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INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

GUIDANCE PAPER ON PUBLIC DISCLOSURE BY INSURERS

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Contents

1. Introduction

1. Public disclosure of reliable and timely information facilitates the understanding by prospective and existing policyholders and other market participants of the financial position of insurers and the risks to which they are subject. This paper provides guidance for public disclosures by insurance companies. It recognizes that supervisors have a role in encouraging companies to make effective disclosure.

2. Supervisors are concerned with maintaining efficient, fair, safe, and stable insurance markets for the benefit and protection of policyholders. This paper recognizes that risk disclosure is critical to the operation of a sound market. When provided with appropriate information that allows them to assess an insurer's activities and the risks inherent in those activities, markets can act efficiently, rewarding those companies that manage risk effectively and penalizing those that do not. This is often referred to as market discipline. It serves as an adjunct to supervision.

3. When insurers become insolvent, policyholders may suffer. There have been cases where expected payments from insurers were reduced, even when policyholder protection schemes are in place. Public disclosure provides consumers with information for making judgments about insurers before entering into contracts.

4. Individual policyholders do not always have the ability or resources to assess insurers' financial stability and understand insurer disclosures. This paper recognizes that other market participants, such as shareholders, equity analysts, insurance agents and brokers, rating

agencies and the news media help individual policyholders monitor insurer activities; albeit, their role and involvement varies both by country and within country by type of insurance product.

5. Regular disclosure can facilitate the smooth functioning of the markets. For example, timely public disclosure can reduce the severity of market disturbances because market participants are informed on a more ongoing basis and therefore are not as likely to overreact to information about current conditions. If disclosure of negative information about an insurer is sudden, it could cause policyholders to surrender their contracts in panic. Such action could further worsen the financial position of the insurer.

6. Markets require a higher level of disclosure about insurance companies than that applied to other companies because of the inherent uncertainties in the industry. These inherent uncertainties are natural in the insurance industry because of the unusual and inverse nature of an insurance contract: a policyholder paying regular or single premiums in exchange for an uncertain benefit of a sometimes uncertain amount at a sometimes uncertain point of time in the future. Because of these inherent uncertainties, there is

- a higher degree of estimation particularly as regards liabilities, than for other general business industries;
- the possibility of systemic underestimation (or overestimation) of liabilities (e.g. asbestosis experience); and
- a significant time lag between estimation and crystallisation of liabilities.

7. Insurers have a long tradition of estimation based on actuarial techniques. The underlying assumptions should be disclosed so that others can understand how they arrive at these estimations.

8. Greater disclosure entails increased costs, which may be direct or indirect. For example, companies may experience a competitive disadvantage from increased disclosure of proprietary information. These costs must be weighed against the potential benefits of increased disclosure required by any standards.

9. The insurance industry is becoming increasingly international. However, comparability of financial information across countries is difficult to achieve since accounting policies, practices and procedures differ considerably. Even within a country, insurance accounting policies, practices and procedures may differ from those used by other enterprises. Therefore, it is necessary to disclose accounting policies so that the financial information can be properly understood and interpreted.

10. It is recognized that the development of the insurance market varies widely around the world. Some IAIS members’ insurance industries are less developed than those of other members. The level of disclosure should reflect the developmental state of the industry and the overall balance of products and markets. More sophisticated markets with more complex products will generally require more disclosure. Further, while comprehensive disclosure is a goal, the speed of implementation may vary by country as members balance the need to allocate resources towards implementing prudential, supervisory reporting vs. enhancing public disclosure.

Scope of paper

11. This paper provides guidance for public disclosure by insurers to enable market participants to understand an insurer's current financial condition and future viability. This information helps market participants assess an insurer's prospective ability over both the short and long term:

- to meet claims, liabilities and other obligations as they fall due; and
- to provide a return on investment to its stakeholders, including any shareholders and participating (with-profits) policyholders.

12. This paper does not propose any obligations for supervisors to disclose information that may be in their possession. The purpose of this paper is to provide guidance for public disclosures by insurance companies. The supervisor has an important role in encouraging companies to make effective disclosure. Nonetheless, this paper also recognizes that the insurance supervisors in many jurisdictions do not control the disclosure requirements, and that the responsibility for ensuring such disclosure may not rest with the insurance supervisor.

