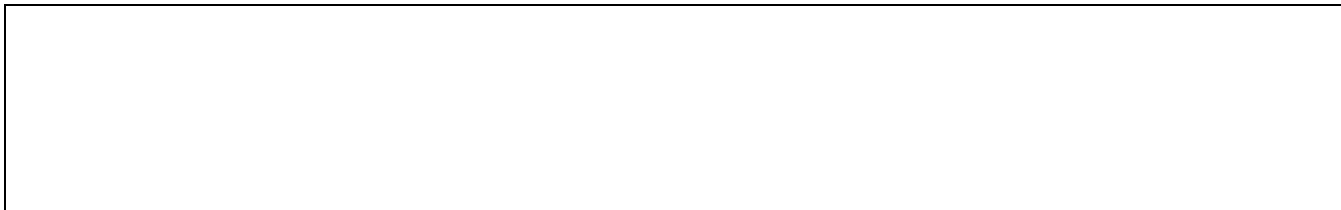


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Current Status of IFRS and US GAAP



Speakers

- Henry Siegel – Moderator
- Patrick Finnegan – IASB Board Member
- Jennifer Weiner – Partner, E&Y
- William Hines – Vice Chair, IAA Insurance Accounting Committee; AAA VP for Risk Management and Financial Reporting



Description of Session

- This session will be a presentation of the current status of the IASB and FASB Insurance Contracts projects and the main challenges facing actuaries to implement them.
- To the extent possible, the presentations will incorporate developments up to the date of presentation.
- Accordingly, it will not be possible to post the presentation much before the actual date. The final version will be available in the room and on line after the session.



IASB INSURANCE CONTRACTS UPDATE



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Agenda

- The story so far
- Respondents to the ED
- Summary of IASB feedback
- Redeliberations – March 2014 Board meeting:
 - Unlocking the contractual service margin (CSM)
 - Use of other comprehensive income (OCI)
- Next steps



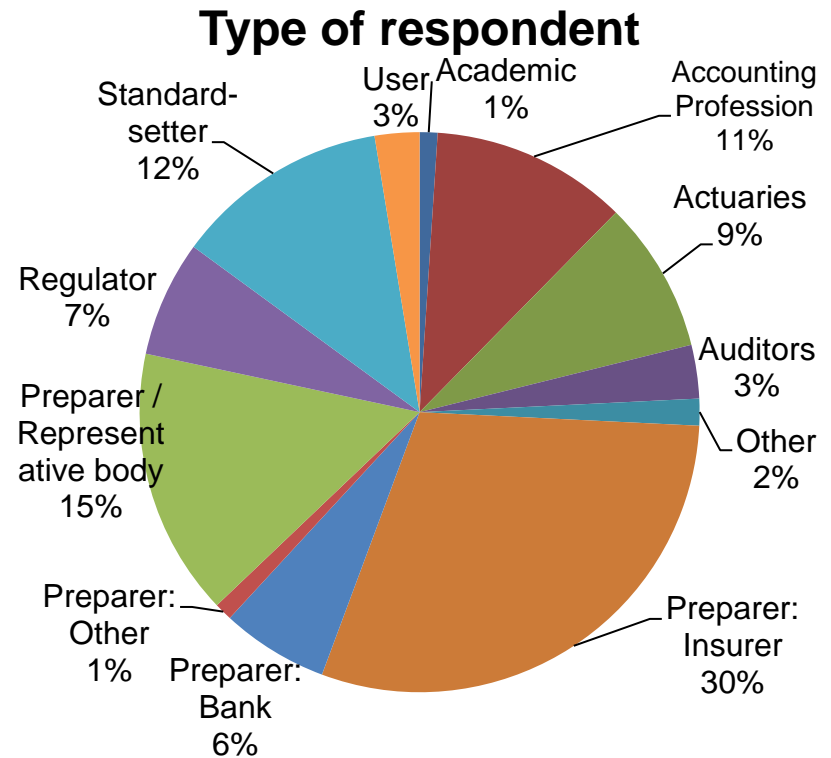
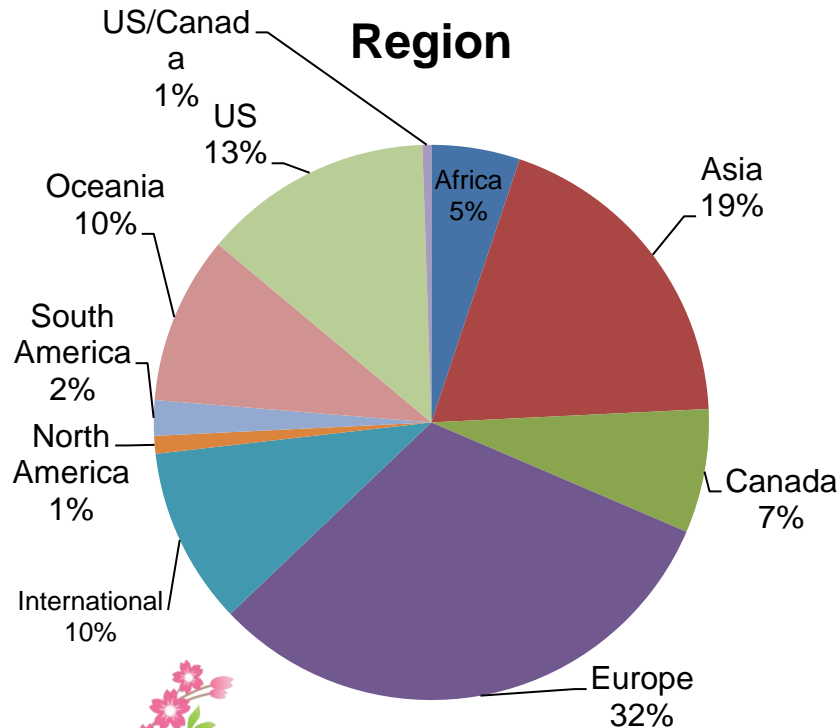
The story so far

