Insurance stocks are famously undervalued. $100 invested in insurance in 1975 would be worth $100 now compared with $1,200 for a basket of general stocks. The aim of the 10-year project of the IASB is to improve accounting for insurance companies in order to improve valuation, enhance decision-making and improve asset allocation. It has a target delivery date of 2011. The first speaker said there was broad agreement on its “building blocks approach” outlined in September last year. This focuses on: an expected cash flow approach; a time value of money including a discount rate; and a risk margin to account for uncertain cash flows.

In terms of the credit crunch, the speaker insisted that fair value accounting was not responsible for the originate-and-distribute model, investors’ lack of due diligence, decisions by ratings agencies and other factors. The final panel of the SEC investigation had found IFRS was not the root cause of the crisis. However insurance certainly needs a more robust model and further work on disclosure of consolidations. One key issue was the discretion given to EU member states in how they implement IFRS that was needed to ensure that the bloc signed up. IFRS would have been weaker without it, the speaker said. One member blamed the IASB for failing to use simple terms and instead resorting to “polyglot language”

The second speaker said IFRS did have weakness such as the mismatch between assets and liabilities but it was an improvement and there was strong support for standardisation. Insurers generally backed the building blocks approach and the ideas of a fulfilment value. He said that only five years after Enron and Parmalat, he doubted there would be attempts to abuse the system. However one member said the AIG experience showed there was a problem with consolidated accounts. The speaker also acknowledged his own company
used other assumptions in its internal business reviews in order to establish the full economic value of all its operations.

The third speaker agreed insurers were historically undervalued and he blamed a lack of standardisation as well as complexity. He contrasted banking accounts, which might be fiction but whose numbers related to the economic purposes of the bank, with insurers where they did not. Insurance includes assets under management and a cash flow but that it not connected to the IFRS accounts. Furthermore a bank’s accounts might run to 30 pages while an insurer’s might run to 300: analysts don’t need to spend that amount of time on a relatively small industry. Ultimately accounting should be able presenting the basic results in a responsible way.

He fourth speaker saw no value in insurers’ published accounts – other to find out what the executives have paid themselves. He doubted the usefulness of a standard-setting system that could compare insurance for an oil tanker in pirate-infested waters with that for corporate bonds. Furthermore little of the $1 trillion insurance trade was insurance – other than annuities. Most was investment. If so, why not apply that accounting standard rather than allowing life companies to “multiply, multiply, multiply, discount, discount, discount”? He cited the examples of NPI and Friends Provident where takeover offers revealed black holes in their accounts.

The fundamental point should be to understand the economic reality, he said. The most useful tool was cash flows – “money in, money out” that one would apply to a fish and chip shop or light engineering firm. This was highlighted by a recent FSA Persistency Survey that showed per 100 life and pensions policies, a third had lapsed within two years and 60% after four. Forecasts that looked at what all policies would be worth at maturity were therefore meaningless. The first speaker said the IASB was seeking to close the loop between accrual and cash flow accounting, as neither was sufficient on its own. The aim was to provide a more comprehensive view of what had happened during the reporting period.