13. A captive insurer is not subject to the same market forces as commercial insurance companies. This paper does not apply to captive insurers. Nonetheless, supervisors are free to decide whether or not to apply the guidance in this paper to captives.

2. Quality of disclosure

14. Insurers should publicly disclose information that is:

a. relevant to decisions taken by market participants;

b. timely so as to be available and up-to-date at the time those decisions are made;

c. accessible without undue expense or delay by the market participants;

d. comprehensive and meaningful so as to enable market participants to form a well-rounded view of the insurer;

e. reliable as a basis upon which to make decisions;

f. comparable between different insurers and other companies; and

g. consistent over time so as to enable relevant trends to be discerned.

a. Relevance

15. Information is relevant where it is material. Information is material if there is a substantial likelihood that a market participant would consider it important in making a key decision. Typically, the key decisions are whether to insure risks with, invest in or effect other transactions with an insurer.

b. Timeliness

16. Information should be provided with sufficient frequency and timeliness to give a meaningful picture of the insurer. Timeliness requires insurers to report material information as soon as practicable after they become aware of it. In some circumstances, this will require ad hoc intra-period reporting.

17. The requirement for timeliness needs to be balanced against that for reliability. Disclosure of information may be delayed for a short period to allow for proper verification, but only where such delay would not significantly disadvantage users.

c. Accessibility

18. Information should be disseminated in ways best designed to bring it to the attention of market participants, but taking into account the relative costs of different methods of dissemination. Disclosure through electronic channels (e.g. internet) should be strongly encouraged.

d. Comprehensiveness

19. Information should be sufficiently comprehensive to enable market participants to form a well-rounded view of an insurer's financial condition and performance, business activities, and the risks related to those activities. In order to achieve this, information should be:

- sufficiently well-explained so that it is meaningful to a reader who is well-informed as to the inherent nature of insurance business but has no particular knowledge of the insurer except as derived from public disclosures;
- complete so that it covers all material circumstances of an insurer and, where relevant, those of the group of which it is a member; and
- both appropriately aggregated so that a proper overall picture of the insurer is presented and sufficiently disaggregated so that the effect of distinct material items may be separately identified.

20. Disclosure is not required where the information is not material.

e. Reliability

21. Information should faithfully represent that which it purports to represent, or could reasonably be expected to represent. In particular, it should, so far as practicable, reflect the economic substance of events and transactions as well as their legal form. Where the economic substance of an event or transaction is inconsistent with its legal form, the former should prevail. It should be verifiable, neutral (that is free from material error or bias) and complete in all material respects. Completeness is important since an omission can cause information to be false or misleading. Information that is audited may have increased reliability.

22. In many instances, insurers may have to balance the interests of reliability against those of relevance and timeliness. For example in some long-tail classes of insurance realistic projections as to the ultimate cost of incurred claims are highly relevant but, due to inherent uncertainties, not always fully reliable. Given the long-term nature of some insurance risks, reliability is a challenge. Expectations need to be managed so the market maintains a healthy scepticism of the reliability of the information disclosed.

f. Comparability

23. So far as practicable, information should be presented in accordance with any applicable generally accepted national and international standards and practices so as to aid comparisons between insurers. At present there are few, if any, applicable international standards for disclosure although important standards are under development.[1] Similarly national standards are at different stages of development in different jurisdictions but even in their more advanced forms do not purport to be fully prescriptive for all circumstances. It is important therefore that the methods and assumptions used in preparing the information are themselves adequately disclosed. While this will assist financial statement users in interpreting the information, it is recognized that, until international standards are developed and adopted uniformly, true comparability cannot be achieved.

g. Consistency

24. In order to assist in the identification of trends over time, an insurer should use methods and assumptions in the preparation of information which are consistent from period to period and disclose these. Where changes in methods and assumptions are made, the nature of such changes, and their effects, should be disclosed. Information should also be presented so as to facilitate the identification of patterns of development over time including providing comparative or corresponding figures from previous periods (e.g. by presenting loss triangulations).

