American Academy of Actuaries Webinar:

Where in the World Are We Going with Insurance Contracts?

January 2, 2014

Presenters

- Tara Hansen, MAAA, FSA
- William Hines, MAAA, FSA
- Bob Miccolis, MAAA, FCAS
- Jim Milholland, MAAA, FSA
- Marc Oberholtzer, MAAA, FCAS
- Henry Siegel, MAAA, FSA
- Roger Smith, MAAA, FSA, CERA
- **Moderator**: Tom Herget, MAAA, FSA, CERA

Purpose of Webinar

- To inform the Academy's membership of how key stakeholders around the world responded to the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) exposure drafts on insurance contracts (EDs)
- To inform the membership of the Academy's comments on key issues
- To express individuals' opinions on where the IASB and the FASB could be headed with this project
- This webinar assumes a basic understanding of the ED, so presenters will not go into detail about the building block approach (BBA) or discount rates

Agenda

- Introduction (5 minutes)
- Key Academy positions (4 minutes)
- Reaction from domestic and global stakeholders (30 minutes)
- A look at the direction of global convergence (36 minutes)
- Questions and answers (15 minutes)

Speaker #1

- William Hines, MAAA, FSA
- Consulting Actuary, Milliman Inc.
- Qualifications for presenting today:
  - Former chair of Financial Reporting Committee (FRC) and now VP of RMFR Council
  - Co-chair, IAA Insurance Accounting Committee
  - Frequently in contact with London
  - Frequently in contact with Norwalk
  - Contributor to SOA earnings emergence study
  - Advisor to major trade organization on impacts

Key Academy Comments (1 of 2)

- General support for objectives of the project
- Convergence between FASB and IASB is important
- Discount rates with top-down method
- Presentation
  - Reinsurance premiums
  - Deposit elements
- Other comprehensive income (OCI) should be optional

Key Academy Comments (2 of 2)

- Income effect of changes in estimates should be deferred
  - Interest rate changes through OCI
  - All other changes adjust the margin
- Method for allocating effect of changes in estimates
- Method for adjusting interest accretion rate for products with asset-dependent cash flows

Speaker #2

- Tom Herget, MAAA, FSA, CERA
- Retired; active in volunteer work
- Qualifications for presenting today:
  - Project Oversight Group chair of SOA's earnings emergence studies of 2007, 2010, and 2013
  - Chief Editor of *US GAAP for Life Insurers*, 2000, 2005, and most likely 2015
  - Former Academy and SOA director, current VP at SOA

IASB Comment Letter Review

- About 180 letters submitted
- http://www.ifrs.org/Current-Projects/IASB-Projects/Insurance-Contracts/Exposure-Draft-June-2013/Pages/Comment-letters.aspx
- Comments selected mostly from cover letters
- Grouped by:
  - Actuaries
  - Accountants
  - Companies
  - Regulators
  - Industry Groups
  - Investors & Analysts

Actuaries - IAA

- International Association of Actuaries
- Represents 95 percent of the actuarial associations in the world (64 full members)
- Highlights:
  - Contractual Service Margin (CSM) should be discounted on the same basis as fulfillment cash flows
  - Par products method too prescriptive
  - Make OCI optional, an irrevocable option at the portfolio level
  - Allow more approximations at transition

Actuaries – I&FA

- Institute and Faculty of Actuaries based in UK
- Represents 25,000 members
- Highlights:
  - OCI should be optional not mandatory
  - Complexity of mirroring
    - moves away from the BBA
    - separate measurement of cash flows inconsistent with how products were designed and priced
    - the combination of the CSM, OCI, and mirroring proposals lead to increased likelihood of accounting mismatches, overly complex calculations, and challenges for users to understand financial statements.
  - CSM unlocking method has inconsistencies
  - Presentation - increased complexity and a disproportionate increase in associated work for preparers with uncertain benefit to users

Actuaries - IAJ

- Institute of Actuaries of Japan
- Represents 2,500 actuaries
- Highlights:
  - Proposed draft standards in the revised ED as a whole seem to be too complex and difficult to understand; improving the draft standards to be as sound principle-based as possible would be the most appropriate way to finalize the standard
  - Specifics
    - Interest rates in ultra years
    - Mirroring - decomposition of cash flows is difficult
    - Presentation- the artificial elements are expensive to manufacture

Actuaries - DAV

- Deutsch Aktuar Vereinigung
- Represents actuaries from Germany
- Highlights:
  - Participating contracts needs overhaul (agrees with HUB and CFO Forum comments)
  - CSM on reinsurance ceded needs attention

