NAIC National Association of Insurance Commissioners

SUMMARY OF COMMENTS REGARDING A FUTURE POLICY DECISION REGARDING STATUTORY ACCOUNTING

OVERVIEW AND BACKGROUND

This document was prepared by NAIC staff and attempts to capture some of the primary comments that have been made by members of the industry and regulators regarding a future policy decision on statutory accounting. More specifically, the comments were made in response to a "Primary Considerations Document," which documents a continuum of options available to regulators with regards to the future of statutory accounting, and more specifically the extent to which that future converges with, adopts, or is replaced by US GAAP or International Financial Reporting Standards (IFRS).

However, the two most significant comments are as follows: (1) the industry does not believe the NAIC should make a decision until the U.S. Securities and Exchange Commission (SEC) makes a decision on IFRS, and also until completion of the International Accounting Standards Board (IASB) Insurance Contracts Project; and, (2) some regulators were concerned about giving up regulatory control to the IASB or Financial Accounting Standards Board (FASB). Based on this feedback, the Chair of the Solvency Modernization Initiative (EX) Task Force, Director Urias (AZ) has decided to monitor ongoing developments and postpone further discussions and decisions until the International Association of Insurance Supervisors (IAIS) insurance core principle for valuation and the IASB, FASB, and the Securities Exchange Commission (SEC) reach their decisions. Mel Anderson (AR) chairs the SMI's International Accounting (EX) Working Group and leads the NAIC efforts in this area, including providing detailed comments to the IAIS, IASB and FASB on their extensive and on-going exposure drafts and discussion papers on these complex issues.

SUMMARY OF COMMENTS

- Global Convergence/International Standards: The policy decision to move to IFRS is not necessarily driven by an improved accounting model, but rather global convergence, which has been emphasized by global leaders. This, in turn, has led to developments at the IAIS, which U.S. insurance regulators will be judged against. It was noted the United States cannot operate in a vacuum, and must consider convergence in some form.

- Relenting Control to a Third Party: High concern was raised that U.S. regulators should not give up their authority to maintain accounting standards. Relenting control might not allow the U.S. regulatory body to respond to a critical issue because the decision would be based on the desire of a separate, non-U.S. body. One interested party noted that the FASB and IASB support the use of separate regulatory accounting models, where the applicable regulator controls the accounting for the industry, as opposed to the FASB and IASB.

- Prescribed and Permitted Basis of Accounting: At least one regulator argued that an entire shift toward IFRS would result in the loss of prescribed and permitted basis of accounting, something two regulators believed was a necessary tool in dealing with specific company situations.

- Principle-Based vs. Rules-Based: Concerns were raised that if U.S. insurance regulators adopted IFRS, it would result in a principle-based accounting rules, which might not be sufficient for regulators or the litigious U.S. society as a whole. One interested party suggested that U.S. regulators could maintain control over the accounting by issuing more detailed guidance and interpretations, thus allowing the United States to maintain a rules-based approach, and be able to respond more timely to critical issues.

- Financial Reporting and Transparency: The United States should not give up its basis of reporting since its world leading. The financial annual statements should be retained using whatever basis of accounting that is used, as the current basis allows easy identification of risks. It was stated that, in some cases, this transparency can work against regulators, noting how typically it is the actions of the rating agencies and their requirements that drive regulatory changes.

- Decision Might Not Be Black and White: One regulator expressed the desire to remain open-minded on the manner in which the IAIS principle could be met. It was noted that it might be possible to meet such a standard, while continuing to retain control over the accounting. The industry discussed the SEC decision, and how some of their reason for not taking a position on IFRS has been that other countries have been allowing exceptions; therefore, those do not represent IFRS, but rather something else.

- Accounting is Another Tool: Too much emphasis placed on a single method of accounting. IFRS should be considered one additional tool that allows regulators to identify risk.

- Too Early to Make A Decision: The SEC said recently the FASB will not go away, even though it has yet to make its decision. The NAIC should monitor SEC action, as well as any actions of the Federal Insurance Office (FIO) that could impact this decision.

- Coordination: Any policy decision should consider the changes that are being made by Capital Adequacy (E) Task Force. The new Solvency Modernization Initiative (EX) Task Force working group should coordinate closely with the Task Force once it comes closer to making a policy recommendation.

- Consider IFRS through the Current Maintenance Requirement: As US generally accepted accounting principles (GAAP) and IFRS converge, consider how statutory accounting principles (SAP) should be modified at that time. It was noted that, unless there were fundamental changes in the US SAP approaches prior to such consideration, or a change in perspective, U.S. regulators might drift further away from the accounting used by other insurance regulators. One regulator responded that U.S. regulators would have to be willing to consider other approaches in reviewing the changes to U.S. GAAP as a result of IFRS, but the entire maintenance process could be based on IFRS instead of U.S. GAAP. This would require what some have termed another codification project. One regulator noted that such a project would be enormous, while another regulator indicated it might not be as large as others suggest. Another regulator expressed concern that U.S. regulators would go through a recodification process, only for a decision to be made in the future by another organization that requires full IFRS. It was noted that there might need to be fundamental changes in the statement of concepts, as U.S. SAP had come under pressure in the past two years that might require such a change. One member of the industry noted that a movement of existing accounting rules into risk-based capital (RBC) would result in substantial ongoing maintenance agendas for RBC (move work from Statutory Accounting Principles (E) Working Group to the Capital Adequacy (E) Task Force)

- Codification Has Resulted in Improved Regulation: Numerous changes have been made to the U.S. solvency system since the late 1980s and early 1990s. This includes an accounting system that has helped to develop a recent track record that speaks for itself, where insolvencies are at a very low number. Questions were raised as to why U.S. regulators should move away from a proven accounting system. Regulators need to understand the possible unintended consequences of a decision to move away from a proven system.

- Statutory Accounting is Fully Integrated into the Solvency System: The US system of data collection is based on U.S. accounting standards, which would be difficult (if not impossible) to move into other regulatory tools. However, it was noted that a recalibration of RBC might be possible.

- Consolidation Accounting: Some comments suggested that IFRS or U.S. GAAP could not be used, because they require consolidated financial statements. However, it was noted that, even though the U.S. regulatory approaches emphasize the legal entity, it is believed that the underlying valuation basis of subsidiary companies of a US GAAP or IFRS company would be valued on the same basis of the consolidated entity as a whole; thus, consolidation might not preclude the use of IFRS or US GAAP as a major input.

- Volatility: Volatility was one concern noted with respect to a movement toward IFRS, because the current state of IFRS results in more volatility. It was noted this volatility might need to be dealt with through RBC.

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