3. What should be disclosed

25. Public information should at least include descriptions of:

a. financial position;

b. financial performance;

c. risk exposures and how they are managed;

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[1] The International Accounting Standards Board is charged with developing international accounting standards. IAS 1 defines overall considerations for financial statements generally (e.g. fair presentation, consistency, materiality and aggregation, etc.) and the minimum structure and content of the four basic financial statements (balance sheet, income statement, cash flow statement, and statement showing changes in equity.) IASB is currently working on a set of standards specifically for insurance contracts. For additional information, see www.iasc.org.uk.

d. the basis, methods and assumptions upon which information is prepared including the accounting policies (and comments on and the economic impact of any changes); and

e. basic business, management and corporate governance information.

a. Financial position

26. Information about the financial position of an insurer is useful in forming a view as to its ability to meet obligations and provide a return on investment to stakeholders, including participating (with-profits) policyholders. Such information includes descriptions of the nature and amounts of assets, liabilities and capital.

27. For assets the description might usefully include, where relevant:

- segmentation of the investment portfolio according to well-defined investment categories;
- the extent of the insurer's reliance on assets of a particular class or market sector, or from a particular counterparty;
- the bases and assumptions upon which assets are valued (measured);
- use of derivatives and the effect on the economic position of the investment portfolio;
- their appropriateness as a match for liabilities, including their ability to be realised (reflecting both credit quality and liquidity) and their duration;
- whether assets are pledged or have restrictions on their use (e.g. pledged as collateral or held in a participating fund); and
- the change in investments during the reporting period;

28. Similarly for liabilities it might, where relevant, include:

- the amount, timing and nature of liabilities, including contingent and prospective liabilities;
- the bases and assumptions upon which provisions for liabilities (including technical provisions) as well as other liabilities are valued (measured);
- segmentation of technical provisions according to lines of business and by category (e.g. provisions for premiums, provisions for claims);
- presentation of technical provisions both gross and net of reinsurance;
- use of derivatives and the effect on the economic position of the liabilities;
- statement of changes in the technical provisions (on a gross and net basis); and
- where the amount or timing of material liabilities is uncertain, the nature of that uncertainty and the circumstances in which the liability might crystallise or fall due earlier or later than expected or assumed.

29. And for capital, it might include:

- regulatory capital or solvency margin required;
- the amounts of the components and structure of capital; and
- the quality of capital, including any rights of redemption or entitlements to fixed or cumulative dividends or interest.

b. Financial performance

30. Information on an insurer's financial position alone is insufficient to enable market participants to take a prospective view of its ability to meet its obligations and provide a return on investment. That ability is determined by the insurer's financial position at the time the obligation falls due or the investment matures. This depends on both its current financial position and future financial performance.

31. Public disclosure of past financial performance, including in particular profitability and its variability over time, helps market participants to assess possible outcomes for future performance. However, as there are always reasons why the past is an imperfect predictor of the future, it is important that information on past financial performance is supplemented by information on present and prospective risk exposures, risk management strategies and practices, investment strategies, and basic business, management and corporate governance information.

32. Information on past financial performance includes information on the sources, and amounts, of income and expenditure and of cash flows. Relevant information might include:

- statements of profit and loss (including the technical underwriting account gross and net of reinsurance by broad lines of business) and of cash flows and key ratios derived from them including comparisons of earnings to capital employed and business volumes;
- statement of changes in equity showing gains and losses recognized directly in equity as well as capital transactions with and distributions to shareholders, and profit-sharing with policyholders;
- segmental reporting by material business line and geographical area including the technical underwriting account (gross and net of reinsurance) and historical patterns of claims development ('triangulations');
- returns on different categories of investments; and
- management's discussion and analysis of financial performance.

33. Within the statements of profit and loss and of cash flows and the segmental reporting, it is often helpful to market participants for insurers to:

- describe the nature and sources of income, expenditure and cash flows so as to help market participants form a view as to the quality and, in particular, potential volatility and sustainability of earnings;
- disclose amounts both gross and net of reinsurance so that the impact of reinsurance protections may be understood;

- report both claims incurred and paid so that changes in the pattern of claims settlement may be more readily identified; and
- identify the impact of acquisitions and lines of business discontinued during the reporting period so that trends may be more clearly discerned and the sustainability of earnings better understood.

34. Segmented reporting helps market participants understand the contribution of individual business lines/geographic segments to financial performance and to make comparisons between insurers. It allows market participants to assess the extent of diversification and exposure to high-risk business lines or geographical areas (e.g. exposure to areas prone to natural catastrophes or to liability insurance in litigious jurisdictions).