Actuaries – Actuarial Society of Hong Kong

- Represents 950 members
- Hong Kong is home for several regional or global home offices for multinational insurers
- Highlights:
  - Mirroring is too complex and results in volatility
  - Eliminate asset-dependent discount rates – nearly all cash flows have some element of asset dependency
  - OCI should be optional
  - Refine contract boundary definition
  - Reconsider presentation model due to costs

Actuaries - AIRC

- Actuarial Institute of Chinese Taipei
- Represents actuaries in Taiwan
- In Taiwan, supply of bonds does not meet the needs of the life insurance industry, either in duration or in quantity; Life industry has over 25 percent of total assets for the financial industry; Government issues 2/3 of bonds: 79 percent shorter than six years, 17 percent between six and 10 years, and 4 percent longer than 10 years; Taiwan has been experiencing extreme negative spread situation
- Highlights:
  - Asks for relief on calculating opening balance CSM on older business which is underwater – too much strain given low interest environment
  - Cost and burden to implement is very high; this presentation not needed in Asia

Actuaries – Towers Watson

- Major international consulting firm
- Highlights:
  - OCI optional
  - Mirroring a challenge; remove it and replace with building block
  - Adjust CSM for changes in the risk adjustment (RA)
  - For transition, include principles for practical expedients rather than prescriptions for approximations

Actuaries and Accountants – Australia

- Combined comments from Institute of Chartered Accountants of Australia and the Institute of Actuaries of Australia
- Highlights:
  - OCI should be optional, not mandatory
  - Eliminate mirroring

Accountants – PricewaterhouseCoopers

- Highlights:
  - Converge with FASB but not at expense of timetable
  - Redo the model for discretionary participating contracts
  - Value options and guarantees at risk neutral or real world?
  - Need irrevocable option, at portfolio level, to use OCI for discount rate change recognition
  - Need consistency in CSM amortization
  - Difficult to explain multiple drivers and operational complexities in dis-aggregating for presentation
  - More time to test is needed

Accountants – KPMG

- Highlights:
  - Participating (mirroring) concepts difficult to implement
  - CSM - should also be adjusted for changes in the risk adjustment related to future coverage
  - OCI should be optional rather than mandatory
  - Unit-linked contracts – allow more exemptions to single-line approach
  - Re-think the presentation; it would be expensive; would it be useful?
  - Align implementation dates of insurance contracts and financial instruments
  - Converge
  - Get more user input before developing final standard

Accountants – Ernst & Young

- Highlights:
  - Additional changes are necessary
  - Volatility caused by accounting mismatch still exists; OCI should be optional
  - The mirroring approach has significant issues
  - CSM unlocking needs clarification
  - Presentation models – two different ones
    - Summarized margin for BBA
    - Earned premium for Premium Allocation Approach (PAA)
  - CSM opening balance estimation too prescriptive
  - Coordinate effective date with IFRS 9 and need three years
  - More field testing

Accountants – Deloitte

- Highlights:
  - Redeliberate differences with FASB, but not at expense of IFRS 4 timeline
  - Improve the CSM unlocking
  - Crack the mirroring approach for par contracts; too complex
  - Presentation – measure of insurance revenue
    - Not relevant to long-term coverage
    - Doesn’t seem to be sought after by investors
    - Not used by management
  - Make OCI optional not mandatory

Companies – Manulife, MetLife, New York Life, and Prudential

- Field Testing actual periods 12/31/2007 thru 12/31/2012
- Nine product lines along with actual assets measured, scaled, and combined
- Aided by third party
- Highlights:
  - Discount rate – primary cause of volatility
    - Market-consistent rate on long-dated cash flows difficult to measure
    - All discount rate change impacts through OCI
    - CSM not updated for change in discount rates
    - Use of historical averages for defaults in creating top-down rate
  - Complexity – will impair ability to produce statement and disclosure amounts that are certifiable, explainable, and timely
    - Revenue – difficult to produce
    - Cash flow bifurcation (par products) – difficult to do
    - CSM unlocking – should be unlocked for all changes to future cash flows except discounting
    - Separate accounts
  - Convergence – six opportunities for FASB and IASB to make changes

Companies – Sun Life

- Large Canadian based insurer with international operations
- Highlights:
  - As it stands, the ED would be inferior to what already exists in Canada
  - ED still doesn't reflect life business model and will result in significant accounting mismatches and consequent inappropriate volatility
  - Lack of alignment between IFRS 4 and IFRS 9 will cause more confusion
  - Another ED and field testing is sorely needed
  - Implementation costs and efforts will outweigh any benefits
  - There doesn't seem to be global support of this

