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Iowa actuaries club education day

Insurance contracts accounting
standards – Update and next steps
February 25, 2014

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Insurance contracts accounting standards – Agenda

- Overview of the Standard(s)
- Feedback to date
- The road ahead

Section 1

Overview of the Standard(s)

Objectives of the proposed FASB and IASB standards:

1

Improve, simplify and converge the financial reporting requirements for insurance contracts

2

Eliminate numerous pieces of current us accounting literature

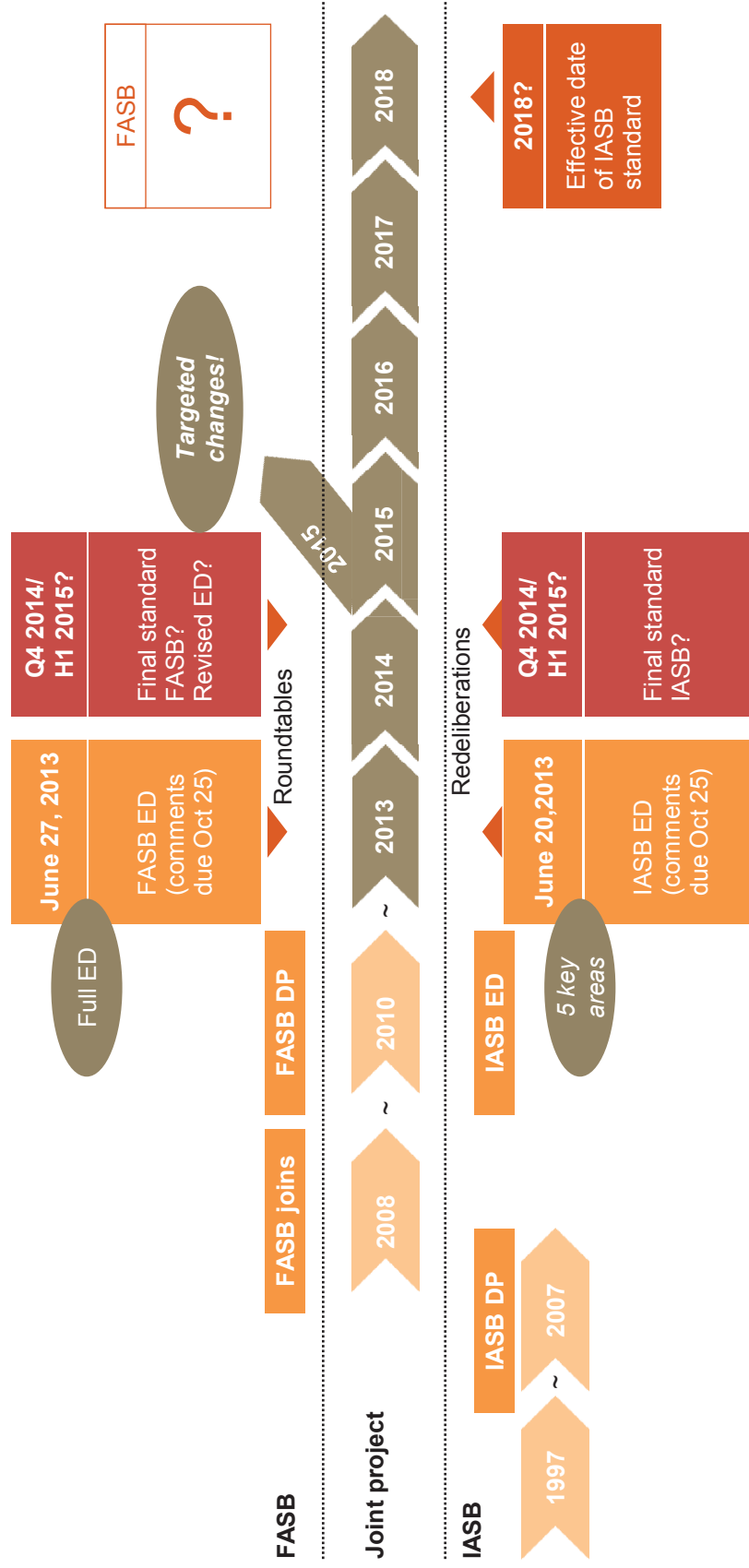
3

Provide a comprehensive insurance standard for IFRS reporting

4

Provide investors with more decision useful information

Background and timeline

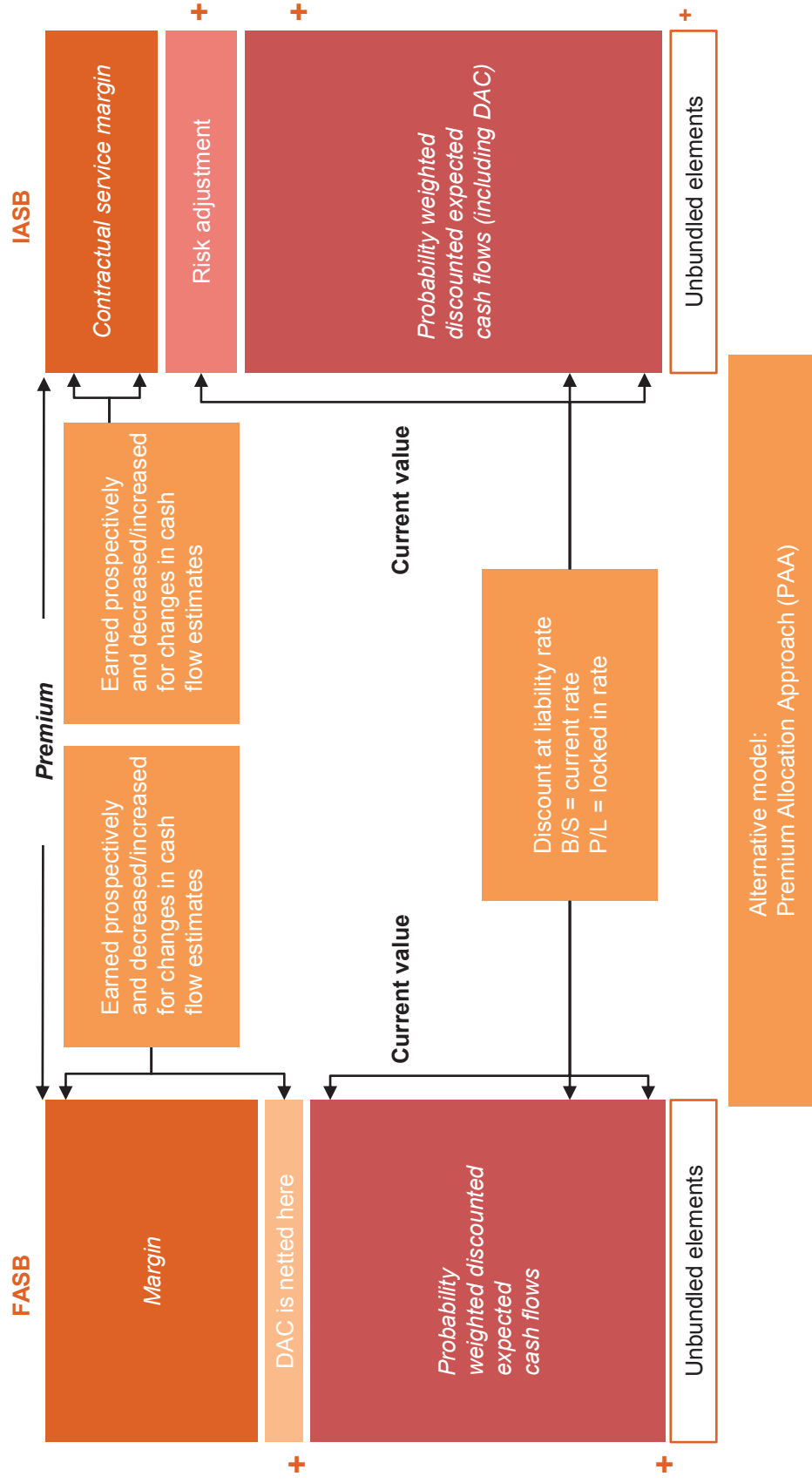


Insurance contracts accounting proposed standards – Components

Scope	Unbundling	Product classification	Portfolio definition
Contract cash flows	Initial recognition	Subsequent measurement	Balance sheet presentation
Income statement presentation	Roll-forward disclosures	Additional disclosures	Non-GAAP measures*

*Not within the Standards, but most companies likely to consider as part of assessment and implementation.

