FASB/IASB Insurance Contracts Project Update

September 15, 2011

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Agenda

- IASB/FASB recent progress
- Project timeline
- Modeling results

Boards re-deliberations

Key topics discussed	Key topics to be discussed
Scope	Risk adjustment/Composite margin*
Fulfillment cash flows	Modified approach
Discount rate	Presentation
Risk adjustment/Composite margin*	Disclosures
Recognition	
Contract boundary	
Acquisition costs	
Reinsurance	
Residual margin	

Key changes to measurement inputs

Measurement input	IASB ED/FASB DP	Result of re-deliberations
Current estimate of future cash flows	Current, explicit and unbiased expected value estimate of future cash flows.	The measurement objective of expected value refers to the mean that considers all relevant information. The Boards noted that not all possible scenarios need to be identified and quantified, provided that the estimate is consistent with the measurement objective of determining the mean.
Discount rate	Discount rate should reflect the characteristics of the liabilities. Derived as the risk free rate plus a premium for illiquidity.	The Boards recognize that an illiquidity premium may be difficult to calculate. Therefore they will allow a top down approach from taking the expected return of a portfolio of assets that have similar characteristics to the insurance contracts minus the spread for credit risk.
Risk adjustment (IASB ONLY)	The risk adjustment should be the amount the insurer would rationally pay to be relieved of the risk and should be updated (remeasured) each reporting period	Objective has been change to, "'The risk adjustment shall be the compensation the insurer requires to bear the risk that the ultimate cash flows could exceed those expected". The IASB tentatively decided that the measurement of an insurance contract should contain an explicit adjustment for risk. The adjustment would be determined independently from the premium and would be re-measured in each reporting period.

Key changes to measurement inputs

Measurement input	IASB ED/FASB DP	Result of re-deliberations
Composite Margin (FASB ONLY)	Difference between premium and current estimate of cash flows discounted for the time value of money	The FASB has tentatively decided that the measurement model should use a single margin approach that recognizes profit as the insurer satisfies its performance obligation . An insurer satisfies its performance obligation as it is released from exposure to risk as evidenced by a reduction in the variability of cash outflows. An insurer should not remeasure or recalibrate the single margin to recapture previously recognized margin.
Residual margin	Eliminate profit at issue then amortize over the coverage period (on the basis of passage of time) but if the insurer expects to incur benefits and claims in a pattern that differs significantly from the passage of time, the residual margin should be released on the basis of the expected benefits and claims	The IASB indicated that they would permit unlocking the residual margin based on changes in estimates of future cash flows. The IASB also indicated that the residual margin should be allocated "over the coverage period on a systematic basis that is consistent with the pattern of transfer of services provided under the contract." The FASB indicated that they would not permit remeasurement of the residual margin if they adopted a two margin measurement approach.