Companies – China Life

- Largest listed life company in the world
- Highlights:
  - Presentation – complexity will escalate the cost of preparation
  - Presentation format not used by management
  - Contracts linked to underlying items – revert to BBA
  - Align effective date with IFRS 9
  - Disclosure of RA confidence level onerous
  - Link the calculation of RA and CSM to the fulfillment cash flows

Companies – Prudential (UK)

- Large British-based international life insurer
- Highlights:
  - Mirroring proposals too convoluted
  - OCI – permit rather than require
  - Align effective date with IFRS 9
  - Need 18 months of field testing before issuing final standard

Regulators – IAIS

- International Association of Insurance Supervisors
- Basel-based association representing virtually all of the world's insurance regulators
- Concurrently working on global principles for liability valuation and desired capital levels; hoping to be able to employ what IASB develops to avoid duplications
- Highlights:
  - Strive to converge with FASB not only on insurance contracts but financial instruments as well
  - The provisions of this ED are complex and will increase the incidence of operational risks
  - Has the objective of improving financial reporting information been achieved?
  - Has concerns with the presentation (income statement)
  - Benefits may be outweighed by costs

Regulators – OSFI

- Office of the Superintendent of Financial Institutions Canada
- Highlights:
  - If this ED adopted, OSFI will likely abandon its single system producing both regulatory and general purpose financial statements
  - The top-down method offers too many ambiguities; the long-term liabilities beyond the observable period where deep and liquid markets exist should grade to a slow-moving long-term rate
  - The standard could be simpler
  - OCI should be optional, not mandatory, in order to properly present for assets other than fixed-income

Regulators – EIOPA

- European Insurance and Occupational Pensions Authority
- Part of European financial supervisory system
- Highlights:
  - Mirroring is complex and inconsistent with fulfillment standard
  - Integrate IFRS 9
  - Needs to better address the calculation of discount rate curves
  - Needs to address benefits of diversification in RA calculation
  - Disagrees with provision to provide comparable confidence intervals on RA if not inherent in its calculation
    - False precision
    - Implies CI is superior method

Industry Groups – LIAJ

- Life Insurance Association of Japan
- Highlights:
  - Understandability of users and preparers of financial statements would be impaired because the requirements in the standard are very complicated
  - The statement of financial position would not faithfully represent the economic reality of insurers providing life insurance products, in particular, with long term coverage

Industry Groups – PCI

- Property Casualty Insurers of America
- Represents 1,000 US-based general insurers with 40 percent market share
- Highlights:
  - Consider current US GAAP as the basis for a single converged model
  - Need to better define portfolio
  - No need to discount claim reserves; investors currently understand this
  - Does not support the ED

Industry Groups – ACLI

- American Council of Life Insurers
- 300 member companies with over 90 percent of U.S. market share
- Highlights:
  - The proposed ED fails to meet the stated objective "to improve the transparency of the effects of insurance contracts on an entity's financial position and financial performance…"
  - Mirroring is overly complex and difficult to understand
  - Splitting the non-mirrored cash flows into at least three and possibly four separate cash flow streams is overly complex, costly, and unworkable
  - The proposed changes to the presentation of financial information in the statement of comprehensive income present neither relevant information nor a faithful representation of the nature of insurance
  - The proposed definition of investment component causes amounts to be excluded from revenue in a way that could produce misleading information that is inconsistent with the nature of certain insurance contracts
  - Need more flexibility and four years for transition
  - Converge

Industry Groups – Insurance Europe / CFO Forum

- CFO Forum represents the views of 21 of Europe's largest insurance companies
- Insurance Europe represents 95 percent of the premium income of the European insurance market
- Highlights:
  - Accounting should reflect the long-term nature of insurance business and address the linkage between assets and liabilities in reporting performance
  - Does not think that the ED achieves these objectives
  - Hence, the ED as currently drafted, and its interaction with the proposed IFRS 9 standard, is not appropriate as it will not provide a suitable basis to explain their business performance to their investor community

Industry Groups – Insurance Europe / CFO FORUM (cont.)