Overview of the building block approach (BBA)



Discount rate – Top down vs. bottom up

Top down

Actual or expected reference portfolio rate

7.0%

Duration mismatches

.3%

Market risk premium for expected credit losses

-1.0%

Market risk premium for unexpected credit losses

-6%

Insurance contract discount rate

5.7%



Difference between the two methods not required to be reconciled

Bottom up

Insurance contract discount rate

5.5%

Liquidity premium

.1.5%

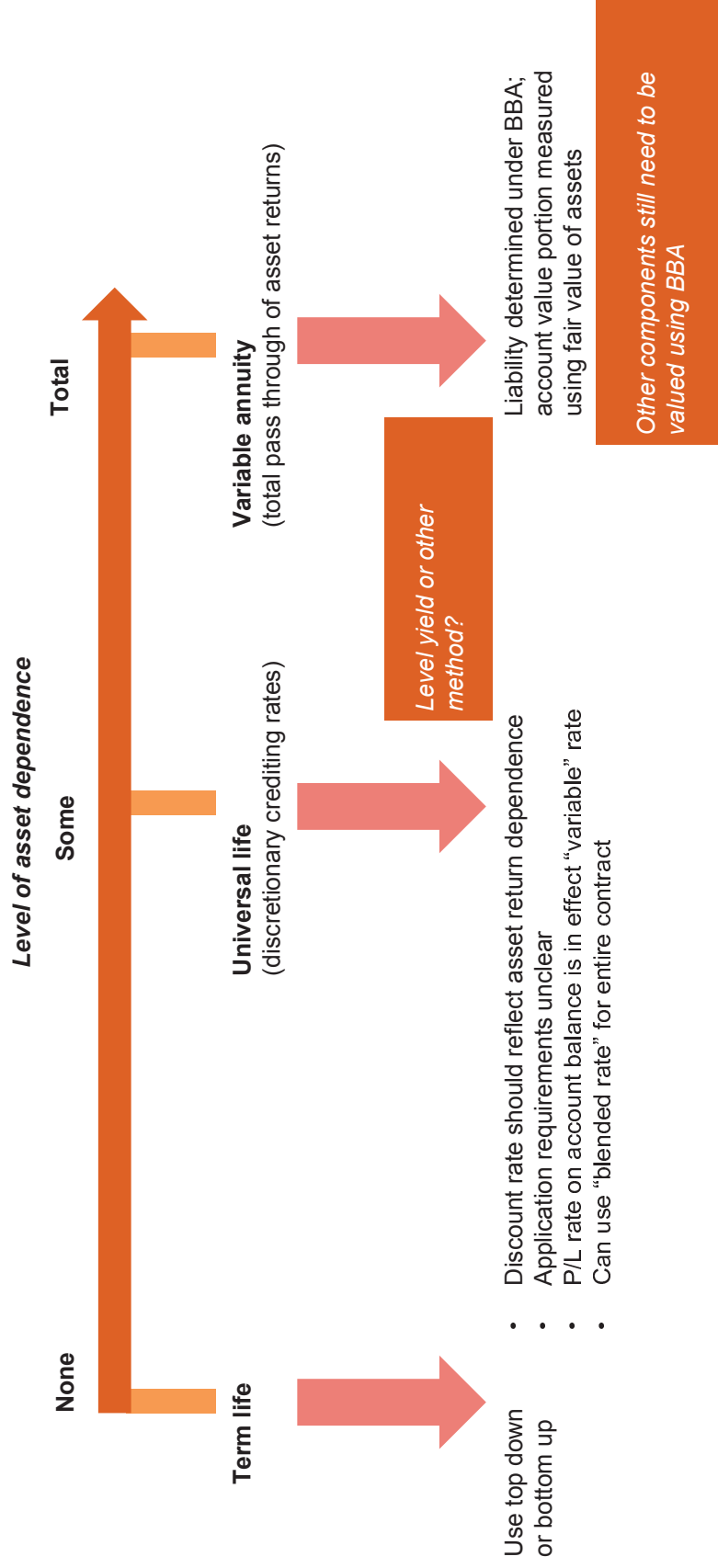
Risk free rate of return

4.0%



Products with asset-affected cash flows – Discount rates

If amount, timing, or uncertainty of cash flows depend wholly or partly on performance of specific assets, discount rates should reflect that dependence



Margin amortization

FASB margin (exposure draft)	IASB margin
Amortize over coverage and settlement period	Amortize over coverage period
Amortized based on release from risk (reduction in variability of cash flows)	Amortize based on pattern of transfer of services
No adjustments to margin for changes in cash flow estimates unless onerous	Adjust residual margin +/- for changes in cash flow estimates related to future service

What is "release from risk" pattern?