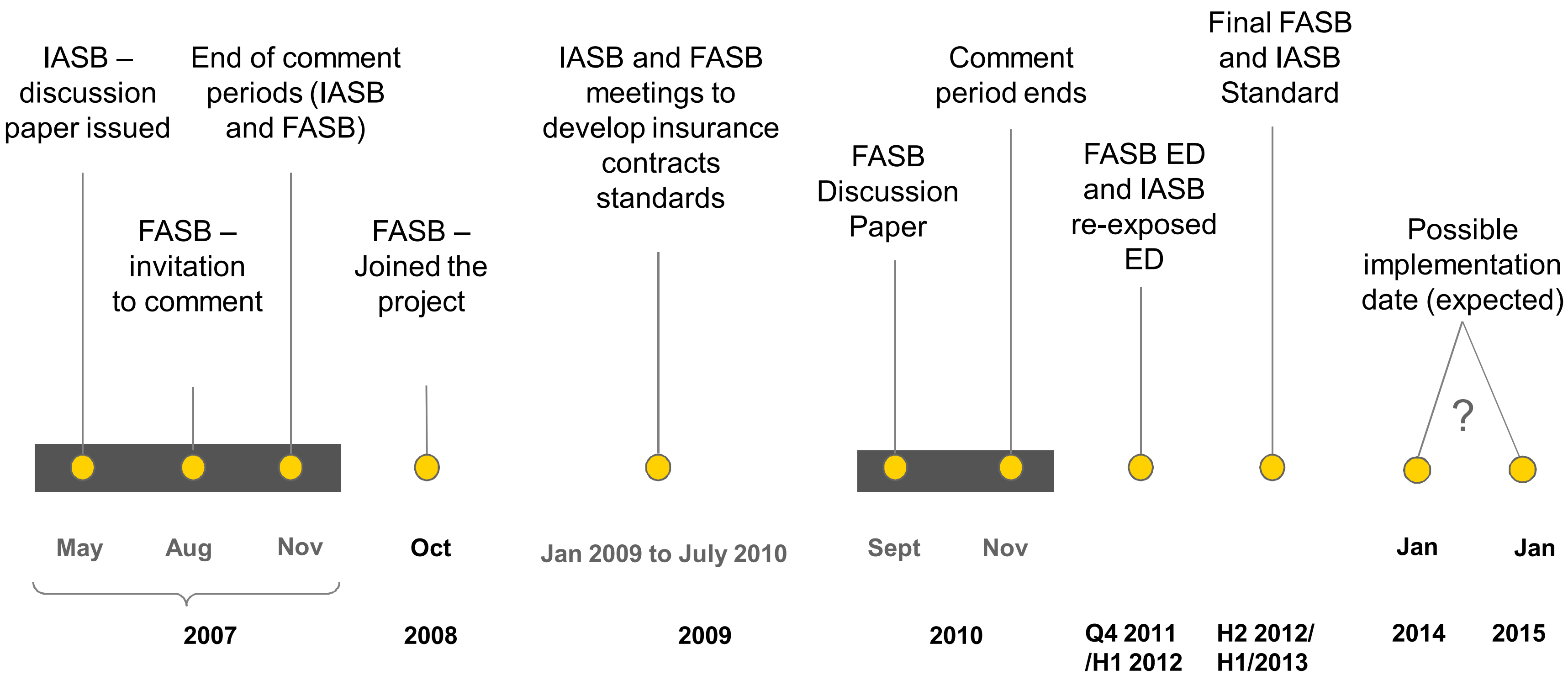
Key changes to measurement inputs

Measurement input	IASB ED/FASB DP	Result of re-deliberations
Reinsurance	Reinsurance contracts accounted for using a mirrored based approach to gross with no losses permitted at issue.	The FASB and IASB recently made several decisions around ceded reinsurance. The three most critical of these decisions were: 1. Losses on a reinsurance contract will be recognized over the coverage period through recorded the loss as an additional reinsurance recoverable. Gains will be recognized through establishing a residual/composite margin in line with direct and assumed contract liabilities. 2. A cedant should not recognize a reinsurance asset until the underlying contract is recognized, unless the reinsurance contract is an aggregate coverage. 3. The ceded portion of the risk adjustment should represent the risk being removed through the use of reinsurance. i.e. the difference between a gross and net risk adjustment is recorded as the ceded risk adjustment.
Acquisition costs	Expenses that were incremental to writing a contract could be reflected in the measurement of the cash flows of the contract.	The IASB has decided to allow all the costs that the insurer will incur in acquiring the portfolio, including costs that relate directly to the acquisition of the portfolio to be included in the measurement of the cash flows. The FASB tentatively decided that the acquisition costs included in the cash flows of insurance contracts would be limited to those costs related to successful acquisition efforts and direct costs that are related to the acquisition of a portfolio of contracts.

Key changes to measurement inputs

Measurement input	IASB ED/FASB DP	Result of re-deliberations
Contract Boundary	The boundary of an insurance contract is the point at which an insurer either: (a) is no longer required to provide coverage, or (b) has the right or the practical ability to reassess the risk of the particular policyholder and, as a result, can set a price that fully reflects that risk. In assessing whether it can set a price that fully reflects the risk, an insurer shall ignore restrictions that have no commercial substance	The Boards decided that contract renewals should be treated as a new contract: • when the insurer is no longer required to provide coverage; or •when the existing contract does not confer any substantive rights on the policyholder. The Boards noted that a contract does not confer on the policyholder any substantive rights when the insurer has the right or the practical ability to reassess the risk of the portfolio the contract belongs to and, as a result, can set a price that fully reflects the risk of that portfolio. The Boards also noted that all renewal rights should be considered in determining the contract boundary whether arising from a contract, from law or from regulation.

