FASB / IASB Insurance Contracts Project Update Webinar

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International Accounting Standards Task Force
Presenters

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Agenda

- Insurance Contracts Refresher
- Update on Discussion and Decisions
  - Scope
  - Future cash flows and acquisition costs
  - Contract boundary
  - Margins and risk adjustment
  - Short duration contracts methodology
  - Reinsurance
  - Unbundling
  - Presentation
  - Transition
- Key FASB-IASB differences
- Recent Academy activity
- Outlook
Polling Question

How familiar are you with current IASB and FASB proposals regarding insurance accounting?

a) What does IASB stand for?

b) I have read the 2010 IASB Exposure Draft and FASB Discussion Paper

c) I regularly follow the project via Academy/CAS/SOA updates and presentations

d) I have Andrea Pryde/Jennifer Weiner on speed dial
Joint project by IASB and FASB

IASB *Exposure Draft* released July 2010, with corresponding FASB *Discussion Paper* released September 2010

- Some differences between FASB and IASB frameworks (discussed later)

Current fulfillment value

- Building Block approach to valuation
- Premium Allocation Approach for short duration contracts
Scope

- Proposed standard will cover insurance contracts
  - Defined as a contract transferring significant insurance risk
  - No change from current IFRS 4 definition

- IASB standard also covers investment contracts with discretionary participating features
  - FASB standard excludes these contracts
Insurance Contracts – Building Block Approach

- Expected future cash flows
  - Unbiased estimate of expected value of future cash flows that will arise as the insurer fulfills the contract

- Time value of money
  - Discount at current market rates

- Risk Adjustment and Margins
  - Explicit estimate of the effects of uncertainty about the amount and timing of future cash flows – IASB
  - Residual Margin (IASB) and Single Margin (FASB)
Future Cash Flows and Acquisition Costs

- All cash flows based on current estimates
- Model reflects expected value (mean)
  - Considers all relevant information
  - No need to identify and quantify all possible scenarios
- Acquisition costs are included in the cash flows for determination of margins
  - Acquisition costs should be incremental to the portfolio of contracts
    - Previous drafts defined acquisition costs at the policy level
  - IASB makes no distinction between successful and unsuccessful acquisition efforts
Residual Margin Re-measurement

- Residual margin should not be locked in at inception
  - Changes in estimates of expected cash flows result in adjustments to the residual margin
  - Residual margin should not be less than zero

- IASB has not prescribed a method for allocating the residual margin
  - Guidance indicates that residual margin should be allocated over the coverage period on a “systematic basis that is consistent with the pattern of transfer of services”
  - Previous guidance indicated with the “passage of time”
Contract Boundary

- Cash flows are defined by the boundary

- Contract:
  - Begins when coverage is effective
  - Ends when is no longer required to provide coverage, or
  - Has the right to reassess the risk of the policyholder

- Contract modification could create a new contract if, for example:
  - Modification changes the accounting model (e.g., insurance vs. investment contract, building blocks vs. premium allocation approach)
  - Modification changes the portfolio the contract is allocated to
IASB Risk Adjustment Objective

Revised objective:

- ‘The risk adjustment shall be the compensation the insurer requires for bearing the uncertainty inherent in the cash flows that arise as the insurer fulfills the insurance contract.’

Clarifies that the insurer should consider both favorable and unfavorable outcomes i.e., the risk is “two-sided”

- IASB does allow for consideration of the degree of risk aversion

IASB has decided to not limit the range of available techniques for estimating the risk adjustment

- Previously limited to three methods: confidence level, CTE, cost of capital
- IASB has defined necessary characteristics for risk adjustment method
Short Duration Contracts

- IASB ED – Premium allocation approach for short duration contracts
  - Covers contracts up to 12 months (i.e., most P&C and health contracts)
  - Includes unearned premiums for pre-claim period, building block approach without residual margin in post-claim period
  - If premium allocation approach elected, additional liability required for onerous contracts

- FASB requires premium allocation approach for short duration contracts
Key issue: status:

- Whether 12-month coverage period is a bright line or a principle
  - IASB current view is that premium allocation approach permitted only if it produces a “reasonable approximation” of building block approach

- Whether mandatory or voluntary
  - IASB - voluntary
  - FASB - mandatory

- Whether discounting be required for all cash flows
  - Discounting required when material
  - Not required for claims paid within 12 months
Reinsurance

- Ceded portion of contract measured using same process as direct contract
- Adjusted for non-performance risk of reinsurer
- For “normal” reinsurance for future events (PV reins premium > PV recoveries including risk adjustment), the cedant should recognize net cost as a part of the reinsurance recoverable and should recognize the net cost over the coverage period
- Where PV reins premium < PV recoveries, the cedant should recognize the net gain as a residual margin over coverage period
Unbundling

Exposure draft proposes unbundling for:

- Products with defined account values
- Embedded derivatives which are not closely related to host contract and which are not insurance themselves

Revised Guidance

- Unbundling required:
  - If an investment component and an insurance component are not highly interrelated
  - If an embedded derivative not clearly and closely related to a host insurance contract
Revised proposal

- Insurers required to present premiums, claims, benefits and the gross underwriting margin in income statement
- BUT their definition of premium different from definitions commonly used today

Other comprehensive income (OCI)

- Changes in liability due to changes in discount rate will be reflected in OCI
- Potential FVOCI asset category within IFRS 9
Under building block approach earned premium should be consistent with Revenue Recognition standard

Revenue stream will look like YRT premiums

Cannot be derived from collected premium and doesn’t affect bottom line

When experience differs from assumed the EP is affected
Transition

- Measure the present value of fulfillment cash flows using current estimates
- Derecognize current DAC balances
- Determine the single or residual margin:
  - Through retrospective application of new principles to all prior periods where it is practical to do so
  - For earlier periods where the retrospective application is not practical, estimate the margin
- Determine the discount rate for a minimum of 3 years
  - Use difference from a reference rate for prior periods if necessary
Key FASB-IASB Differences

- One margin or two margins
- Margin unlocking
- Acquisition costs
- PAA optional or mandatory
Recent Academy Activity

- Prepared and sent to the Boards comments on three specific areas where the staff had requested input (http://www.actuary.org/files/Comments_to_IASB_on_working_drafts.pdf)

- Members of the International Accounting Standards Task Force maintain informal contacts with the staff of both Boards

- Webinars for Academy members

- Preparation for commenting on exposure drafts
Looking Ahead

- New IFRS ED for Insurance Contracts mid-2013
  - This will be an Exposure Draft but they are only asking for comments on five areas:
    - Presentation of premium
    - Unlocking residual margin
    - Changes in discount rate go through OCI
    - Transition requirements
    - Participating contract mirroring

- FASB Exposure Draft for Insurance Contracts expected later in 2013

- Final standards adopted in 2014; effective in 2018
Questions and Answers
For More Information / Provide Feedback

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