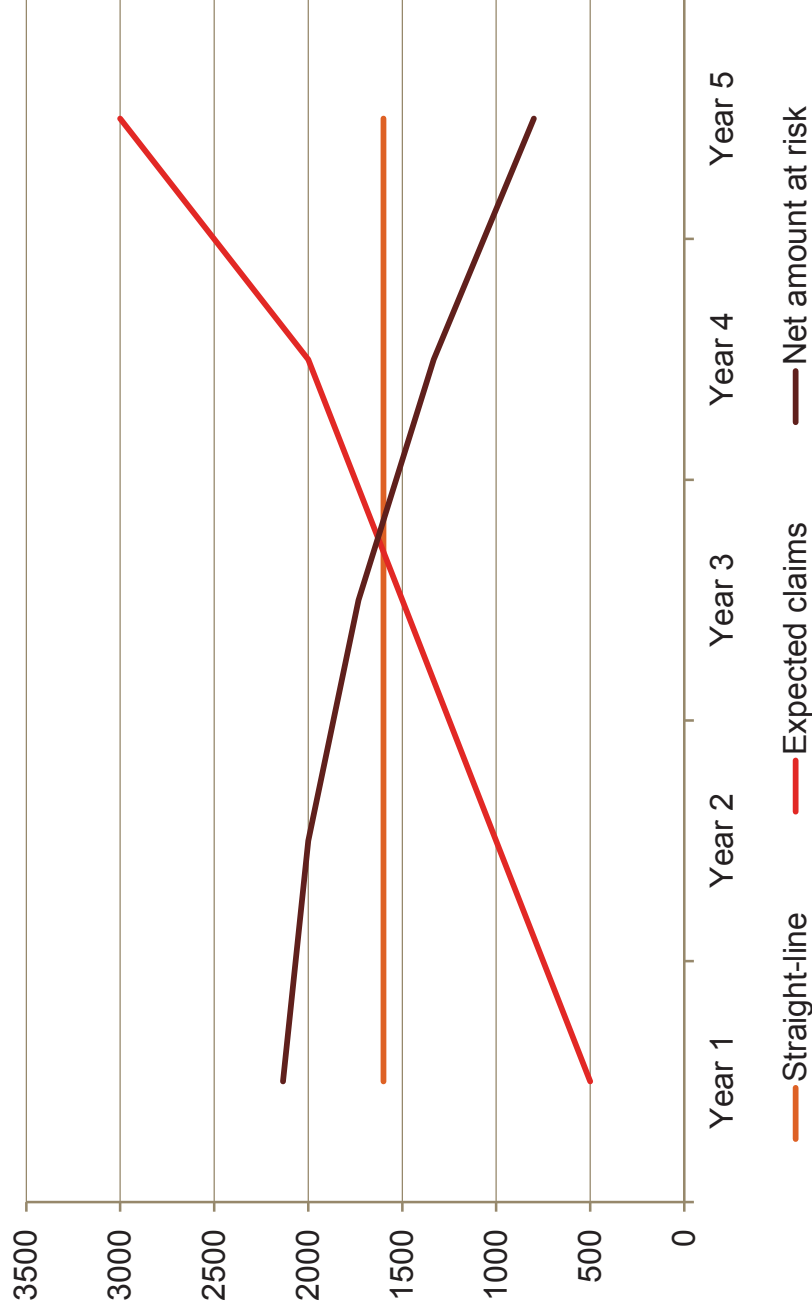
Is this requiring a risk adjustment calculation anyway?

Is there more volatility in FASB model?

Should FASB margin also be adjusted for all changes in estimate?

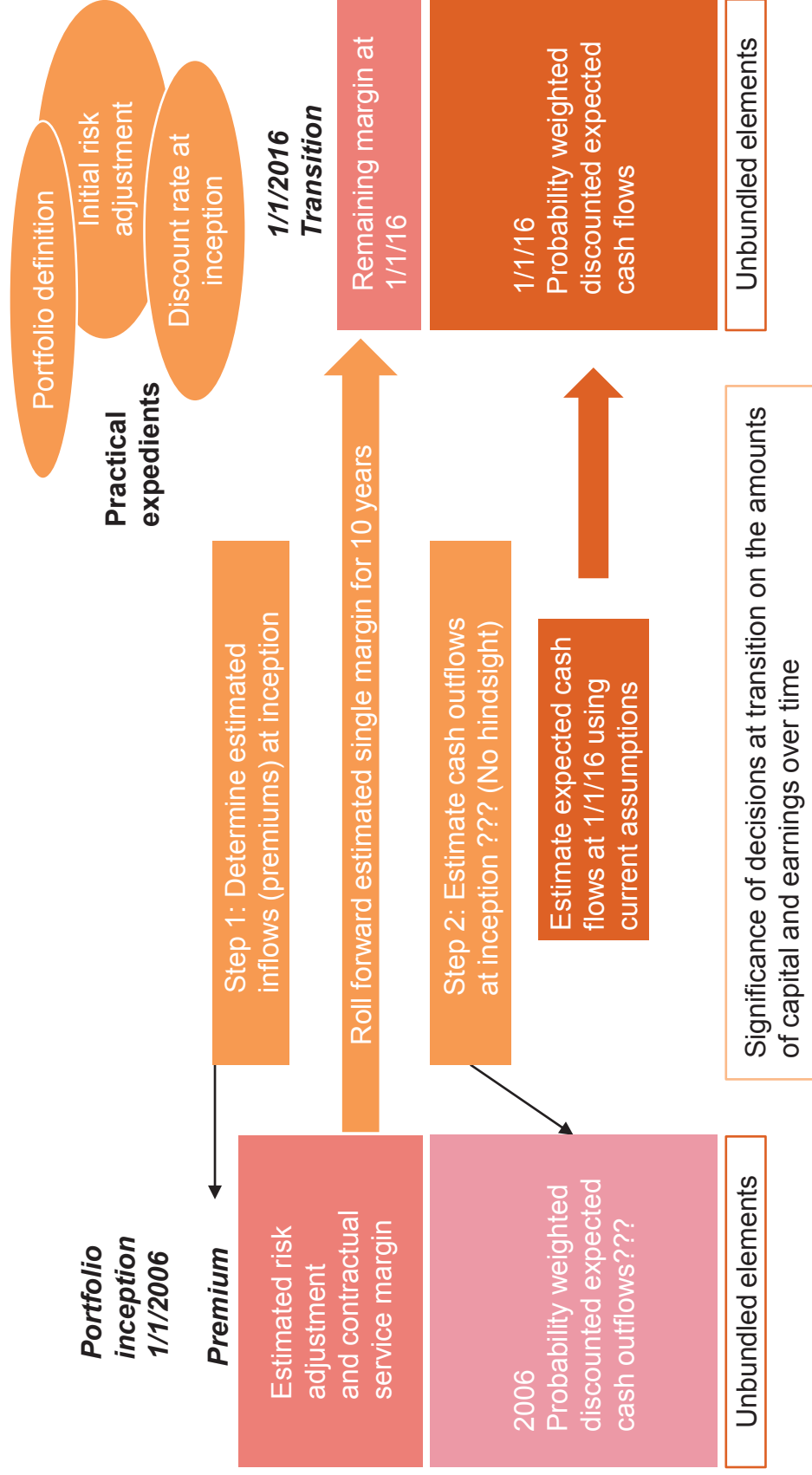
What are the services?