Project timeline



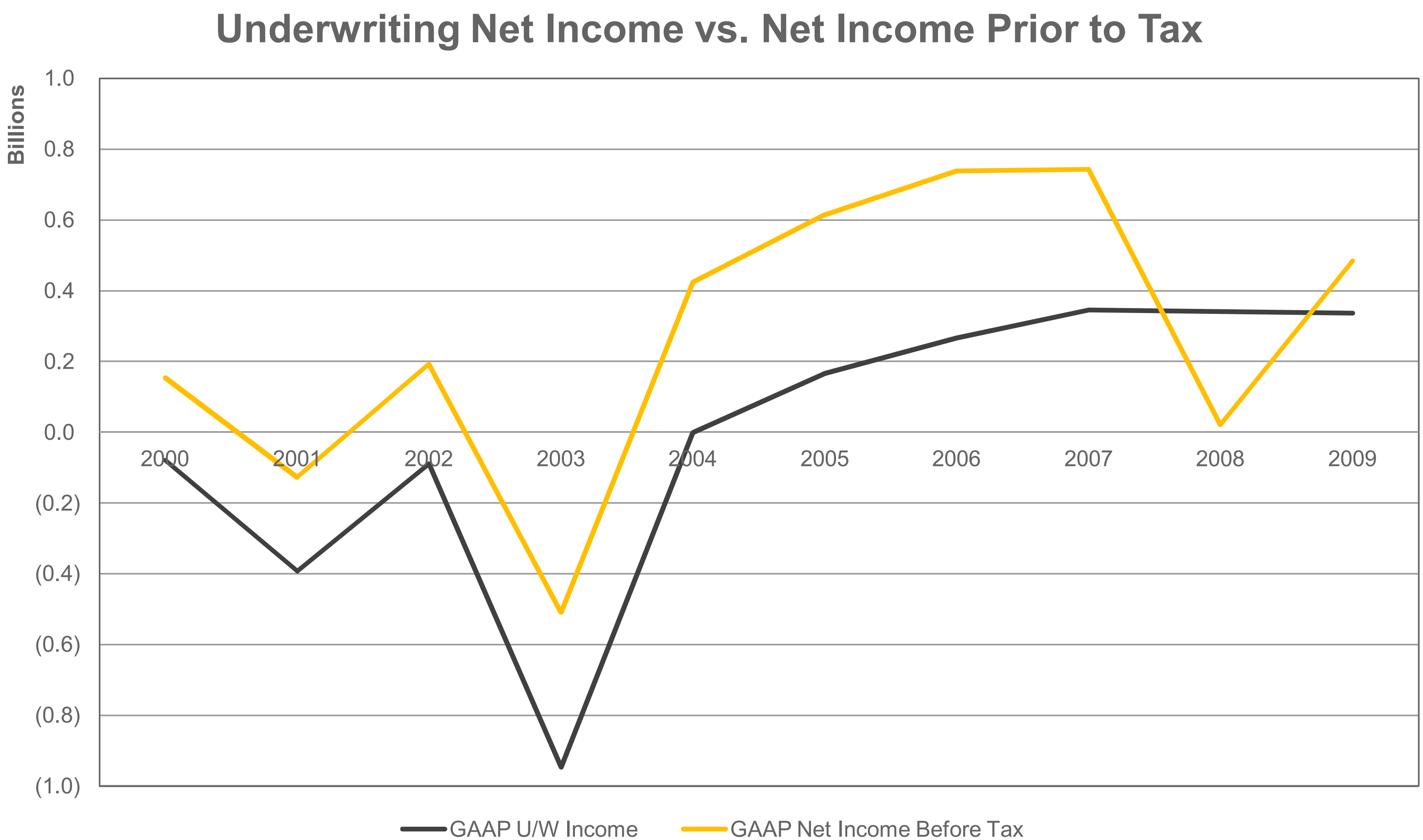
Model background

- The model is designed to show a retrospective view over the last ten years of financial statements under four accounting standards: statutory, current US GAAP, IFRS as proposed by the IASB insurance contract exposure draft, and proposed US GAAP as presented in the FASB insurance contract discussion paper

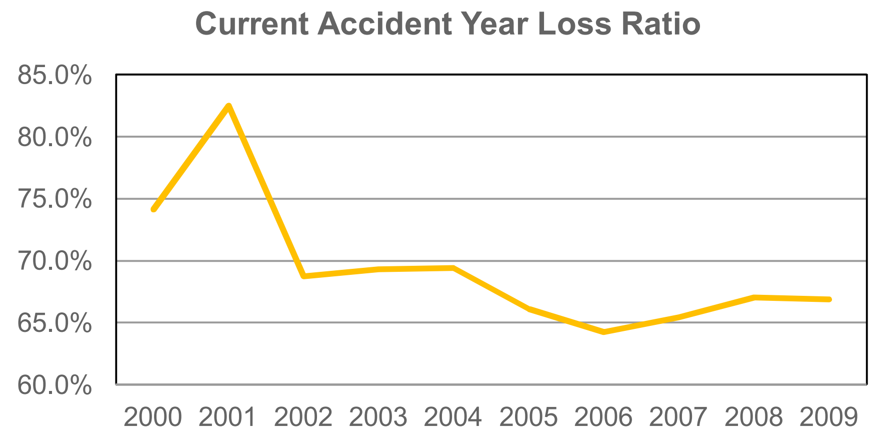
- Data is obtained from 10-K and statutory annual statement filings over the period 1999 through 2009

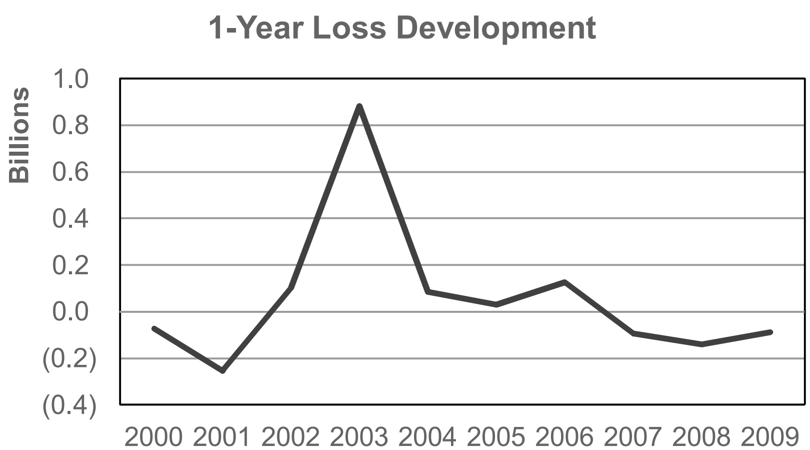
- Throughout the presentation current US GAAP is labeled “GAAP, the IASB proposal is labeled “IFRS” and the FASB proposal is labeled “FASB”.

