Insurance

Dealing with the impact of the new financial instrument standards for Canadian insurers*

A guide to the expanded disclosure requirements
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To Our Clients and Friends

Financial reporting for insurance entities in Canada changed significantly in 2007 as a result of the new accounting standards that were issued by The Canadian Institute of Chartered Accountants (CICA): Handbook Section 1530, “Comprehensive Income”; Section 3855, “Financial Instruments – Recognition and Measurement”; Section 3861, “Financial Instruments – Disclosure and Presentation” and Section 3865, “Hedges.” The adoption of these new standards has resulted in fundamental changes in accounting for financial instruments and will significantly impact the nature and extent of required disclosure in the 2007 financial statements and going forward.

This guide is intended to provide practical assistance to preparers of financial statements. However, it should be used as a point of reference only, as it does not encompass all the disclosure requirements of the new financial instrument standards and, of course, does not address materiality considerations. Insurers will need to consult with their auditors and experts within their organizations to ensure that the various disclosure suggestions are appropriately tailored for their specific entity’s circumstances.

Our insurance professionals are available to consult with you throughout the process and would be pleased to discuss this guide further with you or answer any questions you may have. We are also interested in your feedback.

The new accounting standards referenced above represent the first wave in the overhaul of financial reporting for financial instruments. 2008 will see additional reporting requirements as other accounting standards, in particular, CICA Handbook Section 1535, “Capital Disclosures”; Section 3862, “Financial Instruments – Disclosures”; and Section 3863, “Financial Instruments – Presentation” come into force. Our firm is assessing the impact of these standards and is preparing to provide you with guidance on these standards.

Yours truly,

Bill Bawden
Insurance Industry Leader

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Introduction

In developing this guide, our objective was to develop material for Canadian insurance entities adopting the new financial instrument standards. We reviewed the relevant accounting standards issued by the CICA, in particular the following sections:

- 1506, “Accounting Changes”
- 1520, “Income Statement”
- 1530, “Comprehensive Income”
- 3251, “Equity”
- 3855, “Financial Instruments – Recognition and Measurement”
- 3861, “Financial Instruments – Disclosure and Presentation”
- 3865, “Hedges”
- 4211, “Life Insurance Enterprises – Specific Items”

In this publication, we set out some example wording that you may wish to consider as you draft the disclosures for your 2007 financial statements. This guide covers the following areas:

- change in accounting policies (two examples, the second of which assumes all investments are designated as available-for-sale);
- significant accounting policies;
- amendments to investments and investment income disclosures;
- disclosure of income taxes included in other comprehensive income;
- other fair value disclosures;
- financial risk management policies and objectives; and
- cash flow, interest rate and credit risk disclosure.

The hedge accounting requirements have not been considered, as they will likely only be applicable to a few large insurers.

This guidance does not cover implementation of CICA Section 1535, “Capital Disclosures”; Section 3862, “Financial Instruments – Disclosures”; and CICA Section 3863, “Financial Instruments – Presentation,” which must be adopted from January 1, 2008 by companies with a December 31 year-end.

Change in accounting policies

CICA Section 1506 requires that when an initial application of a primary source of Canadian generally accepted accounting principles (GAAP) has an effect on the current period, an entity shall disclose the following:

- the title of the primary source of GAAP (1506.28(a));
- a description of the nature of the change in accounting policy (1506.28(c));
- a description of the transitional provision (1506.28(d));
- the effect of the change for each financial statement line item (1506.28(f)); and
- the related income tax effect (1506.28(f)).

We provide as illustration the following note disclosures regarding the change in accounting policies for entities that hold several classes of investments and have elected more than one classification for those investments.

Example 1:

Change in accounting policies

On January 1, 2007, the *[Company/Branch]* adopted the following new accounting standards that were issued by The Canadian Institute of Chartered Accountants (CICA): Handbook Section 1530, “Comprehensive Income”; Section 3855, “Financial Instruments – Recognition and Measurement”; Section 3861, “Financial Instruments – Disclosure and Presentation”; Section 3865, “Hedges” and Section 4211, “Life Insurance Enterprises – Specific Items.” The adoption of these new standards resulted in changes in the accounting for financial instruments and the recognition of certain transitional adjustments that have been recorded in *[opening retained earnings and/or opening accumulated other comprehensive income],* as described below. The *[Company/Branch]* adopted these standards at the beginning of the year and, in accordance with the transitional provisions, the prior period balances have not been restated, *[except for the presentation of the currency translation account, which was adopted retroactively].*

Prior to the adoption of these new standards, financial assets and liabilities within the scope of Section 3855 comprising *[cash, investment, accounts receivable and accounts payable]* were recorded at cost or amortized cost. Under the new standards, all financial assets and liabilities, except for policy liabilities, are recorded on the balance sheet at fair value on initial recognition and are subsequently accounted for based on their classification, as described below.

