Comment on: O'Keefe, P.J.L., Desai, A.J., Foroughi, K., Hibbett, G.J., Maxwell, A.F., Sharp, A.C., Taverner, N.H., Ward, M.B., & Willis, F.J.P. (2005), 'Current Developments in Embedded Value Reporting', *British Actuarial Journal* (forthcoming).

Professor R. Macve (a Chartered Accountant), Hon.F.I.A.: I have the honour of being an Honorary Fellow of your Institute. I should like to pick up three brief points. The focus of this excellent paper is primarily on the new valuation approach with some references to the issues relating to financial reporting. I think in terms of selling this to other professions, which has been commented on, and in particular to the accounting profession and the IASB, there are some issues which need specific attention.

The first of these is the one which was raised earlier by Ms Coulthard about the analysis of the change in embedded value from one year to another. How one describes what has contributed to that performance, and how that is analysed, is of course crucial in making this

change comparable to the kind of profit and loss accounts that people are familiar with from other businesses. If we think back long enough, when I first became interested in all this at the beginning of the 1990s, a lot of the “accruals” versus embedded value debate was about which method would bring out more clearly from a management and investor perspective the factors that are driving performance.

The second issue is that we do not know where we are with the IASB because at the latest announcement its chairman said "we are starting with a clean slate again". But from previous discussions, one particular issue which was raised in IFRS 4 as a tentative conclusion for the next step was basically that IASB does not like “day one” profits, and if your MCEV method produces day one profits then it is going to have to pass the test which the IASB laid down - which was there has to be very good market evidence. So I think we have to ask what markets is one calibrating to for all the various elements of this embedded value? Some of the markets are clear, the investment markets; other markets in insurance liabilities

people have always argued are not deep, liquid and transparent. So we have to be clear exactly what is being calibrated to and how reliable that is.

Finally, one thing I have never understood, and maybe somebody one day will tell me the answer, is I do not understand this locked in capital cost. You have some capital, some of it you use in your insurance business, some of it let us suppose you have to keep because the regulator says you have to have it, let us suppose that it is all in gilt-edged stock. Why is the value of that gilt-edged stock not its market value? The authors may say that that is because of company frictions. In other words, investors would rather be holding the gilt-edged stock themselves than entrust it to an insurance company investment manager to ruin value for them. Not a very good advertisement for your business. Why do people invest in unit trusts and investment trusts and everything else? Take an investment trust, they stand at discounts to their asset value. They always have done but nobody has ever suggested that you would not use the market values of the assets in the accounts; you would

then address elsewhere, as it were, the difference from the price at which the company as a whole trades.

It seemed to me, when reading the paper, there was some ambiguity about whether the authors believed in locked-in capital cost or not. As I say, I have never had a sensible explanation of it. I look forward to hearing one.