- Particular lowlights:
  - No consistency between measurement of assets and liabilities
  - Participating and unit-linked contracts
  - Unlocking of the CSM
  - Treatment of options and guarantees
  - Presentation and disclosure
  - Reinsurance contractual service margin
  - Some proposals are overly complex

Industry Groups – HUB

- HUB Global Insurance Group
- Allianz, ACLI, Assicurazioni Generali, AXA, CLHIA , Manulife, Meiji Yasuda, MetLife, New York Life, Nippon Live, SCOR, Sumitomo, Dai-ichi
- Major concerns:
  - Par contracts – bifurcation, discount rates, partial CSM unlocking
  - Discount rate determination for durations where there is no reliable observable market data
  - OCI – should be optional not mandatory
  - Transition – wants more flexibility
  - Presentation – masks information, revenue is artificial, actual premium is more relevant and less costly

Analysts – Standard & Poor's

- Highlights:
  - Wants IASB / FASB convergence
  - Believes the comprehensive and far-reaching changes are warranted
  - Needs clear and comprehensive implementation guidance
  - Welcomes "top-down" approach to supplement "bottom-up"

Analysts - Sandler O’Neill

- Full service investment banking firm and broker-dealer focusing on financial services sector
- Proposal will:
  - Increase volatility of insurers’ equity and earnings dramatically
  - Degrade the granularity, transparency, and relevance of insurers’ financial statements
  - Increase the cost and reduce the availability of capital to insurers
  - Distort business decisions by insurers, reducing the availability of long-term financing to a variety of entities
- Sandler O’Neill is concerned about the stewardship of the Board and the consequent need for stronger governance by its Foundation

Analysts - Alan Zimmermann

- Life and P/C security analyst for 40 years
- Member, IASB insurance contracts working group since 2004
- Highlights:
  - In total, a step up – sources of profits and risks will be more transparent
  - Good reflection of how profits are made
    - Differences in actual cash flows from expectations
    - Changes of expected future cash flows
    - Release of margins
  - Likes discounting P&C reserves
  - Insurers will need to do a good job explaining the new financial concepts to analysts

IASB Predominant Themes

- OCI should be optional
- The approach for mirroring and asset-dependent cash flows is either flawed or too complicated to work in practice
- Concern over discounting for very long duration cash flows and resulting volatility
- General statements that the ED does not reflect the business model and will create volatility
- Disclosure of confidence interval percentage is not useful

FASB Comment Letter Review

- Again, from cover letters
- About 150 letters submitted
- Focus on US-based commenters
- Website: http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=2013-290
- Grouped by
  - Life companies
  - P&C companies
  - Reinsurers
  - Regulators
  - Accounting firms
  - Analysts

Life Companies - MetLife

- Redeliberate and converge
- Key comments:
  - Faithful Representation/Accounting Symmetry – More flexibility needs to be provided to explicitly allow the incorporation of assumptions based on long-term averages when determining the discount rate for longer-dated cash flows for which limited or no observable information is available.
  - Relevance – The margin established at inception should be adjusted to reflect changes in fulfillment cash flows over the life of the portfolio, rather than having changes reflected currently in earnings.
  - Reduced Complexity/Simplicity – The proposed model for recognizing premium revenue and related expenses is very complex and is not a good indicator of financial performance.
  - Reliability/Comparability – The benefit of full hindsight should be available in determining the margin at transition, given the significant time and effort anticipated for full retrospective adoption without a commensurate benefit for preparers or users.
- Unless the key issues highlighted above are addressed in the final standard, the financial statements of life insurers would not provide users with an understandable picture of the financial performance of the entity from period to period.

Life Companies - Manulife

- The discount rate is the number one issue – use of a market consistent discount rate will produce unwarranted volatility and severe unintended consequences
- The proposals are too complex
- Convergence is needed between the FASB and IASB
- To rectify:
  - Allow the use of a discount rate graded to a long-term average rate beginning at the point at which observable inputs are less relevant and supplement with additional disclosures. In addition, the top-down approach needs to better incorporate the use of alternative long duration assets.
  - Allow an option to reflect the effect of changes in discount rates in profit or loss.
  - Reduce complexity through reviewing alternative approaches being proposed to the Board by various industry groups.
  - Work with the IASB to develop a unified global standard for insurance contracts. Allow sufficient time to perform real world testing on the proposed solutions prior to finalizing the standard.

Life Companies – Lincoln Financial

- The objective of any change to US GAAP should result in an improvement
- This can be achieved by targeted changes without creating an entirely new model
- As proposed, the measurement model does not an improvement, or yield financial statements more reliable or understandable.
- Would impede the ability to compete for capital
- Does not fairly represent the economics of the underlying business; decisions would be made on this accounting outcome
- Costs
- Specifically, areas of this ED that do need work:
  - Discount rate, CSM, portfolio definition, business combination, presentation, and disclosure

Life Companies – Prudential US

- The FASB's three objectives of
  - Producing financial statements that are relevant to users and enhance comparability among issuers
  - Reflecting financial results that correspond to the economics of the business and how the business is actively managed
  - Being cost effective to operationalize, especially when weighed against the benefits to be derived by the user communities.
- …falls short. The FASB must provide an accounting model that
  - Reflects the economics of the business
  - Offers comparability of financial results across the industry
  - Minimizes the complexity in both implementation and ongoing administration
  - Provides relevance and appropriateness of presentation and disclosures
- The letter then outlines a number of solutions