Financial assets

Held for trading (HFT): A financial asset is classified into the HFT category at inception if acquired for the purpose of selling in the short term or if designated as such by management (fair value option). Financial assets classified as HFT are carried at fair value on the balance sheet with realized gains and losses and changes in unrealized gains and losses recorded in net income. These financial instruments were previously accounted for at cost or amortized cost. The difference between cost/amortized cost ($•) and fair value ($•), net of income taxes ($•), as at January 1, 2007 has been recorded as an adjustment to opening retained earnings ($•).

Available for sale (AFS): AFS financial assets are non-derivative financial assets that are designated as AFS, or that are not classified as loans and receivables, held to maturity investments or held for trading.

Financial assets with quoted prices in an active market classified as AFS are carried at fair value on the balance sheet with changes in unrealized gains and losses recorded in other comprehensive income (OCI) until realized. Equity investments that are classified as AFS and do not have a quoted price in an active market are recorded at cost. When AFS financial assets are sold or impaired, the accumulated fair value adjustments (and associated income taxes) recognized in accumulated other comprehensive income (AOCI) are transferred to the income statement as net realized gains or losses on investments. A provision for impairment for equity instruments and debt securities classified as AFS is established when there is objective evidence that the investment is impaired and the impairment is other than temporary. A provision for impairment for loans and receivables classified as AFS is established when there is objective evidence that the *[Company/Branch]* will not be able to collect all amounts due according to its original terms. Previously, equity instruments were recorded at cost and debt securities and loans and receivables were recorded at amortized cost; when a loss in value was considered other than temporary, the investment or receivable was written down to its estimated net realizable value *[tailor as appropriate to your policies].*

The difference between cost/amortized cost ($•) and fair value ($•), net of income taxes ($•), as at January 1, 2007 has been recorded as an adjustment to opening AOCI ($•).

Held to maturity (HTM): HTM financial assets have fixed or determinable payments and management has the positive intention and ability to hold them to maturity. These assets are recognized initially at fair value and subsequently measured at amortized cost using the effective interest rate method. A provision for impairment is established when there is objective evidence of impairment and the impairment is other than temporary. The investment will be written down to its fair value. These investments were previously accounted for using *[describe*

previous accounting policy for calculating amortization]. The difference between the *[previous accounting policy]* and the effective interest rate method is described below.

Loans and receivables: Any such assets are recognized initially at fair value and subsequently measured at amortized cost using the effective interest rate method. A provision for impairment is established when there is objective evidence that the *[Company/Branch]* will not be able to collect all amounts due according to their original terms.

Purchases and sales of financial assets are recognized on *[trade date/settlement date].*

Transaction costs are expensed in the income statement for financial instruments classified or designated as HFT. For other financial instruments, transaction costs are *[expensed/capitalized]* on initial recognition. *[If change in accounting policy, describe and quantify impact of change.]*

Changes in fair value of securities denominated in a foreign currency and classified as HFT are recognized in net income. Changes in fair value of securities denominated in a foreign currency and classified as AFS are recognized in OCI.

The effective interest rate method is used to amortize transaction cost capitalized on initial recognition and for the premiums or discounts on the purchase of loans, receivables and AFS securities. Previously, amortization was calculated using *[describe previous accounting policy].* The difference between the *[previous accounting policy]* and the effective interest rate method of $• *[has been recorded in opening retained earnings, net of income taxes of $•/was not material and, therefore, no adjustment was recorded].*

Financial liabilities

Any such liabilities, other than policy liabilities, are measured at amortized cost using the effective interest rate method. *[If change in accounting policy, describe and quantify impact of change.]*

Hedges

The *[Company/Branch]* does not have any derivatives or other financial instruments designated as accounting hedges *[or explain how hedges are accounted for if applicable].*

Policy liabilities

The impact of recording the investments at fair value on the selection of the discount rate and the measurement of the policy liabilities *[was $• and has been recorded as an adjustment to opening retained earnings, net of income taxes of $•/was immaterial].*