- Exposure Draft published 25 June 2013
- Comment letter deadline 25 October 2013
- Comment letter summaries discussed by IASB and FASB in January 2014
- Redeliberations – March 2014 Board meeting:
 - Unlocking the contractual service margin (CSM)
 - Use of other comprehensive income (OCI)
(discussed later)



Respondents to the ED

- The IASB received 194 comment letters from:



- In addition, the IASB received input during 187 outreach meetings.



Summary of IASB feedback

- Broad support for finalising a Standard based on current measurement of the insurance contract:
 - The Standard is needed and the need is urgent
- Convergence not essential but a (very) nice-to-have:
 - It should not come at the expense of further delay to the new Standard
- Widespread agreement with direction of proposals relating to unlocking the CSM and transition
- Opposition to
 - Complexity from mirroring
 - Mismatches from mandatory OCI
 - Insurance contract revenue
- Limited discussion on other issues



March IASB and FASB joint meeting

Decisions apply only to non-participating contracts

The views expressed in this presentation are those of the presenter,
not necessarily those of the IASB or IFRS Foundation

Unlocking the CSM

10

- The IASB tentatively confirmed the proposals in the ED that after inception:
 - differences between the current and previous estimates of the present value of cash flows related to future coverage and other future services should be added to, or deducted from, the CSM, subject to the condition that the CSM should not be negative; and
 - differences between the current and previous estimates of the present value of cash flows that do not relate to future coverage and other future services should be recognised immediately in profit or loss.



Unlocking the CSM—treatment of previously recognised losses

- The IASB tentatively decided that favourable changes in estimates that arise after losses were previously recognised in profit or loss should be recognised in profit or loss to the extent that they reverse losses that relate to coverage and other services in the future.



Whether to unlock the CSM for changes in the risk adjustment

- The IASB tentatively decided that differences between the current and previous estimates of the risk adjustment that relate to future coverage and other services should be added to, or deducted from, the CSM, subject to the condition that the CSM should not be negative.
- Consequently, changes in the risk adjustment that relate to the coverage and other services provided in the current and past periods should be recognised immediately in profit or loss.



Option for presenting the effect of changes in discount rates

13

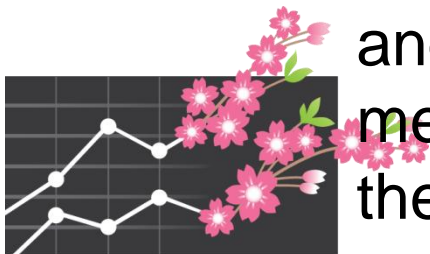
- The IASB tentatively decided that an entity should choose to present the effect of changes in discount rates in profit and loss or in OCI as its accounting policy and should apply that accounting policy to all contracts within a portfolio, subject to developing guidance that would provide rigour about when entities could change accounting policies based on the requirements for changing accounting policy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.



