Update: IASB/FASB Joint Project on Insurance Contracts

Josh Keene
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Key Players

**IASB** - *International Accounting Standards Board*
- **IAS**   International Accounting Standards – before 2001

**FASB** - *Financial Accounting Standards Board*
- **ASC**   Accounting Standards Codification
Presentation Overview

- Insurance Contract Project – a look back
- How different does the future of insurance accounting look?
- When/Will this train reach the station?
Summarized History

2002  IASB and FASB Announce Initiative to Achieve Compatibility in Financial Reporting Standards “Norwalk Agreement”

2003  EU Endorses Use of IFRS/ 2005- 25 EU Countries Switch to IFRS

2006  IASB and FASB Issued a Memorandum of Understanding -Creating a joint project to establish a common global standard

2008  SEC Publishes Roadmap for IFRS Adoption  
FASB Joined the “Insurance Contracts” Project

2010  SEC Publishes Work Plan for transitioning U.S. issuers to IFRS – decision to be made in 2011

2011  SEC releases “Condorsment” model for comment
Project Two Phases:

**IFRS 4 - Phase I** (issued in 2004)
- Definition of an insurance contract
- An interim standard and permits a wide range of accounting practice (effectively, use historical local GAAP)

**IFRS 4 - Phase II**
- Provide for a single measurement approach for Life, Health, P&C and reinsurance
- Recognition, presentation and disclosures
Phase II - Objectives:

- Develop common, high-quality guidance that will address recognition, measurement, presentation, and disclosure requirements for all insurance contracts (including reinsurance).
- Address volatility and timing risk within measurement model.
Joint Project - Insurance Contracts

- Exposure draft ("ED") issued by IASB in July 2010
- Discussion paper ("DP") issued by FASB in September 2010
  - Comment periods ended at end of 2010
  - Initially expected to have a final standard by mid-2011
- Exposure drafts have been delayed as the Boards continue to discuss the models
Why do we care?

- **Potential Changes if implemented are:**
  - Likely to increase loss reserves
  - More work for management, actuaries and auditors

- **Presentation**
  - Potentially much different view into an insurance company operations
Calculation of Reserves

**Old Way**

- Estimated Undiscounted Reserves

**New Way**

- Sum of Projected Paid Loss Cash Flows
- Estimated Discounted Reserves
- Less Amount of Discount
- Plus Risk Adjustment
- Estimated Discounted Reserves
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<thead>
<tr>
<th>Block</th>
<th>Description</th>
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<tbody>
<tr>
<td>Block 1</td>
<td>Estimate of future cash outflows less cash inflows that will arise as the insurer fulfils the insurance contract</td>
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<tr>
<td>Block 2</td>
<td><strong>Discount rate</strong> that adjusts those cash flows for the time value of money</td>
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<td>Block 3</td>
<td><strong>Risk adjustment</strong> for the effects of uncertainty about the amount and timing of those future cash flows</td>
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**PV of Fulfillment Cash Flows**

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<td><strong>Composite margin</strong> to eliminate any gain at inception and includes an implicit risk adjustment margin and residual margin</td>
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“Current proposals and time lines from the International Accounting Standards Board contain flaws that will introduce ‘significant noneconomic volatility for long-duration life contracts and will obscure underwriting results for the property/casualty insurance business.’”

Where Are We Now?

- Meetings continue in 2011…
  - October 14, 2011 Joint Board Meeting—Risk Adjustment and Disclosures
  - September 19, 2011 Joint Board Meeting—Risk Adjustment and Disclosures
  - September 7, 2011 Board Meeting—Single Margin and Liability for Incurred Claims
  - July 21, 2011 Joint Board Meeting—Premium Allocation Approach
  - June 15, 2011 Joint Board Meeting—Statement of Comprehensive Income
  - June 13, 2011 Joint Board Meeting—Residual Margin and Acquisition Costs
  - May 31, 2011 Joint Board Meeting—Reinsurance
  - May 17-18, 2011 Joint Board Meeting—Risk Adjustment
  - May 11, 2011 Joint Board Meeting—Policyholder Participation
  - May 4, 2011 Joint Board Meeting—Unbundling
  - April 27, 2011 Joint Board Meeting—Modified Approach
  - April 12, 2011 Joint Board Meeting—Discount Rate
  - March 29, 2011 Joint Board Meeting—Unlocking the Margin and the Insurance Working Group Meeting
  - March 22, 2011 Joint Board Meeting—Risk Adjustment and Contract Boundary
  - March 21, 2011 Joint Board Meeting—Risk Adjustment, Discount Rate, and Unbundling
  - March 15, 2011 Joint Board Meeting—Risk Adjustment, Discount Rate, Initial Recognition, and Definition
  - March 14, 2011 Joint Board Meeting—Presentation, Composite Margin, and Discount Rate
  - March 2, 2011 Joint Board Meeting—Scope, Field Tests, Uncertainty, and Acquisition Costs
  - March 1, 2011 Joint Board Meeting—Discounting and Scope
  - February 18, 2011 Joint Board Meeting—Discount Rate, Cash Flows, Risk Adjustment, Recognition, Residual or Composite Margin, and Presentation
  - February 17, 2011 Joint Board Meeting—Project Axioms and Assumptions, and Discount Rate
  - February 16, 2011 Joint Board Meeting—Unbundling
  - February 9, 2011 Board Meeting—Changes to U.S. GAAP
  - February 3, 2011 Board Meeting—Discount Rate
  - February 2, 2011 Joint Board Meeting—Acquisition Costs
  - January 19, 2011 Joint Board Meeting—Discount Rate
  - January 18, 2011 Joint Board Meeting—Comment Letter Summaries
What’s next?

- FASB website indicates new exposure draft in 1st half 2012
  - No indication of when final standard is expected to be issued
    - Possibly effective January 2014
    - More likely January 2015
QUESTIONS & ANSWERS

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