Deferred realized gains and losses

CICA Handbook Section 4211, "Life Insurance Enterprises – Specific Items," has replaced CICA Handbook Section 4210 and is no longer applicable to financial instruments within the scope of Section 3855. Accounting for investments in real estate is substantially unchanged from Section 4210. Realized gains and losses on debt and equity investments are no longer deferred and amortized into income but are now required to follow the accounting requirements in the new CICA Handbook Sections 1530, 3855 and 3865. As a result, the balance of the deferred net realized gains and losses on investments, other than real estate, of $• has been recorded as an adjustment to opening retained earnings, net of income taxes of $•.

Comprehensive income

Comprehensive income comprises net income and OCI and includes all changes in equity during a period, except those resulting from investments by owners and distributions to owners. Changes in unrealized gains and losses on AFS investments are recorded in OCI and included in AOCI until recognized in the income statement. *[Add any other applicable transactions such as cash flow hedges and the foreign currency translation of self-sustaining operations.]* AOCI is included on the balance sheet as a separate component of *[shareholders' equity/head office account].*

Embedded derivatives

The *[Company/Branch]* is also required to identify and record separately on its balance sheet derivatives embedded in other financial instruments not classified as HFT (the host instrument). Prior to the adoption of this standard, such embedded derivatives were not accounted for separately from the host contract.

The impact of the change in accounting policy related to embedded derivatives was not material *[or embedded derivatives contained within contracts that have not been classified as HFT are separated and recorded at fair value on the balance sheet, with changes in fair value recorded in net income].* In accordance with Section 3855, the

[Company/Branch] has chosen a transition date of *[January 1, 2003]*[1]. All contracts entered into before this date were not considered for the existence of embedded derivatives. As at January 1, 2007, the fair value of all embedded derivatives entered into after January 1, 2003 of $• has been recorded on the balance sheet and as an adjustment to opening retained earnings, net of income taxes of $•.

Transitional adjustments

A summary of the impact on the balance sheet of adopting the new standards follows.

	As at December 31, 2006 $	*Adjustment on adoption of new standards $*	*As at January 1, 2007 $*
Bonds and debentures	X	X	X
Preferred shares	X	X	X
Common shares	X	X	X
Future income taxes	X	X	X
Policy liabilities	X	X	X
Deferred realized net gains and losses	X	X	X
Retained earnings	X	X	X
Accumulated other comprehensive income	X	X	X

There was no impact on reported net income for the year ended December 31, 2006.

[1] In accordance with the transitional provisions in Section 3855.88(e), the entity has the option to select the transition date for embedded derivatives to be the beginning of a fiscal year ending no later than March 31, 2004. In our example, we have assumed the entity has selected a transition date of January 1, 2003.

This second sample disclosure for a change in accounting policies note is more relevant for entities that have classified all investments as AFS.

Example 2:

Change in accounting policies

On January 1, 2007, the *[Company/Branch]* adopted the following new accounting standards that were issued by The Canadian Institute of Chartered Accountants (CICA): CICA Handbook Section 1530, "Comprehensive Income"; Section 3855, "Financial Instruments – Recognition and Measurement"; Section 3861, "Financial Instruments – Disclosure and Presentation"; and Section 3865, "Hedges."

Section 1530 establishes standards for reporting and presenting comprehensive income. Comprehensive income comprises net income and other comprehensive income (OCI) and includes all changes in equity (net assets) of the *[Company/Branch]* during the year except those resulting from investment by and distribution to owners. Changes in unrealized gains and losses on available for sale (AFS) investments are recorded in OCI and included in accumulated other comprehensive income (AOCI) until recognized in the income statement.

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. Under Section 3855, financial instruments must be classified as held for trading (HFT), held to maturity (HTM), loans and receivables, AFS financial assets or other financial liabilities. All financial instruments, including derivatives, are measured on the balance sheet at fair value, except for those classified as loans and receivables, HTM investments and other financial liabilities, which are measured at amortized cost using the effective interest rate method. Changes in fair value of HFT financial instruments are recorded in net income. Changes in fair value of AFS financial assets are recorded in other OCI until the investment is sold or impaired; at which time, the realized gain or loss will be recorded in net income.

Section 3861 establishes standards for the presentation of financial instruments and non-financial derivatives and identifies the related information that should be disclosed.