FASB single margin amortization – “Release from risk” pattern?



Which pattern is most consistent with release from risk or services provided?

Transition – Retrospective



Premium allocation approach

- Expected to apply to most property/casualty contracts and annual health contracts
 - FASB viewed it as a separate measurement model; now tabled
 - IASB views it as proxy for building block approach
- Similar to current US GAAP unearned premium approach, but with:
 - *Discounting of incurred claims, accreted through investment expense*
 - *Revenue pattern based on expected claims*
 - *Use of “mean” rather than “best estimate” for incurred claims*
 - *Exclude deposit component from revenue and claims incurred expense*
 - *Net DAC against liability*
 - *Lower grouping level for onerous contracts*
 - *Record expected premiums receivable for entire contract term*
 - *Simpler risk transfer criteria*



FASB exposure draft version of balance sheet presentation

IASB less prescriptive – separate contract assets and liabilities, R/I ceded

Assets	Liabilities & equity
Cash	Insurance contract liability (BBA)
Investments	Margin (BBA)*
Insurance contract asset (BBA)	Liability for remaining coverage (PAA)*
Premium receivable (PAA)	Liability for incurred claims (PAA)
Reinsurance contract asset (BBA)	Other liabilities
Reinsurance contract asset (PAA)	<i>Total Liabilities</i>
Other assets	Accumulated other comprehensive income
	Stock and retained earnings
<i>Total Assets</i>	<i>Total Liabilities and Equity</i>

*Capitalized direct acquisition costs are netted in this liability

FASB exposure draft version of statement of comprehensive income

Statement of Comprehensive Income	Derived amount
Insurance contract revenue (BBA) <i>(Excludes deposits in)</i>	
Insurance contract revenue (PAA) <i>(Excludes deposits in)</i>	
Claims/benefits incurred (BBA) <i>(Excludes deposits out)</i>	
Claims/benefits incurred (PAA) <i>(Excludes deposits out)</i>	
Ceded reinsurance premium (expense) (BBA)	Can't net against revenue
Ceded reinsurance premium (expense) (PAA)	
Ceded recoveries (BBA)	Can't net against expense
Ceded recoveries (PAA)	
Changes in estimates of future claims/benefits	
Amortization of acquisition costs	
<i>Underwriting Margin</i>	
Other expenses	
Investment income	
Interest expense	Includes unwind of discount
Income taxes	
<i>Net Income</i>	
Other comprehensive income	Includes interest rate changes
<i>Total comprehensive income</i>	


IASB less prescriptive
 – present revenue,
 benefits and expenses;
 R/I separate; interest
 expense

Statement of comprehensive income “Earned premium” approach under BBA

Revenue:

Recognize over time in proportion to relative value of insurance coverage and other services provided in each period

Revenue earned for period illustrated as:

- 
- +*Expected* claims and benefits for the period (net of investment component)
 - +*Expected* expenses for the period
 - +Release of single margin (or residual margin in IASB model)
 - +Release of risk adjustment (IASB model)

Claims/benefits/expenses:

Recognize actual costs as incurred (net of investment component)

Recognize changes in estimates of future claims/benefits/expenses

Statement of comprehensive income

Estimated refundable amount

Estimated refundable amount: excluded from income statement presentation (i.e., amount is excluded from premium revenue and, later, from claim payments).

- *Entire contract, including estimated refundable amount, continues to be measured under insurance model (differs from “unbundling” requirement, which requires financial instrument measurement model).*
- *Estimated refundable amount measured as PV of amount insurer is obligated to pay policyholder regardless of whether an insurance event occurs.*

