

CAS Task Force on Fair Value Liabilities

White Paper on Fair Valuing Property/Casualty Insurance Liabilities

Section J – Summary and observations

This white paper has discussed many of the major issues involved in fair value accounting as applied to insurance liabilities. While the focus has been on property/casualty insurance liabilities, many of the issues are also applicable to other insurance liabilities.

In brief, some of the major findings of this paper include:

- ***New task*** - Generally, fair value accounting rules have not yet been applied to property/casualty insurance liabilities. Therefore, implementation of fair value accounting would likely result in unforeseen consequences and a learning curve for those charged with implementing the new rules. (One way to address this issue may be to field test a fair value accounting system before full implementation, possibly via footnote disclosure.)
- ***More work*** - Implementation of fair value accounting for these liabilities would be an increase in workload for those setting the liabilities. New systems and procedures would have to be set up, and additional estimation variables would have to be monitored.
- ***More assumptions*** - Fair value accounting would increase the number of subjective assumptions required for most property/casualty reserving. The impact of these additional assumptions, however, may still be of second order importance when compared to the variability across companies in the (undiscounted, pre-risk adjustment) expected loss estimates.
- ***Multiple methods*** - A critical component in fair value estimation is estimation of the risk margin, or risk adjustment. There are several methods that can be used to estimate these risk adjustments. Each method has advantages and disadvantages, and, depending on the variation in liabilities to be estimated, the use of multiple methods may be necessary.
- ***Can be done*** - No issues have been identified that are not susceptible of actuarial estimation.
- ***Not without concerns*** - As mentioned previously, problems would undoubtedly occur during any initial implementation of fair value accounting.
- ***Evolutionary process*** - Familiarity, expertise and available methods for estimation of fair value liabilities should grow over time, once fair value accounting for insurance liabilities is implemented. Many of the initial estimation problems should diminish over time.
- ***Presentation and Implementation issues, in addition to estimation issues*** - There are issues besides strict estimation issues that actuaries (and accountants) will have to deal with. These include questions as to how historic loss development should be presented in a fair value paradigm, and whether the lack of "value additivity" is an advantage or disadvantage of an estimation method.
- ***Alternatives exist*** - There are other accounting paradigms besides the fair value paradigm focused on by this white paper. Some of these alternatives contain several of the advantages sought by fair value proponents, but at a smaller cost (in resources, subjectivity.) Each alternative also brings its own disadvantages, hence

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- there is no clear "right" answer. The selection of any financial accounting paradigm is at least partially a value judgement, not a pure scientific exercise.
- ***Reflection of credit standing is a controversial issue*** – There are arguments for and against the reflection of credit standing in fair value estimates of insurance liabilities. The task force has consciously avoided taking a position on this issue. Instead we have attempted to present both sides in a clear, objective fashion.

The task force chair wishes to thank all involved with this project for the tremendous amount of work done in a short period of time. In approximately six months, the task force team (with the help of key contributors) produced what I believe to be an excellent workproduct, one that hopefully will be a major contribution to the profession's understanding of the fair value issue. Thank you, once again.

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December 1999 - August 2000 members

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