Section 3865 describes when and how hedge accounting can be applied. *[The [Company/Branch] does not have any hedging relationships.]*

On adoption of the new standards, as at January 1, 2007, the *[Company/Branch]* classified all of its investments as AFS. The adjustment to *[increase/decrease]* the carrying value of these investments from cost/amortized cost ($•) to fair value ($•) has been recorded as an opening adjustment to ACOI, net of income taxes of $•. Accounts receivable are classified as loans and receivables, while bank indebtedness, accounts payable and accrued liabilities are classified as other financial liabilities, all of which are measured at amortized cost. The amortization of premiums and discounts is calculated using the effective interest rate method. Previously, amortization was calculated using the *[describe previous accounting policy].* The difference between the *[previous accounting policy]* and the effective interest rate method of $• has been recorded in opening retained earnings, net of income taxes of $•. *[Or was not material and, therefore, no adjustment was recorded.]*

The impact of recording the investments at fair value on the selection of the discount rate and the measurement of the policy liabilities *[was $• and has been recorded as an adjustment to opening retained earnings, net of income taxes of $•/was immaterial].*

A summary of the impact on the balance sheet of adopting the new standards follows.

	As at December 31, 2006 $	*Adjustment on adoption of new standards $*	*As at January 1, 2007 $*
Bonds and debentures	X	X	X
Preferred shares	X	X	X
Common shares	X	X	X
Future income taxes	X	X	X
Policy liabilities	X	X	X
Deferred realized net gains and losses	X	X	X
Retained earnings	X	X	X
Accumulated other comprehensive income	X	X	X

There was no impact on reported net income for the year ended December 31, 2006.

Other considerations

In addition to the above disclosure, other items to consider include:

- writeoff of deferred transaction costs;
- reclassification of deferred charges;
- embedded derivatives;
- disclosures applicable to hedges (refer to Section 3865);
- impact on earnings per share; and
- the requirement to restate prior years for foreign currency translation of self-sustaining foreign operations.

Significant accounting policies

The note to the financial statements that outlines significant accounting policies should be amended to describe the accounting policies adopted under the new financial instrument standards. In the year of adoption, the extensive change in accounting policy note previously described will likely result in the following note being repetitive. **We have provided some illustrative note disclosures below to be included in the 2008 and subsequent financial statements**. We caution that this is not an exhaustive list of accounting policies that will be impacted by the new standards and each entity should ensure all accounting policies that are impacted by the new standards are appropriately described.

Accounting policies

AFS financial assets

AFS financial assets with quoted prices in an active market are carried at fair value on the balance sheet from the *[trade date/settlement date].* Any changes in fair values are recorded, net of income taxes, in OCI until the financial asset is disposed of or has become other than temporarily impaired. When the asset is disposed of, or has become impaired, the accumulated fair value adjustments recognized in AOCI are transferred to the income statement and, accordingly, a corresponding adjustment (net of income taxes) is made to OCI. A provision for impairment for equity instruments and debt securities classified as AFS is established when there is objective evidence that the investment is impaired and the impairment is other than temporary. A provision for impairment for loans and receivables classified as AFS is established when there is objective evidence that the *[Company/Branch]* will not be able to collect all amounts due according to their original terms. Equity investments that are classified as AFS and do not have a quoted price in an active market are recorded at cost.

HTM financial assets

HTM financial assets have fixed or determinable payments and management has the positive intention and ability to hold them to maturity. These assets are recognized initially at fair value and subsequently measured at amortized cost using the effective interest rate method. A provision for impairment of debt securities classified as HTM is established when there is objective evidence of impairment and the impairment is other than temporary. The investment will be written down to its fair value.

HFT financial assets and liabilities

HFT financial assets and liabilities are carried at fair value on the balance sheet from the *[trade date/settlement date*] and changes in fair values are recorded in net income. HFT financial assets and liabilities are purchased or incurred with the intention of generating profits in the near term (classified as HFT) or are designated as such by the *[Company/Branch]* (designated as HFT/fair value option).

Loans and receivables

Financial assets classified as loans and receivables are initially recognized at fair value and subsequently measured at amortized cost using the effective interest rate method.