35. Management has a detailed knowledge of the business that outsiders cannot have. Therefore management can greatly assist market participants by discussing:

- the main factors that influenced an insurer's financial performance during the reporting period;
- differences in performance as compared to prior periods and to prior disclosed forecasts/projections ; and
- factors which they believe will have a significant influence on the insurer's future financial performance.

36. In particular the discussion might usefully identify past and prospective material changes in:

- underwriting strategy, including the channels of distribution of business;
- the nature, frequency and severity of claims;
- the potential for aggregation of claims from the same occurrence or series of occurrences arising from the same originating cause;
- the nature, level and collectability of reinsurance protections and the bases and assumptions used for setting technical provisions; and
- returns on different categories of investments.

c. Risk exposures and how they are managed

37. Disclosures on risk exposures, including strategies for managing risk and the effectiveness of those strategies, help market participants to assess an insurer's stability and viability including:

- the sensitivity of its earnings to potential changes in circumstances;
- whether returns are appropriate for the level of risk it has assumed; and
- ultimately its ability in times of stress to meet obligations and provide a return on investment.

38. Risk areas relevant to public disclosure typically might include:[2]

- **technical risks** (liability risks): i.e. various kinds of risk which are directly or indirectly associated with the technical or actuarial bases of calculation for premiums and technical provisions in both life and non-life insurance, as well as risks associated with operating expenses and excessive or uncoordinated growth;
- **investment risks** (asset risks): i.e. various kinds of risk which are directly or indirectly associated with the insurers' asset management; and
- **non-technical risks**: i.e. various kinds of risk which cannot in any suitable manner be classified as either technical risks or investment risks.

39. In discussing each risk area, an insurer should present sufficient qualitative and, where relevant and available, quantitative information to help market participants understand the nature of material exposure to risk, how it is managed and its potential impact. Special care needs to be taken to ensure that disclosures on risk are meaningful because risk exposures can change very quickly and strategies for dealing with risk have become more sophisticated, and thus more difficult to explain. Disclosures might usefully include descriptions of:

- the insurer's overall risk management philosophy and policy, including its risk appetite;
- how risks arise;
- how risks are managed and controlled;
- whether and how reinsurance, derivatives, securitisation and alternative risk transfer or mitigation mechanisms are used to manage risk; and
- how sensitive the risk measures disclosed are to changes in assumptions.

d. How information is prepared

40. So that public disclosure is meaningful to market participants, it should include an adequate description of how information is prepared, including methods applied and assumptions used. Such disclosure of methods and assumptions also assists market participants to make comparisons between insurers. Accounting and actuarial policies, practices and procedures differ not only between countries but also between insurers within the same country. Meaningful comparisons can thus only be made where there is adequate disclosure of how information is prepared. Similarly meaningful comparisons from one reporting period to another can only be made if the reader is informed how the methods and assumptions of preparation have changed and, if practicable, the impact of that change.

e. Basic business, management and corporate governance information

41. In order to help them evaluate public disclosures on financial position, financial performance and on risk and its management, market participants need fundamental

[2] Definitions from paragraph 5.2.5 of the IAIS Sub-Committee on Solvency and Actuarial Issues' Issues Paper "On Solvency, Solvency Assessments and Actuarial Issues" dated 15 March 2000.

information about an insurer’s business, management and corporate governance. Such information helps market participants assess an insurer’s efficiency and overall strength, future prospects and ability to respond to change.

42. Relevant disclosures might include:

- the insurer’s position within the market in which it competes, its strategy and its progress toward achieving its strategic objectives;
- the board structure (e.g. the size of the board, the board committees and membership), senior management structure (i.e. responsibilities and reporting lines), the incentive structure (i.e. how compensation for executive and staff is set and the amounts of that compensation) and the overall corporate culture;
- the legal entity and lines of business structure of the insurer itself and, where applicable, of the group of which it is a member, including the organizational structure of the group, and material transactions between the insurer and related firms or individuals;
- the structure of ownership;
- significant strategic alliances and outsourcing arrangements entered into by the insurer with third parties;
- information regarding the future potential of identifiable intangible assets (e.g. capital expenditures on research and development, intellectual capital, new product development, training, and reputation); and
- the regulatory framework (e.g. the insurer must meet the specified standards of the regulator).