Life Companies - Protective

- If convergence is not achieved, the FASB should seek targeted changes to current US GAAP
- If we can converge, these items need to be addressed:
  - The application of BBA or PPA should be optional
  - "Portfolio" needs to be redefined. The phrases "priced similarly to the risk assumed" and "similar duration and similar expected patterns of release from risk" could result in portfolios at undue level of granularity.
  - The IASB has better definition of costs to be included in fulfillment cash flows
  - Cash flow assumptions should be evaluated "regularly" and not "every reporting period"
  - Discount rates should be derived from actual assets backing the liabilities
  - Unlock the margin

Life Companies - Genworth

- The ED will not achieve goals of developing high-quality guidance through improving, simplifying, and achieving convergence of the financial reporting requirements for insurance contracts, and to provide investors with decision-useful information.
- This conclusion is grounded on the additional complexities, artificial volatility, reduced clarity and comparability, and the clouding of decision-useful information the Proposal would introduce.
- The elimination of long-standing valuation and performance metrics increases our concern that investors and analysts would fail to find incremental benefit that would exceed the impact to our earnings and investment value from the significant implementation and ongoing operational costs.
- Additionally, the proposal would result in financial statements that would not reflect how we manage our businesses or evaluate performance, both of which are instrumental in providing users decision-useful information.

Life Companies – NY Life

- In addition to observations in field test report
- Liability cash flows should include policyholder dividends that represent what is expected to be paid. Mutual insurance companies can have surplus; not all surplus will be paid in dividends. Similar to other entities, mutual insurers need to retain a level of surplus for future expenditures, unforeseen risks and to meet minimum and rating agency capital requirements.
- The FASB should establish an implementation working group whose function will be to receive questions from prepares and auditors and to prepare response for the Board to confirm.

Life Companies – Pacific Life

- Lack of convergence
- Portfolio definition
- Discount rates – use expected return on the actual assets backing the liabilities
- Unlock the margin
- More transition flexibility
- Costs to implement are excessive
- Effective date no earlier than year-end 2019
- Align any changes in financial instruments accounting with insurance contracts
- Reissue a new ED

Life Companies - Principal

- “The proposed guidance would result in the following negative impacts for the users of insurers' financial statements and the insurance industry:
  - Complexity - The proposed guidance has become so complex that the resulting financial statements will not be understandable or meaningful to users. Furthermore, we do not believe that it will improve the availability of decision-useful information to the users of our financial statements.
  - Cost vs. Benefit - We anticipate that the proposed guidance will result in substantial additional costs for the preparers, users, and auditors of financial statements. We do not believe that the proposed changes in accounting guidance provide sufficient benefits to justify the significant costs of initial implementation and ongoing compliance.
  - Cost of Capital - The added complexity of the proposed accounting guidance and resulting volatility in our presentation of earnings and equity will make it more difficult for analysts and investors to understand the financial results of insurance companies. We believe this will lead to a reduction in the pool of potential investors, decreased valuations for insurance companies and an increased cost of capital for insurers.
  - Based on these concerns, we are unable to support the proposed guidance in its current form.”

Life Companies - AFLAC

- Recommend targeted changes to improve current U.S. GAAP versus adopting a new standard
- Issues (selected) with ED:
  - Relevant information not produced
  - Unlocked present value (PV) cash flows but locked margin
  - Definition of portfolio
  - Include all relevant cash flows in the liability calculation
  - Update assumptions when there is an identifiable trend, not each reporting period
  - Discount rate should be that of the assets backing the portfolio
  - Revenue recognition model unsuitable for insurance
  - Presentation requirements
  - Disclosures are excessive and overly detailed at the cost of clarity and decision usefulness.

Life Trade Association – ACLI

- For the most part, reflects all the sentiments expressed above
- This is not an improvement
- Costs don't justify benefits
- Likely increase in cost of capital
- If you can't converge, then target specific existing US GAAP
- The impact that the proposed insurance contract accounting could have on long-duration insurance products, such as life insurance, long-term care insurance and income for life guarantees, which decrease financial burdens on the public sector, could be significant.