Embedded derivatives

A derivative instrument may be embedded in another financial instrument (the host instrument). Embedded derivatives are treated as separate derivative financial instruments when their economic characteristics and risks are not clearly and closely related to those of the host instrument, the terms of the embedded derivatives are the same as those of a stand-alone derivative financial instrument, and the combined contract is not designated or classified as HFT. Embedded derivatives are accounted for at fair value on the balance sheet and changes in fair value are recorded in net income.

Transaction costs

Transaction costs are expensed as incurred for financial instruments classified or designated as HFT. For other financial instruments, transaction costs are *[expensed/capitalized]* on initial recognition. *[The effective interest rate method is used to amortize transaction costs capitalized on initial recognition.]*

Amendments to investments and investment income disclosure

Investments

The new financial instrument standards will also result in significant changes to the investments note. Under Sections 3855 and 3861, an entity is required to disclose fair values for all classes of financial assets and liabilities, with a comparison to the corresponding carrying amounts in the balance sheet. Under Section 3855.88(c)(i), each investment category should include the amounts that are (i) required to be classified as HFT; (ii) designated as HFT, (iii) AFS, and (iv) HTM, with a comparison to the classification and carrying amount in the last-issued financial statements.

If all investments have been classified as AFS, a statement to that effect should be made in the note disclosure. The prior year's comparatives should reflect both the carrying amount (amortized cost basis) and the fair value. We have assumed that the majority of investments held by Canadian insurers will have quoted prices in an active market. Sections 3861.70 and 3861.71 require further disclosures when this is not the case and when it is not practical to measure reliably the fair values of financial instruments. The number of situations where the determination of fair value is not practical is expected to be very limited.

Investments

The fair value of the *[Company's/Branch's]* investment portfolio by financial instrument classification as at December 31 is:

	2007						*2006*	
	Classified as HFT	*Designated as HFT*	*Classified as AFS*	*Classified as HTM*	*Total carrying value*	*Total fair value*	*Total carrying value*	*Total fair value*
	$	*$*	*$*	*$*	*$*	*$*	*$*	*$*
Cash	X						X	X
Short-term investments	X	X	X	X	X	X	X	X
Bonds and debentures	X	X	X	X	X	X	X	X
Preferred shares	X	X	X		X	X	X	X
Common shares	X	X	X		X	X	X	X
Other invested assets	X	X	X	X	X	X	X	X
Total investments	X	X	X	X	X	X	X	X

Management reviewed currently available information for AFS investments with unrealized loss (totalling $•) and determined that the impairment was temporary.

Investment income

Under the disclosure and presentation requirements of Section 3861.82, current disclosure of investment income information must be expanded to include the following information:

- the total amount of the change in fair value of investments required to be classified as HFT that is recognized in net income;
- the total amount of the change in fair value of investments designated as HFT (fair value option) that is recognized in net income;
- the total amount of interest income or expense (calculated using the effective interest rate method) for financial assets and financial liabilities that is not classified as HFT; and
- the amount of any gain/loss realized on AFS investments that has been reclassified from AOCI to net income.

This could be done in tabular format or as a narrative description. The table below summarizes total net investment income recorded in the income statement.

Investment income

Investment income as at December 31, 2007 was derived from the following:

Investment income

	$
AFS securities	
Dividend income	X
Interest income	X
Realized gains/losses	X
HTM interest income	X
Impairment of financial assets	(X)
Net fair value gains/losses on financial assets classified as HFT	X
Net fair value gains/losses on financial assets designated as HFT	X
Total investment income	X

Income taxes included in OCI

We have not presented an example of the Statements of Comprehensive Income and Accumulated Other Comprehensive Income, as OSFI returns already provide a suggested presentation, but we want to highlight here the further disclosure requirements with respect to income taxes.

In accordance with Section 1530.06, an enterprise is required to disclose either on the face of the statement or in the notes to the financial statements the amount of income tax expense or benefit allocated to each component of comprehensive income, including reclassifications to income. The following note is one alternative for disclosing this information.

Income taxes included in OCI

The amounts included in the statement of comprehensive income as at December 31, 2007 are shown net of the following, tax expense/(benefit):

	$
Tax impact on:	
Change in unrealized gains and losses	X
Reclassifications to earnings of (gains)losses	X
Total income tax expense(benefit) included in OCI	X

[Where applicable, entities should include in the above table, the income tax effect on derivatives designated as cash flow hedges.]

Financial risk management and risk disclosures

Other disclosures

Under Section 3861, entities are required to provide information about financial risk management objectives and policies relating to financial instruments, as well as information on fair values and liquidity, interest rate and credit risks.