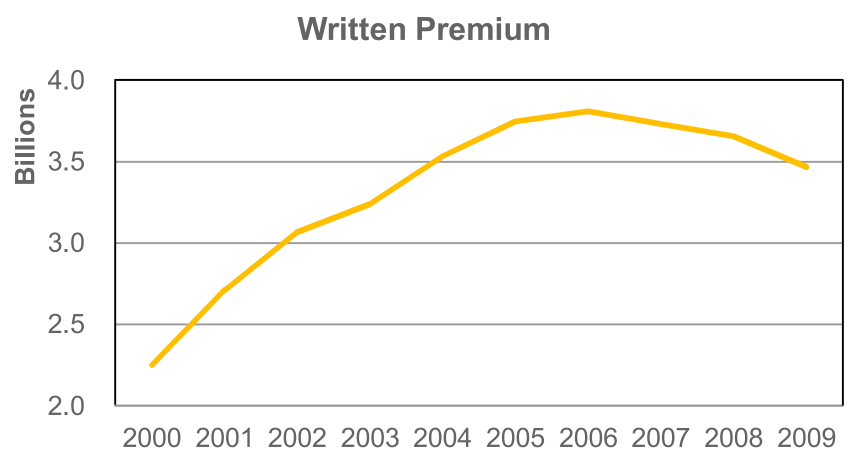
Key events from 2000-2009



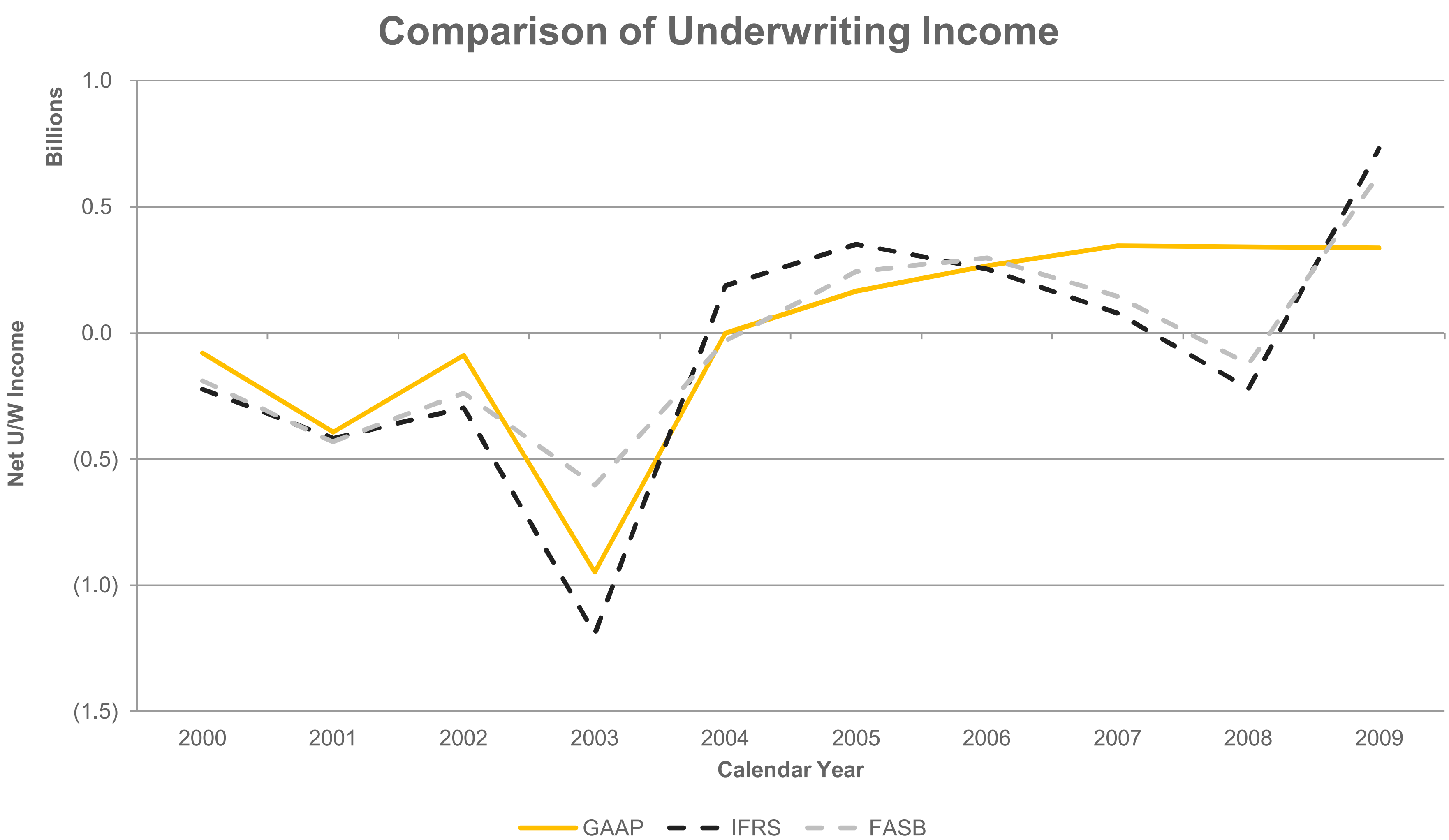