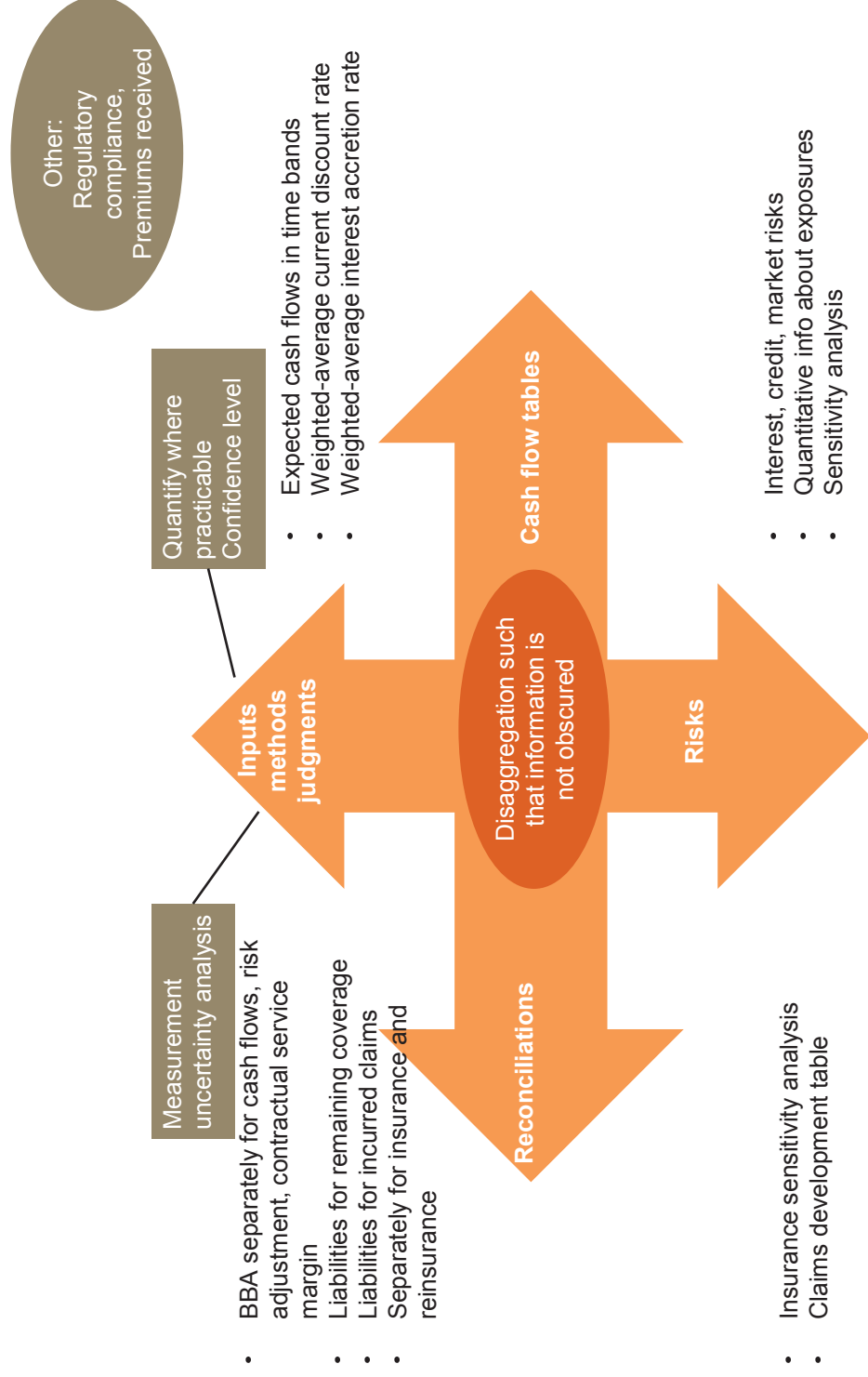
Rationale:

Amounts that will always be repaid to policyholder, whatever the form.

Inconsistent with “earned revenue” concept to show deposit component as revenue

- ***Examples: explicit account balances, cash surrender values, experience accounts***

Disclosures – Overview



Section 2

Feedback summary

General themes – U.S. life industry

U.S. life industry supports a converged standard with substantial changes. If not converged, some recommend only targeted changes to US GAAP.

- The proposal in its current form does not represent an improvement over existing U.S. GAAP
- Some U.S. life industry suggestions for substantial changes to proposal:
 - Unlock the margin
 - Discount rate consistent with economics of business
 - Optional OCI for changes in discount rates
 - Revise portfolio definition – too granular
 - Revise income statement presentation – not representative of economics and too complex
 - Simplify transition

General themes – U.S. life industry

Targeted changes

Many suggested making targeted changes in absence of convergence; a few made specific suggestions...

- Update assumptions for traditional (FAS 60) products
- Make DAC amortization method consistent and simpler across all products
- Provide one consistent model for GMXBs
- Enhance disclosures

FASB ED response – Key themes overview

Issue	Life	P/C	Big 4	AAA
<i>Discount rate</i>	Pricing rate	None; or simplify	Clarify or revise	More weight on L/T estimates
<i>OCI for rate changes</i>	Optional	Optional	Optional	Optional
<i>Unit of account</i>	Clarify	Clarify	Clarify	Clarify
<i>Expected value</i>	Clarify	Clarify	Clarify	Clarify
<i>Single margin</i>	Most support	Few comments	Mixed	Mixed
<i>Margin unlock</i>	Unlock	Unlock	Unlock	Unlock
<i>PAA criteria</i>	Retain GAAP; make optional	Retain GAAP; make optional	Clarify; make optional	Clarify; make optional
<i>PAA margin</i>	Few comments	Too front ended	Too front ended	Too front ended
<i>P/L approach</i>	Reject	Few comments	Mixed	Neutral
<i>Transition</i>	Use IASB hindsight	Few comments	Use IASB hindsight	Robust field testing needed

IASB ED response – Key themes overview

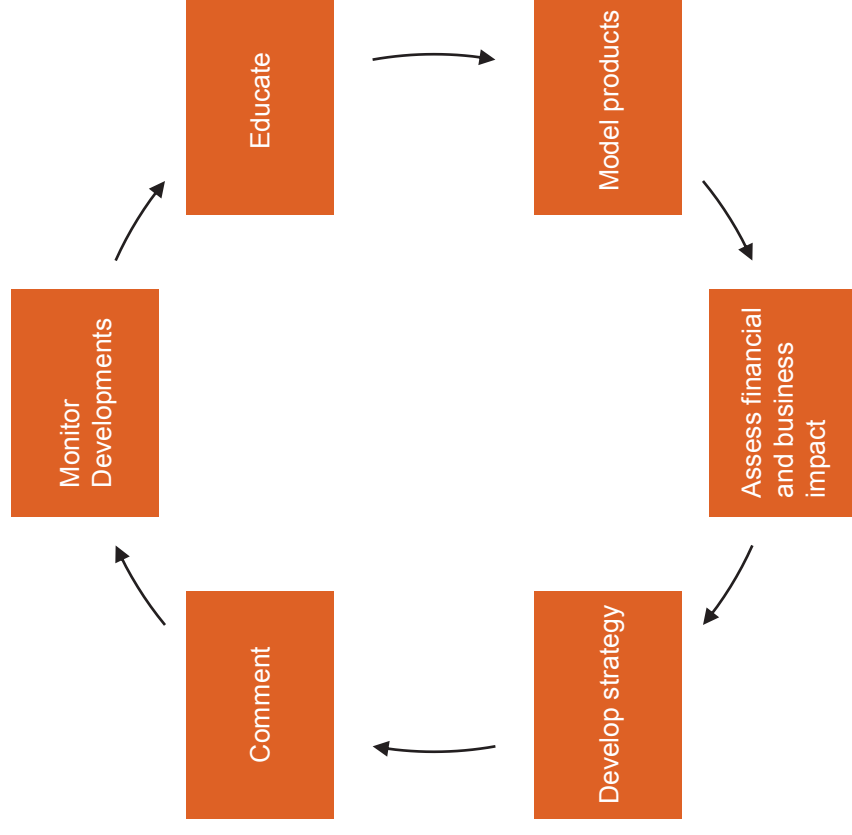
Issue	Life	P/C	Big 4	IAA
<i>Margin unlock</i>	Unlock	Unlock	Unlock	Clarify
<i>OCI for rate changes</i>	Optional	Optional	Optional	Optional
<i>Par contracts</i>	Reject	Few comments	Reject	Reject
<i>P/L approach</i>	Reject	Few comments	Mixed	Neutral
<i>Transition</i>	Support	Support	Support	Support