Use of OCI to present the effect of changes in discount rates

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- The IASB tentatively decided that if the entity chooses to present the effect of changes in discount rates in OCI, that an entity should recognise:
 - in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised; and
 - in OCI, the difference between the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date and the carrying amount of the insurance contract measured using the discount rates that applied at the date the contract was initially recognised.



Disclosure of the effect of changes in discount rates

15

- The IASB tentatively decided to require disclosures that would disaggregate the change in interest expense, which will improve comparability.

Effect of change in discount rates on insurance contract measurement	Profit or loss approach	OCI approach
<i>Analysis of interest expense in profit or loss / total comprehensive income</i>		
Interest accretion at current rate b/f	38,018	38,018
Difference between the measurement of amounts that adjust the CSM at locked-in and current discount rates	7,266	7,266
<u>Effect of change in discount rates in period</u>	<u>47,785</u>	<u>47,785</u>
Interest expense in period	93,069	93,069
<i>Reconciliation of total interest expense to the statement of comprehensive income</i>		
Profit or loss: Interest accretion expense		38,555
<u>Movement in OCI</u>		<u>54,514</u>
Interest expense in total comprehensive income		93,069



Next steps

- April Board meeting:
 - Discussion of insurance contracts revenue
 - Considering approach to issues raised in comment letters that were not subject of targeted questions
- Redeliberations are planned to be completed in 2014
- Publication is planned for 2015

More exact timetable will depend on decisions the IASB takes in April.



For more information...

Stay up to date

- Visit our website:
 - go.ifrs.org/insurance_contracts
- Sign up for our email alert

Ask questions or share your views

- Email us:
insurancecontracts@ifrs.org

Resources on IASB website

- IASB Update
- Project podcasts and webcasts
- Snapshot
- Feedback statement
- Investor resources
- High level summary of project



FASB INSURANCE CONTRACTS UPDATE



February 19, 2014 FASB Meeting

Exposure Draft

February 19

Board decision

All contracts that meet definition of insurance regardless of industry

Scope

Insurance entity; consider explicitly including other contracts later

Changes to recognition, measurement and disclosures (building block approach)

Long-duration contracts

Improvements to existing US GAAP for recognition, measurement and disclosures

Changes to recognition, measurement and disclosures (premium allocation approach)

Short-duration contracts

Improvements to disclosures

LD - Expected cash flow assumptions

Existing guidance

Are there potential improvements?

FAS 60 products:

- Locked in assumptions at the initial contract recognition date and perform loss recognition test

FAS 97 products:

- Record policyholder account balance plus the value of some guarantees
- Some guarantees and options not accounted for under existing guidance or accounted for using a glide path formula under existing guidance

▶ No

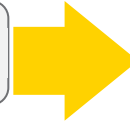
▶ Disclose current assumptions and the effect on the financial statements

Changes to recognition and measurement with some aspects of building block approach

- ▶ Update assumptions each reporting date and recognize in the income statement or against an explicit margin
- ▶ Include all expected cash flows: surrenders (and surrender charges); fees (cost of insurance mortality and expense charges and asset management fees); and, expenses (asset management expenses)
- ▶ Include expected value of all guarantees and options

LD - Discount rates

Existing guidance



Are there potential improvements?

FAS 60 products: discount rate based on estimates of investment yields (net of related investment expenses) expected at the time insurance contracts are made consistent with circumstances, such as:

- Actual yields
- Trends in yields
- Portfolio mix and maturities, and
- The insurer's general investment experience (typically includes defaults and reinvestment risks)

FAS 97 products: a discount rate is not applied to the account value because the liability is recorded at the account value

▶ No

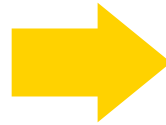
▶ Disclose current rates and the effect on the financial statements

Changes to recognition and measurement with some aspects of building block approach

- ▶ Use discount rates that reflect the characteristics of the liability (with clarifications)
- ▶ Recognize the impact from changes in the discount rates in OCI (with potential option for recognition in I/S)
- ▶ Contractual participating features: ignore discount rate; record at corresponding asset value

LD - Margin

Existing guidance



Are there potential improvements?