10-Year History of Key Income Drivers



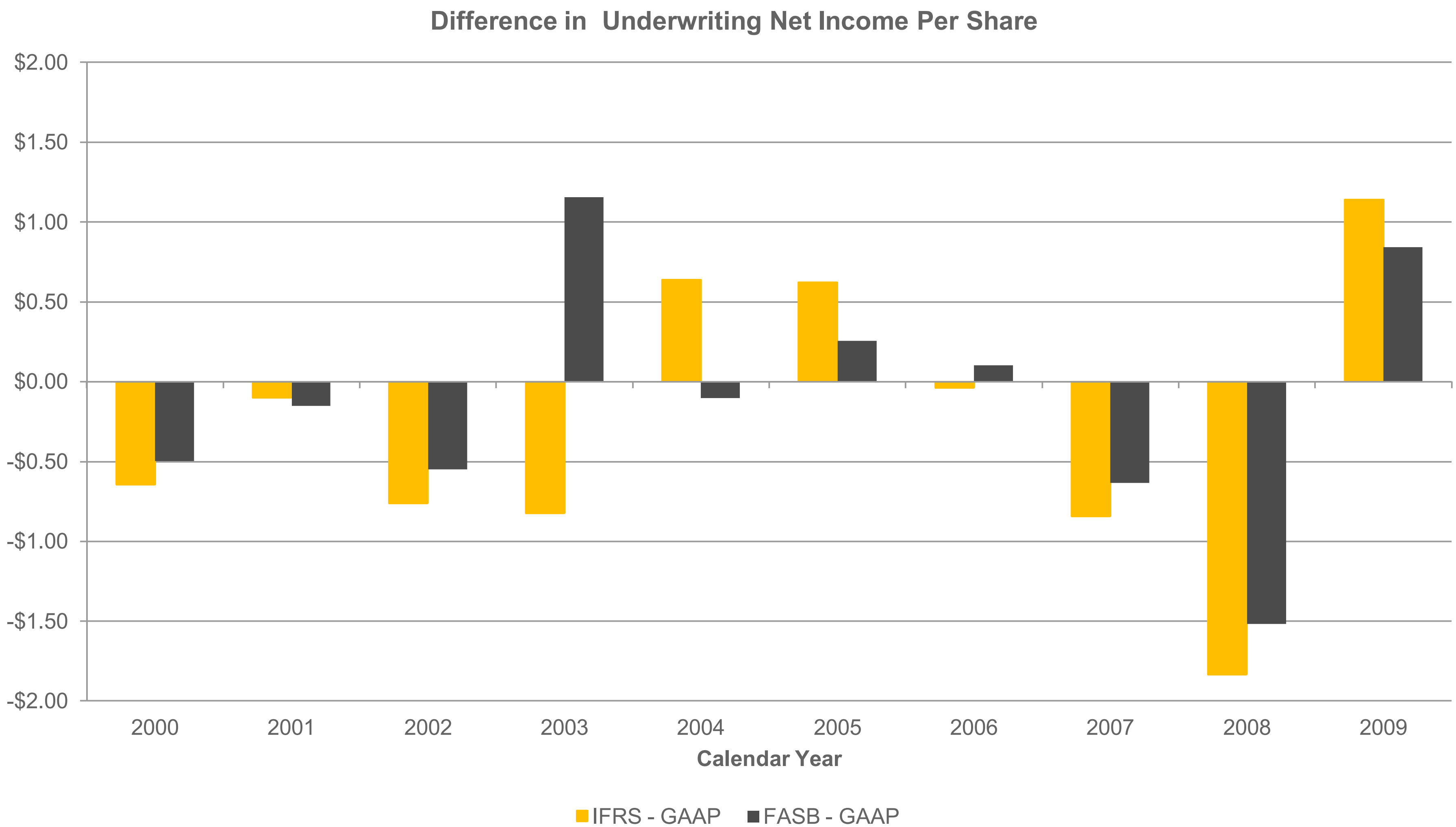




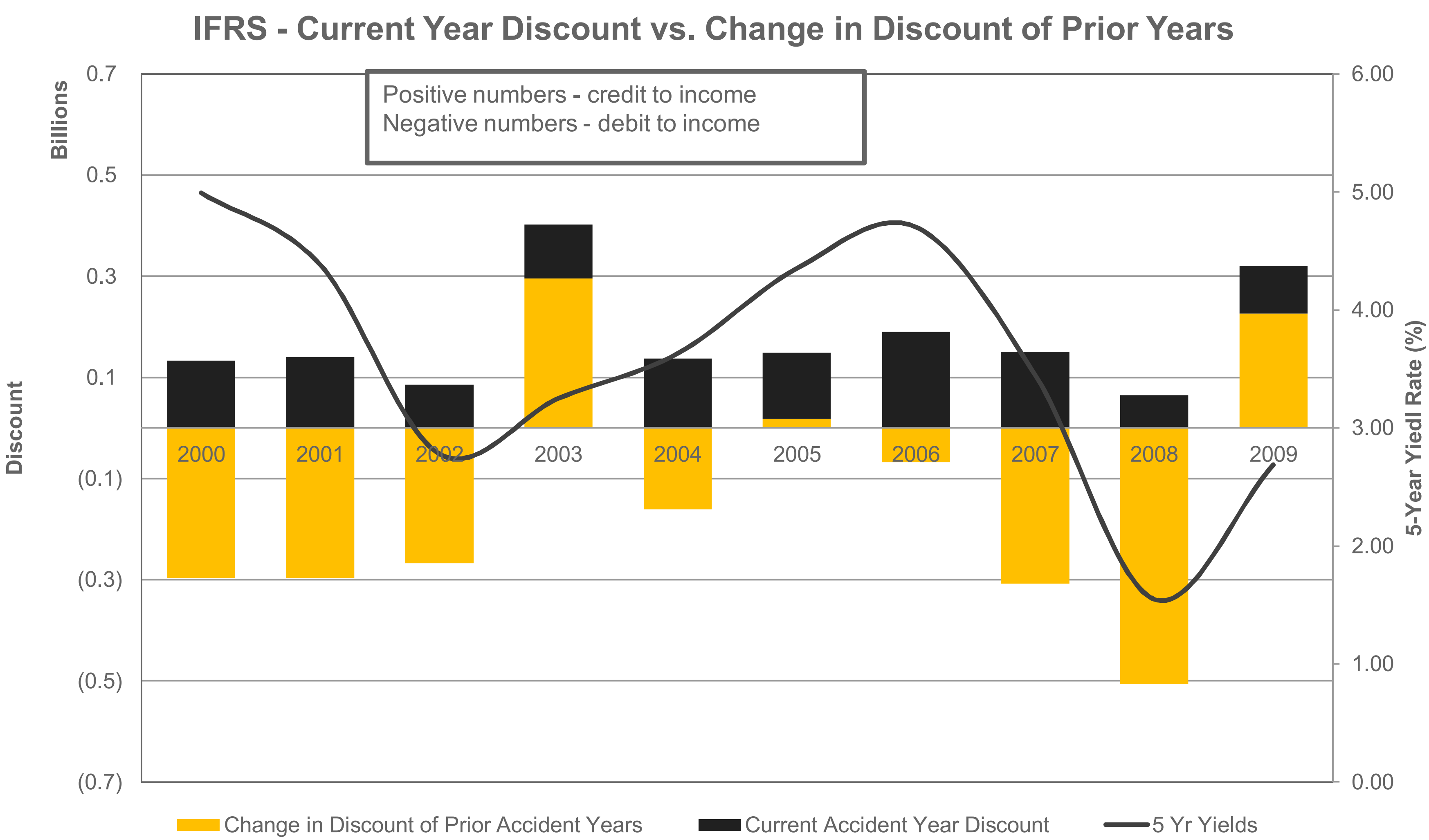
