

FASB / IASB Insurance Contracts Project Update

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International Accounting Standards Task Force



Presenters

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Today's topics

- Recent IASB / FASB activity
- Recent AAA activity
- Update on discussion and decisions
 - Margins and risk adjustment
 - Discount rates
 - Short duration contracts methodology
 - Acquisition costs
 - Reinsurance
 - Unbundling
 - Presentation
 - Transition
- Outlook



IASB / FASB Proposals and Status

■ IASB

■ Timing

- Exposure Draft released July 2010
- Comments received by November 2010
- Re-deliberations with FASB, final standard now expected by later in 2011 (fourth quarter?)

■ Building block approach that includes two margins, a risk adjustment and a residual margin

■ Modified approach for short duration contracts



IASB / FASB Proposals and Status

■ FASB

■ Timing

- Discussion Paper released September 2010
- Comments received by November 2010
- Re-deliberations with IASB, exposure draft possible in 2011; date of final standard unknown

■ Building block approach that includes a single composite margin

■ No position yet as to whether there is a separate approach for short duration contracts



Recent Academy Activity

- Education: Building block 1 methods
 - Documents shared with boards
- Education: Discount rate
 - Presentation at joint FASB / IASB meeting
- Research: Financial statement effects
 - Extended SOA study



Risk Adjustment Objective

- Revised objective:
 - “The risk adjustment shall be the compensation the insurer requires to bear the risk that the ultimate cash flows could exceed those expected.”
- Removes wording ‘the amount the insurer would rationally pay to be relieved of the risk’ and to a ‘maximum amount’
- Agreed to clarify that this amount would reflect both favorable and unfavorable changes in the amount and timing of fulfilment cash flows.
- IASB is moving toward less prescription
 - ED limited to three bases
 - (a) confidence level
 - (b) conditional tail expectation
 - (c) cost of capital
- Boards have not concluded whether a risk adjustment can be done in a meaningful (comparable, verifiable) way
 - FASB is leaning towards not having a separate risk adjustment



Margin Remeasurement

- Boards are moving towards allowing residual/composite margin to absorb effects of changes to non-financial assumptions
- Have not concluded how to run off the residual/composite margin over time



Discount rates

- Discount at current market-based rates
 - (amortized cost methods rejected)

- Principle: reflect characteristics of the contract.
 - Same principle applies to both participating and non-participating contracts

- Top-down and Bottom-up methods are both approved, no detailed guidance will be provided.



Discount Rates

Expected portfolio rate

Discount rate

Risk-free rate



Spread for investment risks retained by the company.

Spread for investment risks characteristic of the contract*, including loss of liquidity.

*Contract characteristics may include non-guaranteed elements such as interest crediting rates and dividends, or linkage to separate account funds.



Short Duration Contracts

- IASB ED - Modified 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
- FASB did not take a view in its Discussion Paper, will consider during re-deliberation phase



Short Duration Contracts

- Key outstanding issues to be discussed during re-deliberation
 - Whether 12-month a bright line or a principle
 - Whether mandatory or voluntary
 - Whether discounting be required for all cash flows
 - If an alternative model for short duration contracts is necessary, desirable, implementable under a composite margin approach



Acquisition Costs

- Exposure draft defined incremental acquisition costs at the policy level
- Boards tentatively changing definition to apply at portfolio level
- Significantly reduces size of residual margin for recurring premium products
- FASB would limit acquisition costs to those associated with successful sales



Reinsurance

- Exposure Draft proposes to measure ceded portion using same process as direct contract
- Adjusted for non-performance risk of reinsurer
- Consistency may be difficult to achieve in practice if measure reinsurance asset on its own



Unbundling

- Exposure draft proposes unbundling for:
 - Products with defined account values
 - Embedded derivatives not closely related to host contract and not insurance themselves
- Boards
 - Have confirmed decision to unbundle embedded derivatives
 - Have yet to re-deliberate on products with account values



Presentation

- Exposure draft proposed summarized margin approach
 - Not enough detail for users or management
 - No cash flow information would be reflected
- Alternatives being discussed
 - Expanded margin presentation
 - Traditional income statement with supplementary source of earnings analysis



Presentation (continued)

- Other Comprehensive Income
 - Boards exploring whether some changes in assets and liabilities could/should be reflected in OCI
 - Potentially changes in non-financial or non-observable inputs to valuation
 - Users don't seem to have a preference regarding geography as long as data is reported
 - Unlikely to change IFRS 9 presentation



Transition

- EVERYONE agrees the transition language was flawed
- Correction has not been formally discussed but leaning towards one of two options:
 - Recalculating the residual/composite margin from inception
 - Starting with existing reserve and subtracting first building block to determine remaining residual/composite margin
 - Other alternatives would be welcome



Looking Ahead Through 2011

- IASB and FASB continue intense re-deliberations – with a goal (albeit an optimistic one) of completing by June 30th
- Some follow up on issues expected after June 30th
- New IFRS for Insurance Contracts expected later in 2011
- FASB Exposure Draft for Insurance Contracts expected later in 2011; a new final standard would be expected in 2012



Wrap up

Questions and Answers