FAS 60 products:

- Policyholder reserve includes implicit margin; earned over life of policies

FAS 97 products:

- Margin is not typically recorded; recognized when fees are earned
- Margin recognized for unearned revenue liability (gross premium > net premium); recognized in constant relationship with inforce (life) or the amount of expected future benefit payments (annuity)
- EGP's used to determine DAC amortization

▶ No

▶ Disclose

Changes to recognition and measurement with some aspects of building block approach

- ▶ Recognize an explicit margin for the difference between the present value of the expected premiums and the measurement of the liability
- ▶ Recognize the margin as insurer satisfies its performance obligation and therefore is released from exposure to risk
- ▶ IASB approach: Recognize a risk adjustment for the compensation required for bearing the uncertainty about the amount and timing of future cash flows and a contractual service margin for remainder of difference between the present value of the expected premiums and the measurement of the liability recognize as revenue over the coverage period based on services provided

LD - Premiums and benefit expense

Existing guidance

Are there potential improvements?

FAS 60 products:

- Recognize “premiums” and “benefit expense” when premiums are due
- Include all premium and benefit payments in income statement

FAS 97 products:

- Recognize revenue when fees and charges are due
- Exclude from revenue and expenses account balances

▶ No

▶ Disclose

Changes to recognition and measurement with some aspects of building block approach

- ▶ Recognize revenue in proportion to the value of coverage and any other services provided, including interest accretion on cash inflows
- ▶ Recognize claims and benefits expense as well as other fulfillment costs when incurred
- ▶ Exclude from revenue (and expenses) the amount of premium that the insurer is obligated to pay the policyholder or a beneficiary regardless of whether an insured event occurs

Short-duration

▶ Disclosures

- Broad support for loss development tables
- Potential disclosure of principles in ED such as:
 - Actuarial central estimate
 - Discounted measurement of loss reserves
 - Certain assumptions such as duration of claims, frequency, severity, etc.

▶ Potential changes to/clarification of reinsurance guidance

- ▶ Reinsurance project to address perceived issues with existing guidance stopped in 2007



Timeline

- ▶ FASB directed the staff to analyze existing US GAAP guidance for insurance entities and identify potential areas for improvement for long-duration contracts and potential disclosure improvements for short-duration contracts
- ▶ Discussion regarding scope expected in April/May
- ▶ Deliberations to begin immediately after scope decisions
- ▶ Could split into multiple projects with separate Exposure Drafts



Challenges

- Long-duration contracts:
 - Change in focus from convergence to improvements
 - Some think if don't converge should not make any changes
 - Unclear what “improvements” means
 - Are some potential improvements really fundamental changes to existing model?
 - Should there be (and can Board get to) one model?
- Short-duration contracts – disclosure improvements:
 - Is there really support for loss development table - some raising too costly and not beneficial at the level that would be included
 - Consideration of principles in ED may get push-back, such as:
 - Actuarial central estimate
 - Duration of claims (discounted values or enough information for users to determine discounted values)
 - Mixed views on prior reinsurance project