GAAP v IFRS v FASB underwriting income



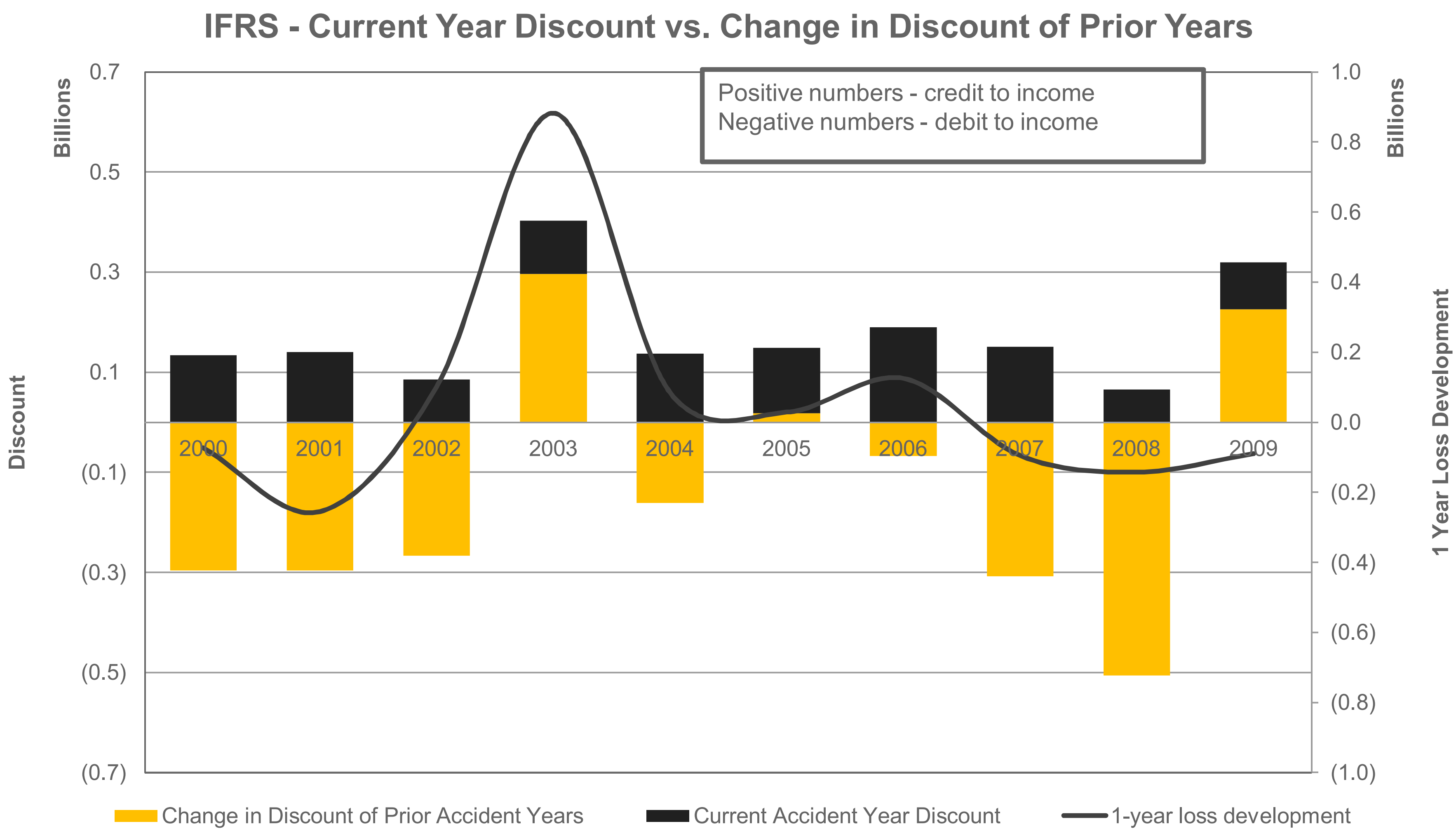
Impact on underwriting net income per share