Financial risk management objectives and policies

CICA Handbook Section 3861.41 requires an entity to describe its financial risk management objectives and policies (including its policy for hedging each main type of forecasted transaction for which hedge accounting is used).

In addition to providing specific information about particular balances and transactions related to financial instruments, the entity should provide a discussion of the extent to which financial instruments are used, the associated risks and the business purposes served. A discussion of management's policies for controlling the risks associated with financial instruments includes policies on matters such as hedging of risk exposures, avoidance of undue concentrations of risk and requirements for collateral to mitigate credit risk. Such discussion provides a valuable additional perspective that is independent of the specific instruments held or outstanding at a particular time.

The standard does not prescribe either the format or the information required to be disclosed on management's financial risk management objectives and policies. However, management's objective should be to provide users of the financial statements with information that allows them to understand the extent of the risk related to both recognized and unrecognized financial instruments.

Most companies already include a discussion in their financial statements regarding the management of insurance risks, including the use of reinsurance. The following sample disclosure focuses on non-insurance risks. Management should use its judgment and entity-specific information when determining the nature and extent of disclosure. A company which has designated assets as HFT under the fair value option is required to follow OSFI Guideline D-10 and will likely wish to provide greater transparency on the extent of its risk management activities than other organizations. Some smaller companies or branches with large foreign parents may focus on risk management at the group level and specific policies at the level of the Canadian organization may not exist. If this is the case, disclosure of the decision not to have specific policies for the reporting entity should be considered.

Financial risk management objectives and policies

Credit risk: The company is exposed to credit risk principally through its investment securities and balances receivable from policyholders and reinsurers. The company has policies to limit and monitor its exposure to individual issuers and classes of issuers of investment securities which do not carry the guarantee of a national or Canadian provincial government. The company's credit exposure to any one individual policyholder is not material; however, the company's policies are distributed by brokers who manage cash collection on its behalf. The company monitors its exposure to brokers and has procedures to ensure that it works only with licensed firms in good standing with their regulatory bodies. The company has policies which limit its exposure to individual reinsurers and regular review processes to assess the creditworthiness of reinsurers with whom it transacts business.

Equity price risk: The company has policies to limit and monitor its exposure to individual issuers and classes of issuer of equity instruments.

Asset and liability matching: The company is exposed to:

- changes in the value of its fixed income securities and policy liabilities to the extent that market interest rates change;
- the risk of losses to the extent that the sale of a security prior to its maturity is required to provide liquidity to satisfy policyholder and other cash outflows;
- the risk that future inflation of policyholder cash flows exceed returns on long-dated investment securities; and
- foreign currency risks with respect to investments, receivables and policy liabilities denominated in foreign currencies.

To mitigate these risks, the company has policies to ensure that assets and liabilities are broadly matched in terms of their duration and currency. The company's exposures are monitored on a regular basis and actions are taken to balance positions when approved risk tolerance limits are exceeded.

Risk management is carried out by *[a central treasury department/group function/local management/investments committee]* under policies approved by *[the board of directors/head office].* The *[Company/Branch]* has written principles for overall risk management, as well as written policies covering specific areas, such as underwriting, reinsurance, foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments and investment of excess liquidity.

Fair value

Fair value information is widely used for business purposes in determining an entity's overall financial position and in making decisions about individual financial instruments. It is also relevant to many decisions made by users of financial statements because, in many circumstances, it reflects the judgment of the financial markets as to the present value of expected future cash flows relating to an instrument. Fair value information permits comparisons of financial instruments having substantially the same economic characteristics, regardless of their purpose and when and by whom they were issued or acquired.

Paragraph 3861.69 requires an entity to disclose the fair values of each class of financial assets and liabilities in a way that permits them to be compared with the corresponding carrying amounts in the balance sheet. This will generally require additional disclosures relating to those classes of financial instruments not already recorded in the balance sheet at fair value, including HTM assets and loans and receivables carried at amortized cost.

Insurance contracts are financial instruments and while they are not within the scope of the new standard on recognition and measurement (Section 3855), they are within the scope of the new standard on presentation and disclosure (Section 3861). Life insurers are provided some disclosure relief when it is not practical within the constraints of timeliness or cost to measure reliably the fair value of their actuarial liabilities (Paragraph 3861.70). Life insurers are, however, required to follow Accounting Guideline AcG 08, "Actuarial Liabilities of Life Insurance Enterprises – Disclosure," and, under Section 3862.71:

- state the fact that fair value information has not been disclosed for actuarial liabilities because their fair value cannot be measured reliably;
- provide an explanation of why fair value cannot be reliably measured; and
- supply information about the market for the instruments.