ACTUARIAL ASPECTS



Agenda

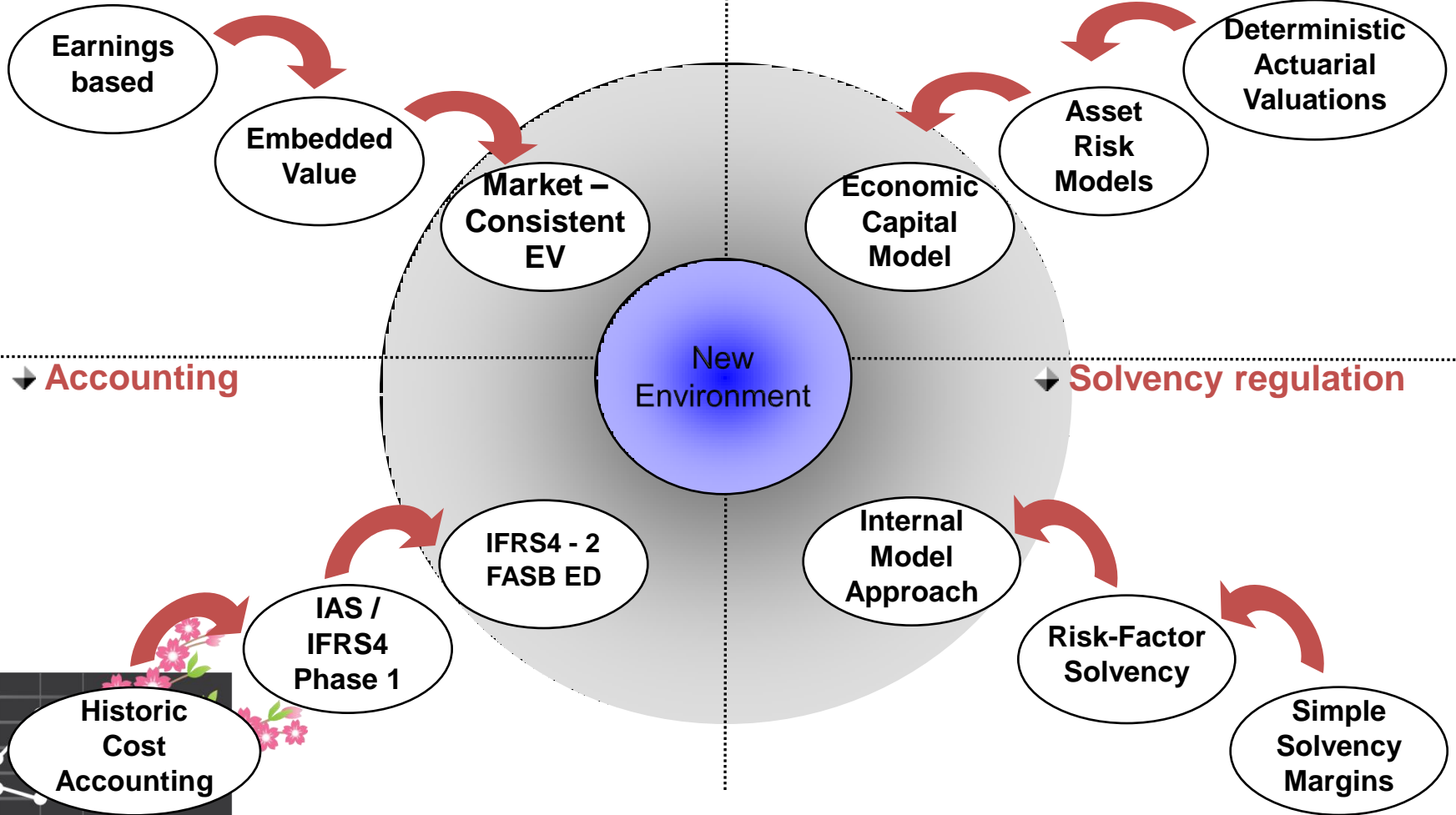
- Global background
- Overview of proposals
- Actuarial issues
- IAA activities