Section 3

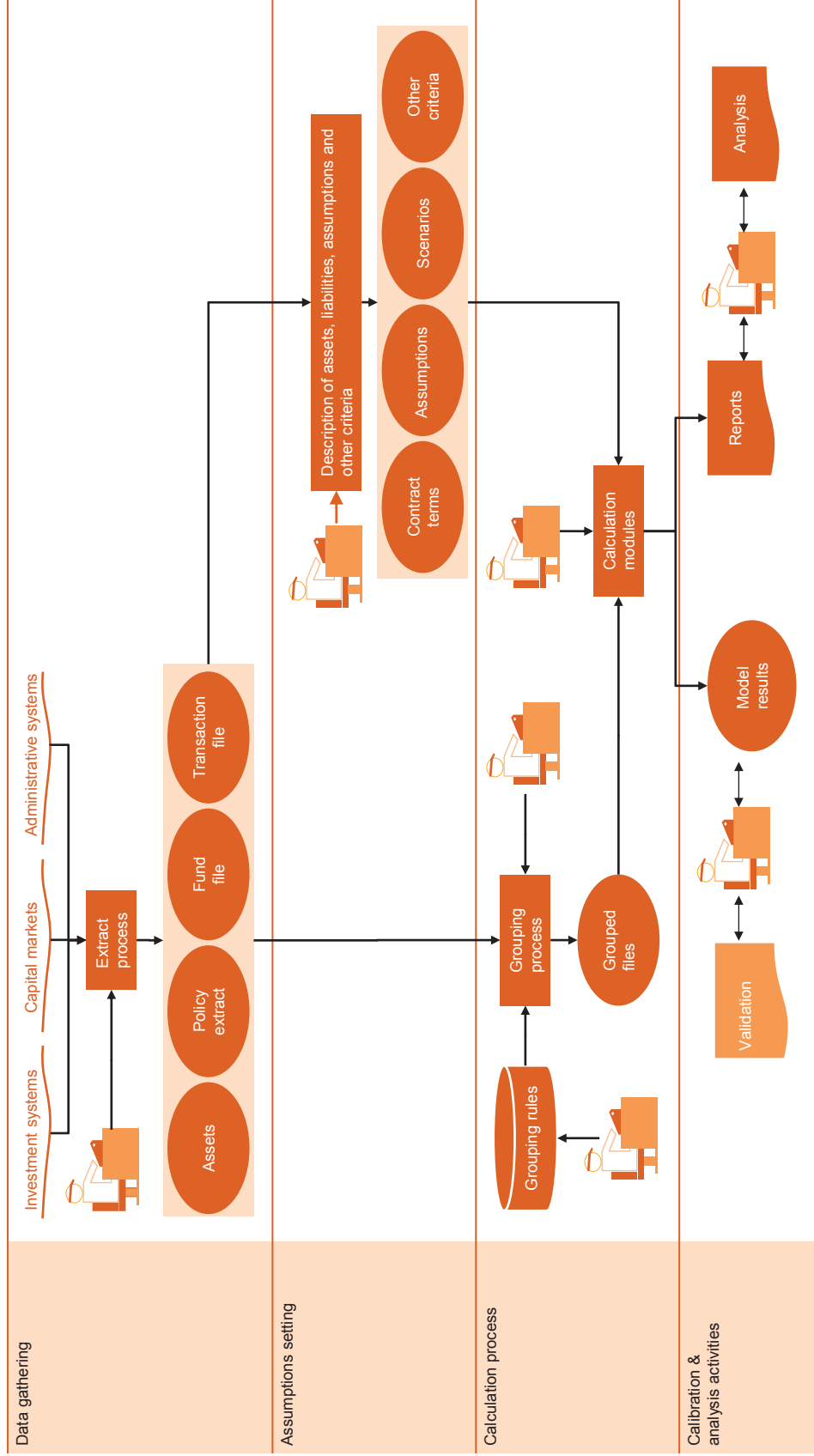
The road ahead

What are insurers doing?

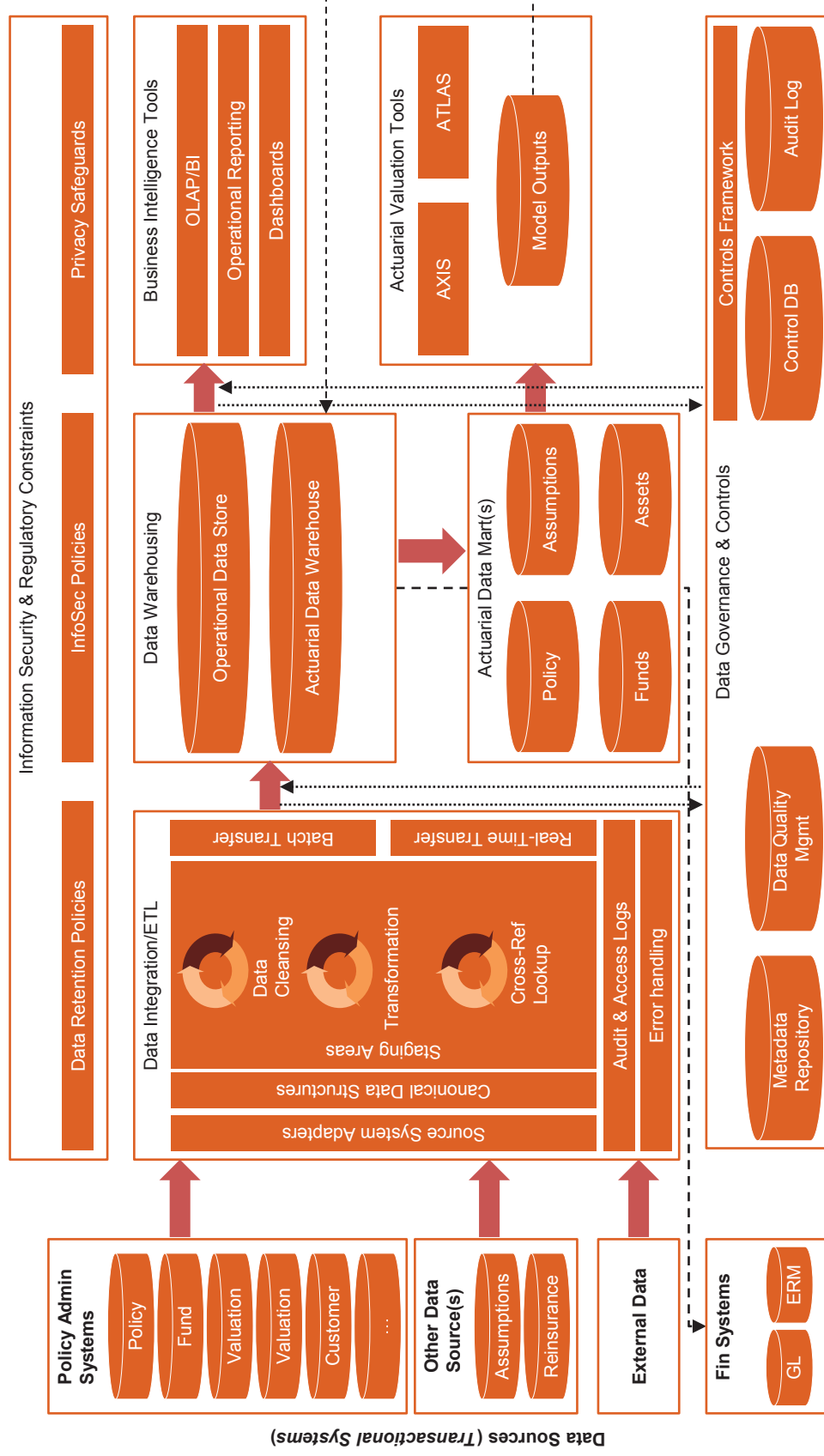
- Higher level of focus for life insurers than P&C
- Life insurers activities span the spectrum...
 - Most companies continue monitoring/education efforts
 - Many have performed modeling, with varying depth and scope including some support of field testing
 - Some continue to focus on lobbying
 - There is an increasing focus on assessing the impact and developing a broader strategy
- Coordination/sharing of experience across companies