Reinsurers – Swiss Re

- Agrees with objectives of revising current insurance accounting and the ED principles, but there are areas of the guidance that need attention:
  - Leads to misleading reporting of performance
  - Principles are overly complex
  - The cost of complying does not justify the benefits in terms of higher decision usefulness
  - Premiums earned does not provide period-specific, actual information on sales activity
  - Should not exclude estimated returnable amounts from insurance contract revenue
  - Unlock the margin
  - Converge

Reinsurers – Gen Re

- The current P&C model does not need change
- Not much attention has been paid to reinsurance assumed. The reinsurer will not have access to the data that the direct writer does.
- Definition of portfolio not easily applied to reinsurance contracts
- And many other comments ….
- FASB's goal to improve the usefulness of financial statements has not been achieved by this ED

Reinsurer Trade Association - RAA

- The Reinsurance Association of America has many concerns
- The U.S. centric RAA members ultimately cannot support the proposed model because convergence is not achieved and because the added complexity, subjectivity and significant implementation costs associated with the proposal do not justify a change from existing U.S. GAAP for short duration, non-life insurance contracts.
- Our European-based members are willing to support the proposed model if certain critical elements are improved.
- A large proportion of RAA members do not believe that the FASB's proposed accounting and measurement model contained in the ED would result in more relevant, reliable, comparable and decision useful information for users of insurance and reinsurance financial statements.

P&C - CNA

- The proposed update would require significant changes that will increase complexity, reduce transparency, and provide less precise financial reporting results for P&C contracts due to layering of estimates and judgments, including timing of cash flows, discount rates, and portfolio composition.
- Coupled with the voluminous proposed required disclosures, the financial statements will be overwhelming and difficult to understand and interpret. In addition, traditional measures of P&C performance, such as the loss ratio and combined ratio, will not be apparent to financial statement readers.

P&C - Travelers

- The complexity in the proposed model would require P&C insurers to expend a significant amount of time and resources to create systems to collect information to comply with the standard but would not be used to manage our business or convey operating results to readers of our financial statements.
- Believes that during the process of developing the ED, the concept of pooling of insurable risks was overshadowed by the view that P&C products are analogous to bank products or life insurance products.
- Believes the proposed accounting model would

  make it more difficult for users, including non-specialists,

  to understand the risks and uncertainties associated with

  its products.

P&C - AIG

- Agrees with the FASB's objective to increase the decision usefulness of the information about an entity's insurance liabilities and the effect on the statement of comprehensive income and to provide comparability regardless of the type of entity issuing the contract, believes that the proposed accounting guidance fails to meet this objective with respect to the statement of comprehensive income.
- For several key aspects of the ED as discussed in this letter, there is either no financial reporting benefit or the cost of adopting the change substantially exceeds any perceived financial reporting benefit. To render the new guidance workable as a whole, it is essential to reduce complexity and costs for those areas in which the financial benefit is questionable.
- If this cannot be accomplished within the developed framework, current generally accepted accounting principles in the U.S. GAAP need not be overhauled completely but merely amended for a few targeted changes.

P&C - Chubb

- Believes that the proposed exposure draft would represent an improvement to generally accepted accounting principles currently in use in the U.S. GAAP.
- Believes that the model as proposed in the exposure draft would result in financial statements of P&C insurers that are less relevant, reliable, and transparent.

P&C – Liberty Mutual

- Continues to support current U.S. GAAP
- Accommodate greater transparency needs through additional disclosures, not a new accounting system

P&C - Allstate

- Supports the goal of a globally-converged accounting standard for insurance contracts, which has already been achieved in the form of the existing measurement and reporting model for P&C insurance contracts under U.S. GAAP, which continues to be the world's most effective, time-tested, investor preferred framework for P&C insurance accounting and reporting.
- Notes that only a few jurisdictions, whose collective premium is not globally significant, do not apply U.S. GAAP or a close variant in their accounting and reporting for P&C insurance contracts. Accordingly, given the desire for a globally converged standard, recommends the FASB advocate that its existing, time-tested, seasoned, and investor preferred framework be accepted as the global standard.

P&C – State Farm

- Believes that the proposed ED is not an improvement upon current model used in the US and could create significant unintended consequences.
- Key concerns:
  - Measurement model not appropriate for differing business models
  - Use of "unbiased probability weighted cash flows"
  - Discounting and discount rates
  - Definition of portfolio
  - Decision usefulness comparability
  - Complexity / cost

P&C – Trade Organizations

- PCIAA – "Overall, we do not believe the guidance related to reporting for short duration non-life insurance contracts would provide more decision useful information than current U.S. GAAP reporting. The current accounting and reporting framework for P&C insurance contracts is well functioning, consistent with the business model of P&C insurers, and preferred by investors."
- NAMIC – "A U.S. GAAP accounting reporting system has been in place for decades that FASB, auditors, investors, lenders, companies, and regulators alike have found decision-useful, consistently evolving, and comparable between entities. The proposed changes to the current U.S. GAAP system for insurance will create unnecessary challenges, significant costs and drastic loss of historical data, while yielding minimal benefit for the users of property/casualty financial statements."
- AIA – "Given the overall complexity of the proposed ED, the loss of useful information, and the significant and unjustified burden the change will require, AIA has no choice but to conclude that the proposed ED does not improve existing GAAP."