Global Trend – Internal Models

➤ Pricing & Valuation

➤ Risk Management Approach



Overview of Proposals

Measurement

- Model based discounted CF approach
- Margins
- Unlocked assumptions

Presentation

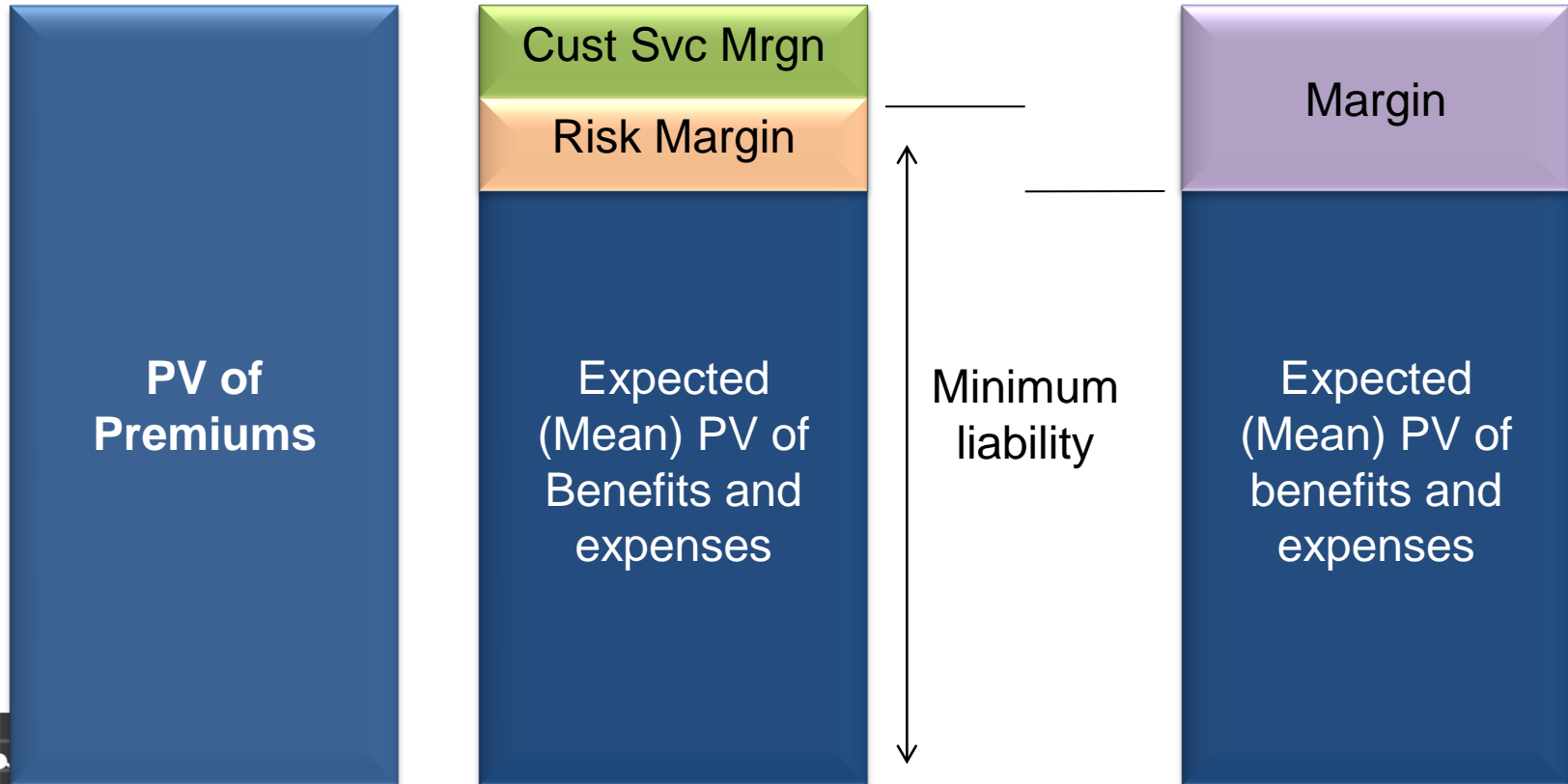
- New definition of revenue and expense
- Income statement elements

Disclosure

- Significant increase in numerical computations, sensitivities



Building Block – Initial Calibration



Actuarial Issues

Reserve Measurement & Analysis

- Multi-scenario analysis to capture time value of options and guarantees
- All assumptions unlocked
- Discount with yield curves
- Analysis of movement may require multiple valuations