Assessing the current state – Readiness for pending requirements (not just Insurance Contracts!)

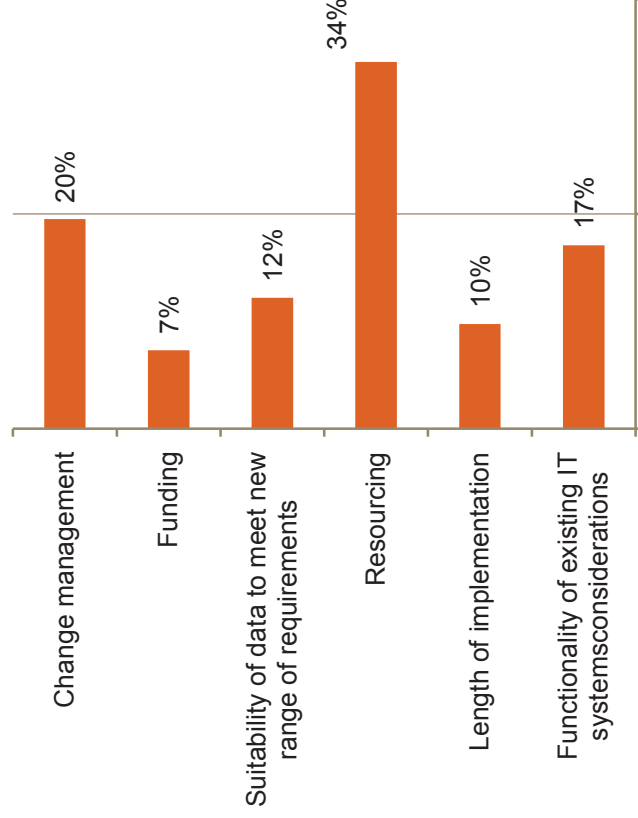


Focusing on the finish – An actuarial “modernization” future state

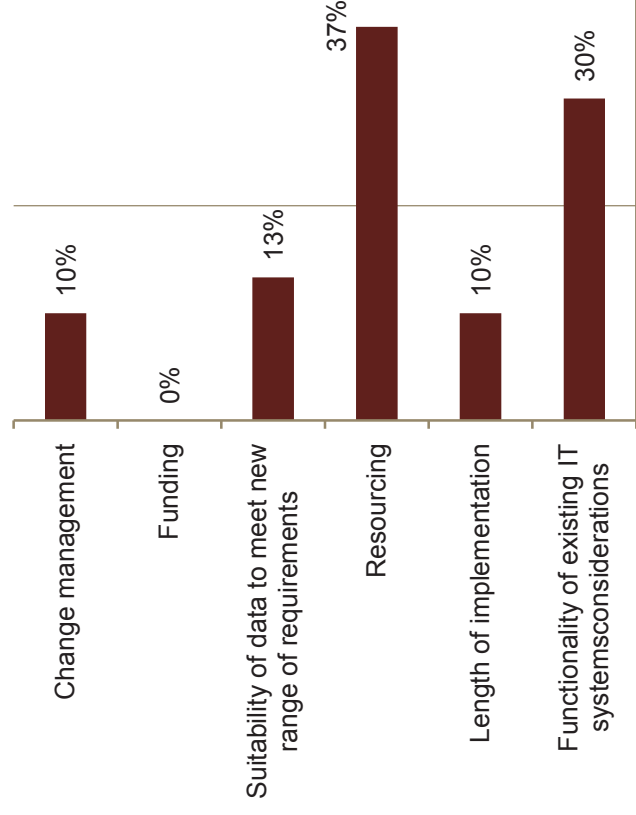


What challenges do you see in implementation?