Regulators – NAIC (1 of 2)

- Why NAIC interested in US GAAP?
  - SAP built using U.S. GAAP framework
  - Prefer minimal differences
  - Support IAIS goal of being able to use IFRS for supervisory reporting purposes
  - While primary goal is protecting policyholder, have profound interest in
    - Ensuring insurers have access to capital
    - Providing new and innovative products
    - Increase competition in existing markets
    - Meet liquidity and capital needs in stress situation
    - Regulators use U.S. GAAP statements to evaluate groups

Regulators – NAIC (2 of 2)

- Goal: supporting a single, high-quality global standard for insurance contracts
- The IFRS and FASB EDs do not meet this objective; NAIC does not support the FASB ED
- FASB's proposal would jeopardize a comprehensive accounting system in place for decades
- Costly, especially for small and mid-sized companies
- Place greater emphasis on "high-quality" than need for a converged standard

Regulators – Other

- Federal Reserve
  - Supports new GAAP for insurance contracts, but eliminate scope exception for derivatives and hedges
  - Supports locked-in, single margin; encourages convergence
- World Bank
  - Exclude financial guarantees from scope
- IAIS
  - IAIS wants to see convergence; hopes to use a converged valuation basis for its solvency purposes

Accounting Firms

- All four – strive to converge
- All four – provide comprehensive list of other options
- One firm (PwC) – if convergence can't be achieved, target specific areas of U.S. GAAP

Analysts - Franklin

- Franklin Mutual Advisers LLC - investment advisor to mutual funds
- Reactions:
  - Troubled by current ED
  - Reduces transparency
  - Is a step backwards from current accounting standards
  - Doesn’t reflect how companies manage their business
  - Increases volatility for the industry

Analysts - SIFMA

- Securities Industry and Financial Markets Association
- Don’t scope in items previously not considered insurance, which includes:
  - Representations
  - Warranties
  - Indemnifications
  - Cat bonds

Analysts - KBW

- Keefe, Bruyette & Woods, investment bank and broker-dealer in North America and Europe
- Please reject the guidance, especially for short-duration P&C contracts. Four most significant objections:
  - Introducing time value of money into claim reserves
  - Unbiased probability reserve-setting removes ability to use judgment
  - Comparison between peers will be more difficult than today
  - Burdensome expense without adequate return

Analysts - Heimerman

- Sole practitioner with significant sell-side equity research experience at Goldman Sachs and JP Morgan
- Current proposal could have the unintended consequence of hurting investor users by making the industry more difficult to understand
- Investor users will likely become more dependent upon managements to understand results
- Three reservations:
  - Period-to-period financial performance is likely to be increasingly volatile
  - Underlying valuation of claims liabilities could become automated (e.g., reserve setting is using the statistical mode) rather than incorporating actuarial experience and judgment
  - Difficult to calculate many historical performance measures such as combined ratio, return on premium, earnings, and return on equity due to changes in the measurement, definition, composition and to the presentation of the financial statements

Analysts - Dowling

- Sole practitioner analyst, primarily P&C with experience at Conning and Fox-Pitt, Kelton
- Analysts want to understand the portion of an insurer's operations that is within management's control and repeatable (i.e., what is useful for estimating future performance)
- Accounting that assists in understanding the way management thinks about the business and helps understand the underlying insurance contracts is most useful. While it may seem obvious, amounts paid by customers to insurers for coverage should be premiums.
- The identification of specific scenarios and probabilities in estimating future cash flows implies far more precision than the real world allows.
- The current FASB ED does not improve financial reporting and is likely to obscure rather than clarify the nature of the underlying contracts.

Analysts – Barclays

- “Comments from a sell-side equity analyst with coverage responsibilities for the US P&C and Life insurance industries.”
- “None of the investors with whom we discussed the proposed changes to GAAP accounting with are in favor of them
  - This does not reflect how companies manage their business
  - These proposed changes are a solution in search of a problem
  - Management’s best estimates for reserving no longer apply
  - Substantial volatility would be introduced to life insurers’ earnings and capital positions—not good for SIFIs (AIG, PRU, MET) because the Fed will focus on GAAP financials.”