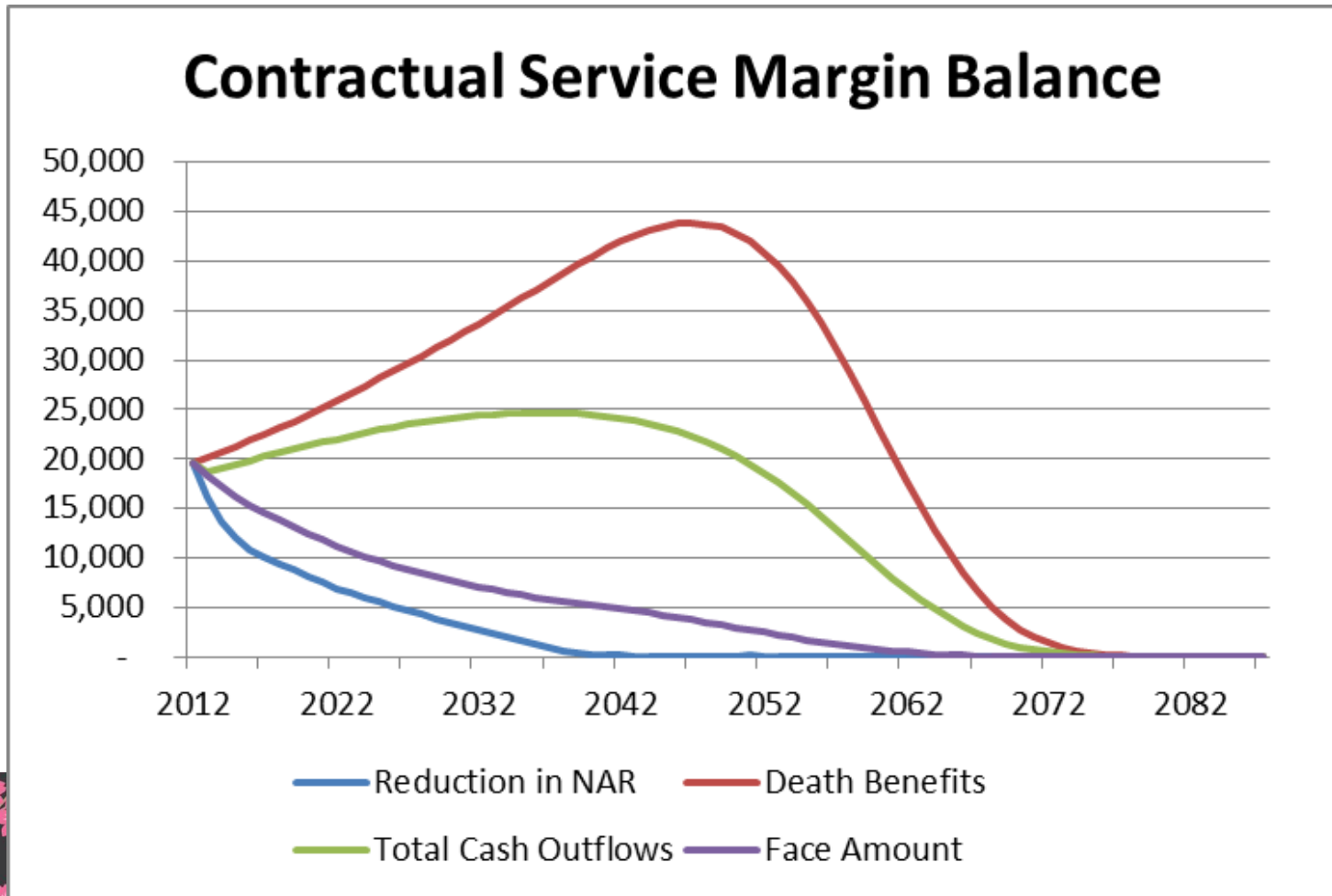


Actuarial Issues Margins

- Risk Adjustment
 - Required under IFRS model
 - Insurer not constrained as to methodology
 - Needs to reflect risk preference of entity
- Single/Customer service margin
 - Basis of amortization needs to be chosen
 - Should reflect pattern of services provided



Driver of Release of Margin



Presentation



Revenue

- Revenue recognized in proportion to provision of service
- Release of margin + expected claims and expenses



Expense

- Claims and expenses are presented when incurred
- Amortization of acquisition costs



Interest Margin

- Investment income, net of
- Interest expense based on locked in discount rate



Other Comprehensive Income

- Change in liability due to unlocked discount rate



Actuarial Issues

Income Statement Presentation

- Valuation needs to be done (at least) twice
 - With unlocked discount rates
 - With locked in discount rates
 - Difference presented in OCI
 - Cash flows may need to be bifurcated
- Revenue is expected release of reserve
 - Including release of margins
- Actuarial models will be producing several elements of the income statement



Actuarial Issues

Sensitivity Analysis

- Reconcile opening to closing balance sheet amounts
 - Separately for expected PV of future CFs, risk adjustment, contractual service margin
- Effect on profit and loss from
 - Changes in relevant risk variable that were reasonably possible at the end of the reporting period
 - Changes in the methods and inputs that are used in preparing the sensitivity analysis



Actuarial Issues Transition

- Full retrospective application is required
- Margins need to be calibrated to pricing
- What pricing information is available for business issued more than 10 years ago?
- Could standardized industry factors be more cost effective?



IAA Activities

- Insurance accounting committee
- Education and practice subcommittee
- Monographs
 - Stochastic Modeling
 - Discount rates
 - Risk adjustment
- Actuarial Notes



Q&A

