framework: should make sense at each of gross, RI and net level

Variability / Risks
Best Estimate (?)
Discount

x MARGIN related somehow to volatility / risk
We can’t just debate the rules

- We have to think about methodologies as well.
- IAA working group, involving actuaries in many countries. More life than general.
- Need more effort from the UK
  - More co-ordination of efforts of different working parties, close interest from GI Board.
  - Relevance of reserve uncertainty working party

Company-level percentiles or similar

For
- a) In theory relates to risk of each company’s actual portfolio.
- b) Gives lots of scope for judgement
- c) It’s what e.g. Australia appears to have and was the only existing model to follow

Against
- a) Results not comparable between companies
- b) Gives lots of scope for judgement (!) – earnings manipulation
- c) Lacks coherence between Gross, RI and Net
- d) Methodologies not up to the job?

Portfolio-invariant approach

For
- a) Can apply theories such as cost of capital and “fair value”
- b) Likely to give less scope for judgement – could be calibrated from the mean
- c) “Same liability whichever company” ensures cannot manipulate “value” by e.g. merging companies.

Against
- a) Momentum of thought favours percentile approach to date
- b) Policyholder protection levels have to be equalised through different levels of explicit capital
- c) Methodologies not up to the job?
Some places to look

- www.IASB.org.uk “insurance project”
  - All board meetings and discussions held in public
  - Meeting papers available under meetings / notes for observers
- www.CEIOPS.org
- www.Actuaries.org
- Keep an eye out for updates from the profession
- Contact us: Martin White / Peter Sterling