Income effects of loss reserve discount – IFRS Basis



Loss development effects of loss reserve discount – IFRS Basis



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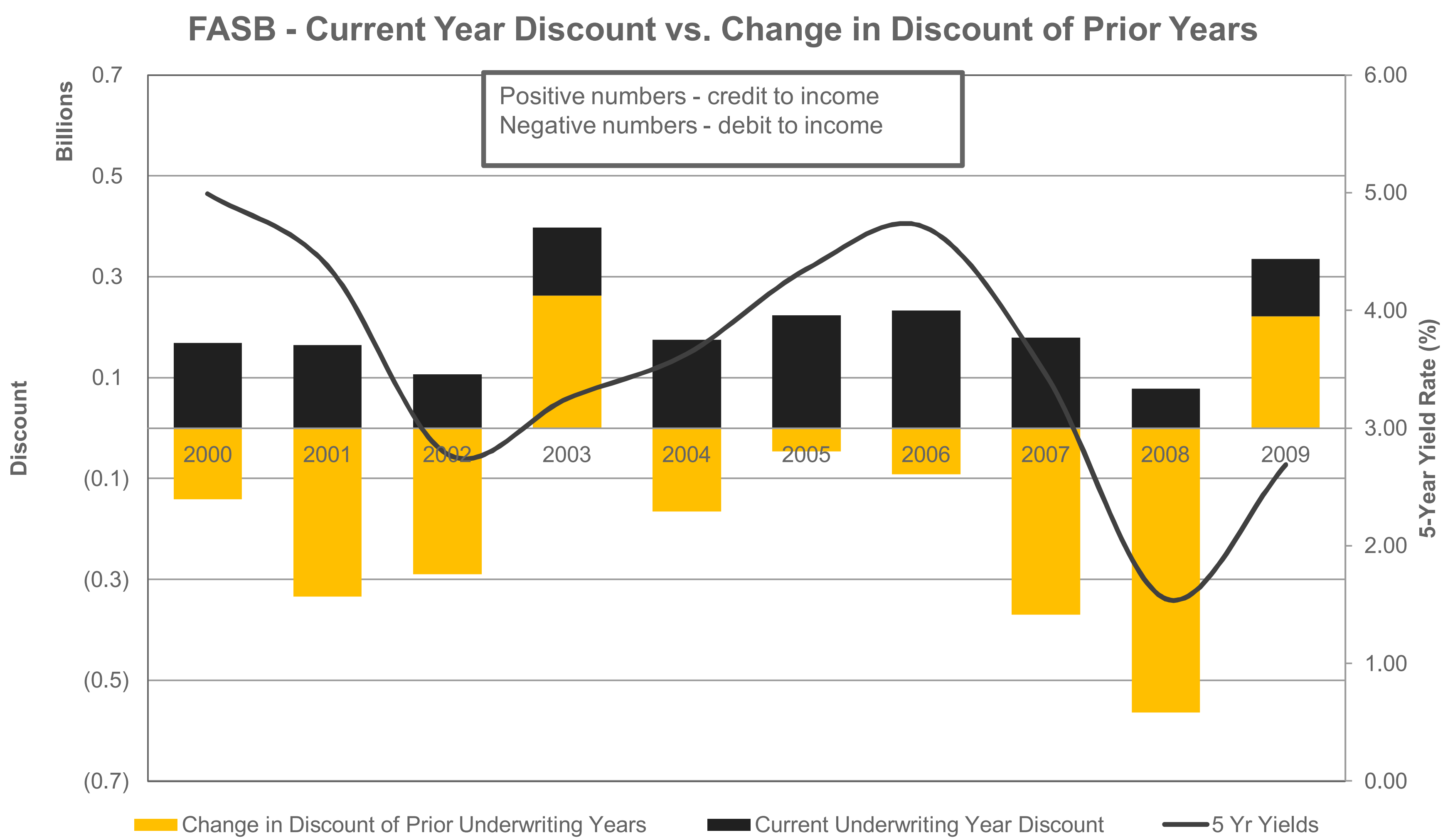
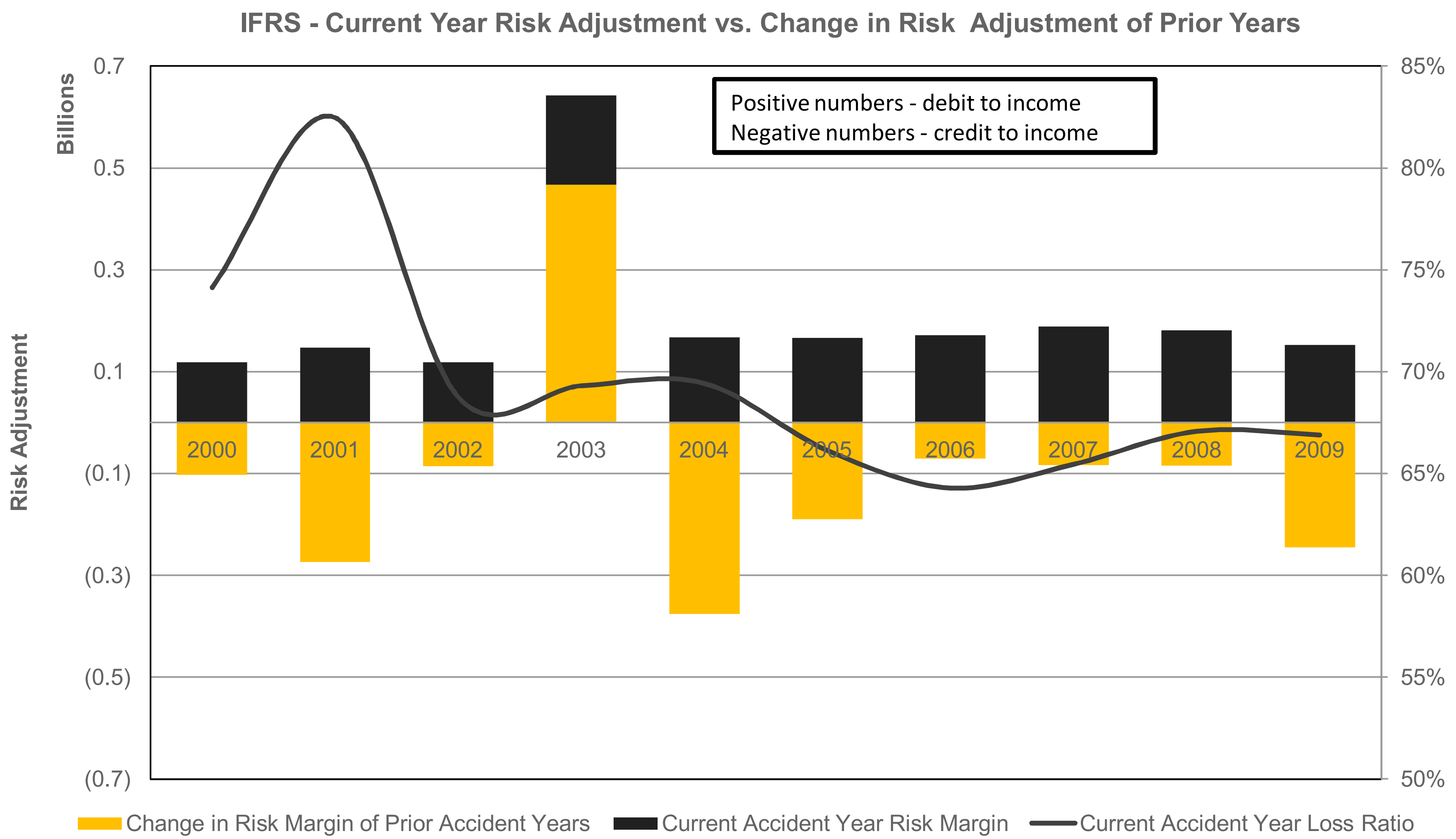
Income effects of loss reserve discount – FASB Basis