Life



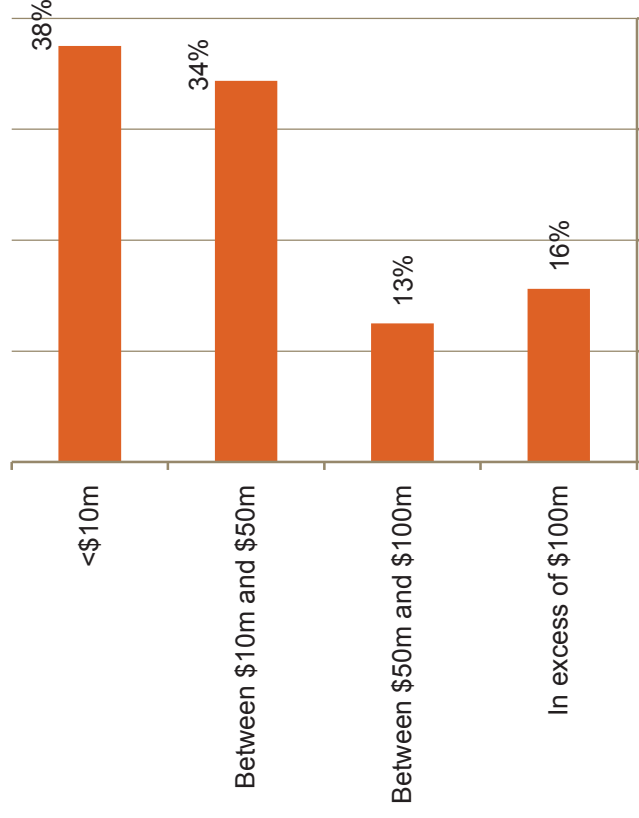
P&C



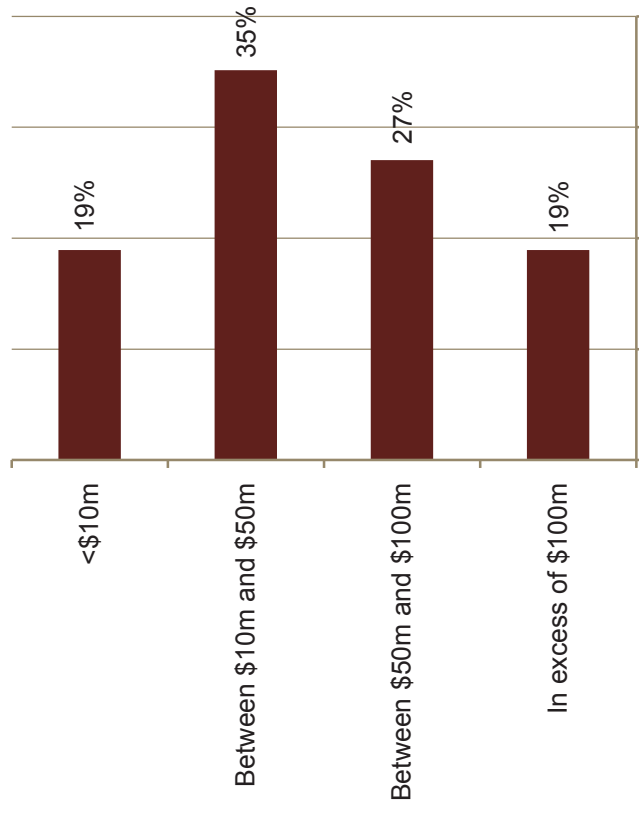
Key Takeaway: Realization that IT systems are a critical part of the effort as well as recognition that the stress of human capital will be significant.

What is your current “guesstimate” of the cost of implementation?

Life



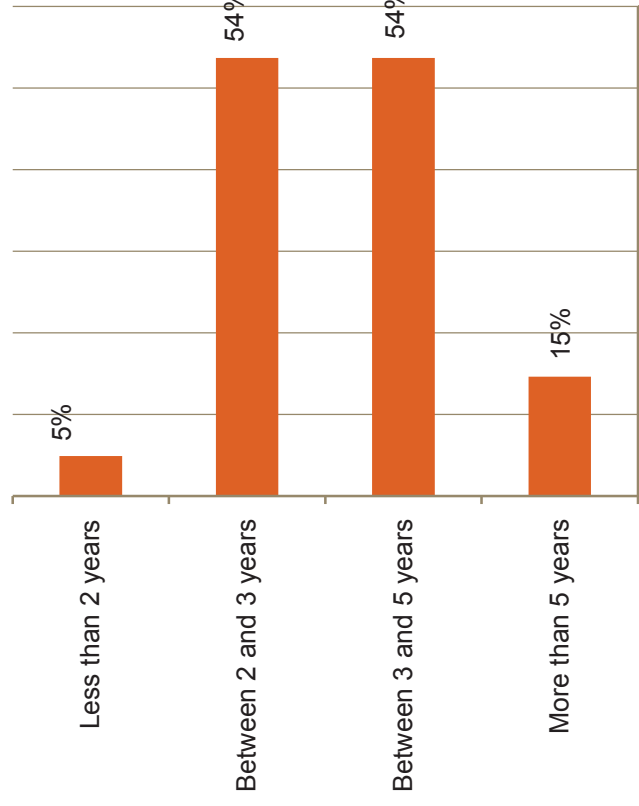
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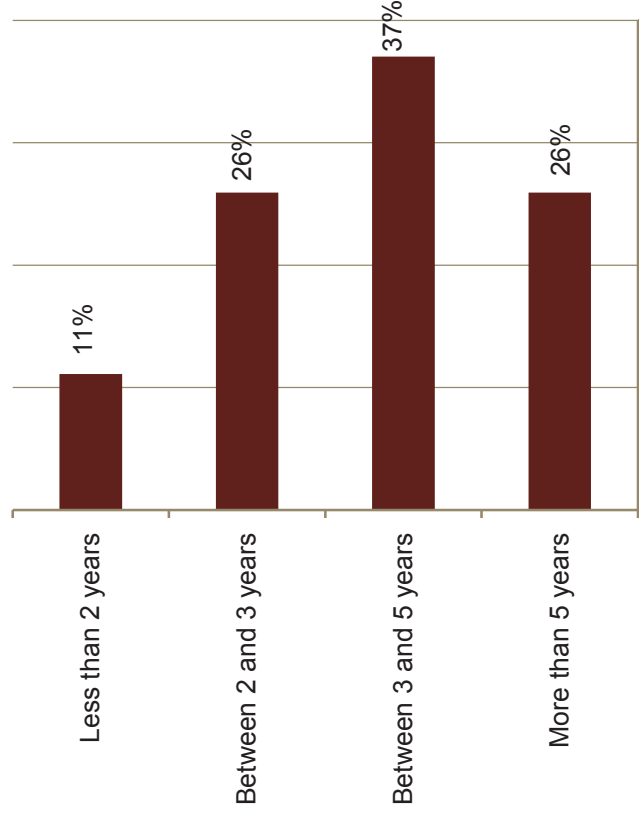
Key Takeaway: The amounts are substantial and are likely to increase.

Over what period do you think you will be working on these changes?

Life



P&C



Key Takeaway: We are on a journey - a 3-5 year average commitment appears realistic.

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Thank you!

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