FASB Predominant Themes

- For Life companies
  - The new proposal is more complex and difficult to understand
  - Some companies don’t think the cost is justified without convergence
  - Clarification needed for determining discount rates
  - CSM should be unlocked
  - Fix portfolio definition
- For P&C companies
  - Don’t want any change
  - Don’t want discounting of liabilities

Where Are We Headed?

- Presented by actuaries with national and international financial reporting practices
- Speakers are presenting their own viewpoints

Speaker #1 William Hines' Viewpoints

- Future of Insurance Project
  - IASB
  - FASB
- Impact on earnings emergence
- Presentation requires as much work as measurement
- Is there a need for supplemental information?

Speaker #3

- Marc Oberholtzer, MAAA, FCAS
- Principal, PricewaterhouseCoopers
- Qualifications for presenting today:
  - Member, CAS Accounting Changes Committee
  - CAS Representative, International Actuarial Association Insurance Accounting Committee
  - Previously a member of the Academy's Financial Reporting Committee and chair of Committee on Property/Liability Financial Reporting

Marc Oberholtzer's Viewpoints

- IFRS 4 is coming
- U.S. GAAP – targeted changes versus a new comprehensive standard
- Complexity and understandability
- Cost versus benefit

Speaker #4

- Bob Miccolis, MAAA, FCAS, FCA
- Director, Deloitte Consulting LLP
- Qualifications for presenting today:
  - Member, Financial Reporting Committee
  - Member Academy Board, Casualty Practice Council, RMFRC
  - CAS President-Elect, CAS Board & Executive Council
  - Primary author/editor, IAA monograph on Risk Adjustments
  - IAA Education & Practice Subcommittee for IFRS
  - Co-author of actuarial paper on risk adjustments under IFRS

Bob Miccolis' Viewpoints

- Impact areas for P&C: unbiased reserve estimates, discounting, risk adjustments, reinsurance
- New actuarial reporting components with limited common practice or established standards
- Differences in actuarial values between STAT, U.S. GAAP (FASB) and IFRS; potentially lots of judgments
- Need to educate actuaries, develop methods, guidance and practices based on IFRS principles, reconcile differences in values, explain values to management

Speaker #5

- Roger Smith, MAAA, FSA, CERA
- President, PolySystems, Inc.
- Qualifications for presenting today:
  - Contributor to SOA earnings emergence study
  - More than 30 years of experience with reporting systems
  - Global perspective

Roger Smith's Viewpoints

- Measuring and amortizing margins
- Organizing assumptions
- Attribution analysis
- Alternate assumptions for disclosure
- Measuring revenue – getting closer to administrative functions
- End-to-end documentation

Speaker #6

- Jim Milholland, MAAA, FSA, former CPA (GA)
- Semi-retired; former partner at Ernst & Young
- Qualifications for presenting today:
  - Involved with IFRS since 2001
  - Global experience with conversions to IFRS 4
  - SOA's representative to IAA Insurance Accounting Committee
  - Frequent contributor to SOA's *The Financial Reporter*
  - Advisor to IASB and staff on Earned Premium Approach

Jim Milholland's Viewpoints

- Explaining earnings
- Underwriting profit equals
  - Excess of premiums over claims and amounts set aside for future claims
  - Excess of margins over experience differences
  - Excess of release of amounts in liabilities providing for claims, expenses and margins over actual claims and expenses
- How to explain why P&L and increase in equity differ

Speaker #7

- Tara Hansen, MAAA, FSA
- Principal, Ernst & Young
- Qualifications for presenting today:
  - Vice-chair, SOA Financial Reporting Section Council
  - Project Manager, SOA earnings emergence study in 2013
  - POG member of SOA's earnings emergence study in 2010
  - Contributor to SOA's earnings emergence studies of 2007, 2010 and 2013
  - Advisor to numerous companies field testing the proposed standards

Tara Hansen’s Viewpoints

- Convergence is key
- Political landscape is uncertain
- Broad commitment to high quality standards
- Long journey, worthwhile outcome

Speaker #8

- Henry Siegel, MAAA, FSA
- Former VP at New York Life (now in first day of semi-retirement)
- Qualifications for presenting today:
  - Former VP of Academy's RMFR Council
  - Member of IASB's Insurance Working Group
  - Academy representative to IAA's Insurance Accounting Committee
  - Frequent contributor to SOA's *The Financial Reporter*
  - Significant contributor to 8 international organizations' comment letters
  - POG member for SOA earnings emergence study

Henry Siegel's Viewpoints

- Lots of political pressure on IASB
- Actuaries need to find ways to simplify transition
- Is there a way we can produce a "standard" result for transition?
- How will (should) analysts use this information?

Final Speakers - You

- Questions and answers
- Thank you for participating