Property and casualty (P&C) insurers are not afforded the same exemption as life insurance enterprises and are required to disclose the fair value of insurance contracts, which would include the provision for outstanding claims (earned portion of the contract), the unearned premiums (unearned portion of the contract) and any related reinsurance. The Canadian Institute of Actuaries' valuation techniques for P&C policy liabilities are discounted cash flow models which are generally consistent with fair value techniques contemplated under GAAP (Section 3855.A47). Some P&C insurers may take the position that the discounted values of financial assets and liabilities approximate their fair values. Such considerations should be discussed with the Appointed Actuary.

Fair value

Refer to note • with respect to fair value disclosures on investments. The carrying values of accounts receivable and payable approximate their fair values due to the short term to maturity of those financial instruments. The *[Company/Branch]* estimates that the fair value of policy liabilities, *[as well as the fair value of unearned premiums],* approximates their carrying values (refer to note • with respect to the valuation methodology and assumptions).

Cash flow, interest rate and credit risk disclosure

Additional objectives of Section 3861 are to provide information to enhance the understanding of the significance of financial instruments to an entity's financial position, performance and cash flow, and to assist in assessing the amounts, timing and certainty of future cash flows associated with those instruments. Most companies already demonstrate the extent of interest rate, cash flow and credit risks relating to investments by providing a sensitivity analysis on the fair value of debt securities due to a change in interest rates, a maturity schedule for investments and an analysis of investments by class of issue, and credit rating.

To meet the above objectives, insurance entities should consider providing further clarity as to their exposure to interest rate, cash flow and credit risk with respect to policy liabilities.

Interest rate and cash flow risk

An entity may be able to provide useful information about its exposure to interest rate risks by indicating the effect of a hypothetical change in the prevailing level of market interest rates on the value of its financial instruments and future earnings. The following example may be considered.

Interest rate risk

The sensitivity analysis for interest rate risk set out below illustrates the impact of a 1% change in interest rates on the carrying value of policy liabilities as at the reporting date. The sensitivity of actuarial liabilities to changes in interest rates is dependent on the duration of the liability. Due to the time value of money, a reduction in the interest rates would normally produce a higher insurance liability.

An increase of 100 basis points in the interest yields would result in a decrease to the actuarial liabilities of $•.

A decrease of 100 basis points in the interest yields would result in an increase to the actuarial liabilities of $•.

Further disclosure on cash flow risk may also be useful given the significance of the actuarial liabilities on an insurance entity's financial statements. As explained in Section 3861.56(c), an entity may disclose its exposure to interest rate cash flow risk through a table indicating the expected payment pattern of the actuarial liabilities. This information should be available from an entity's Appointed Actuary.

Future cash flows

The following table summarizes the expected timing of cash flows arising from insurance obligations as at December 31, 2007:

	Total $	*Less than 1 year* $	*1-5 years* $	*5-10 years* $	*Greater than 10 years* $
Actuarial liabilities at carrying amount	X	X	X	X	X
Less: Reinsurance recoverable	X	X	X	X	X
Net actuarial liabilities	X	X	X	X	X

Credit Risk

Information relating to credit risk permits users of the financial statements to assess the extent to which failures by counterparties to discharge their obligations could reduce the amount of future cash inflows of the entity. Section 3861.58 requires entities to disclose information about their exposure to credit risk at the balance sheet date, including the maximum credit risk exposure, without regard to potential recoveries from realization of collateral and significant concentrations of credit risk. Insurance entities have exposure to credit risk when they have amounts outstanding from reinsurers, policyholders or insurance intermediaries or when they have entered into derivative transactions and there is counterparty risk. The following table may be used:

Reinsurance recoverables

The following table summarizes the balances outstanding from reinsurers as at December 31, 2007 by risk rating:

Credit rating	*Gross reinsurance recoverable*	*Less: Provisions and securities held*	*Net reinsurance recoverable*
	$	*$*	*$*
A	X	X	X
BB+	X	X	X
B-	X	X	X
Not rated	X	X	X
Pools and facilities	X	X	X
	X	X	X

For more information

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