Risk adjustment – effects of changing loss ratios



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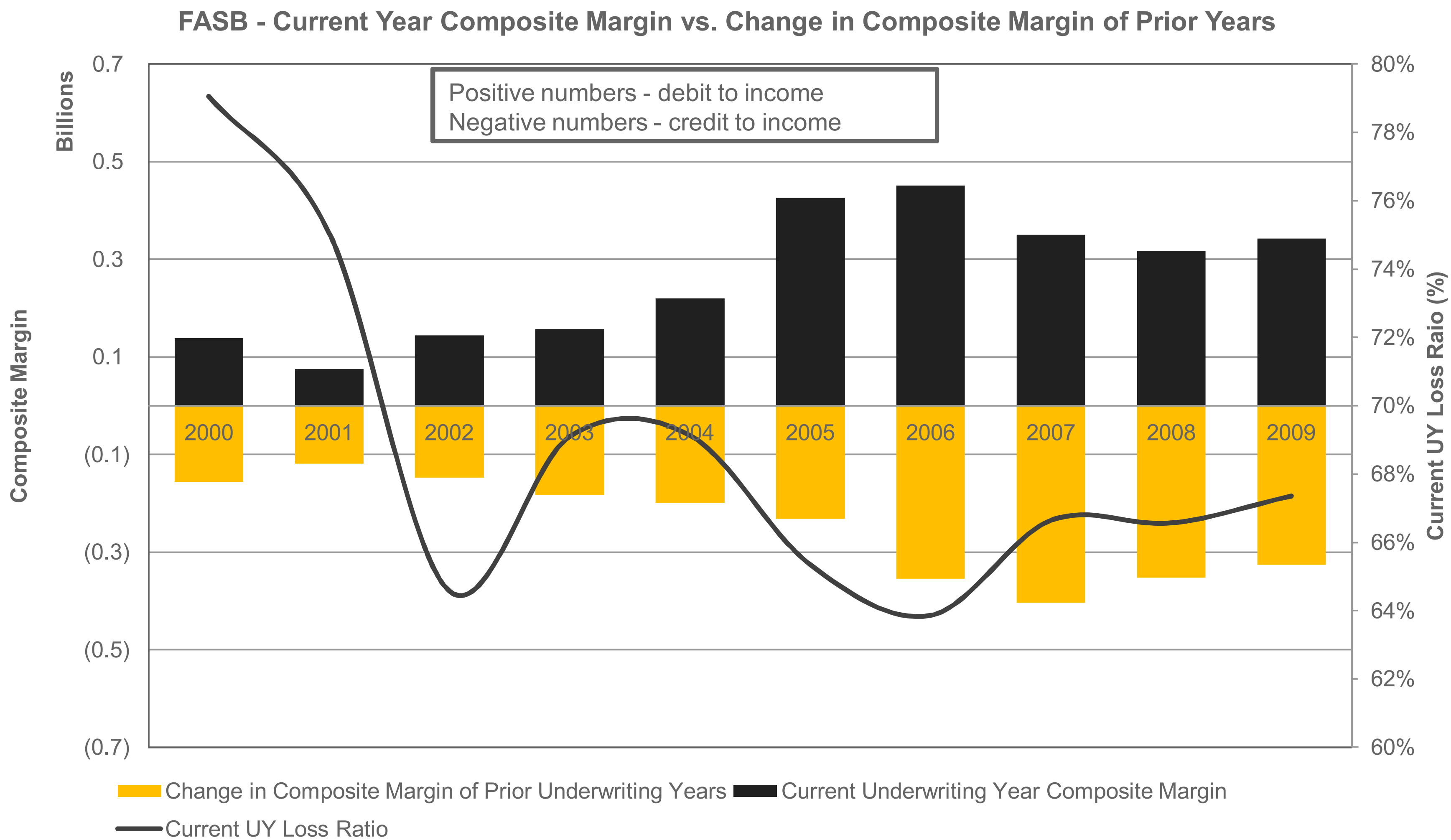
Composite margin – effects of changing loss ratios



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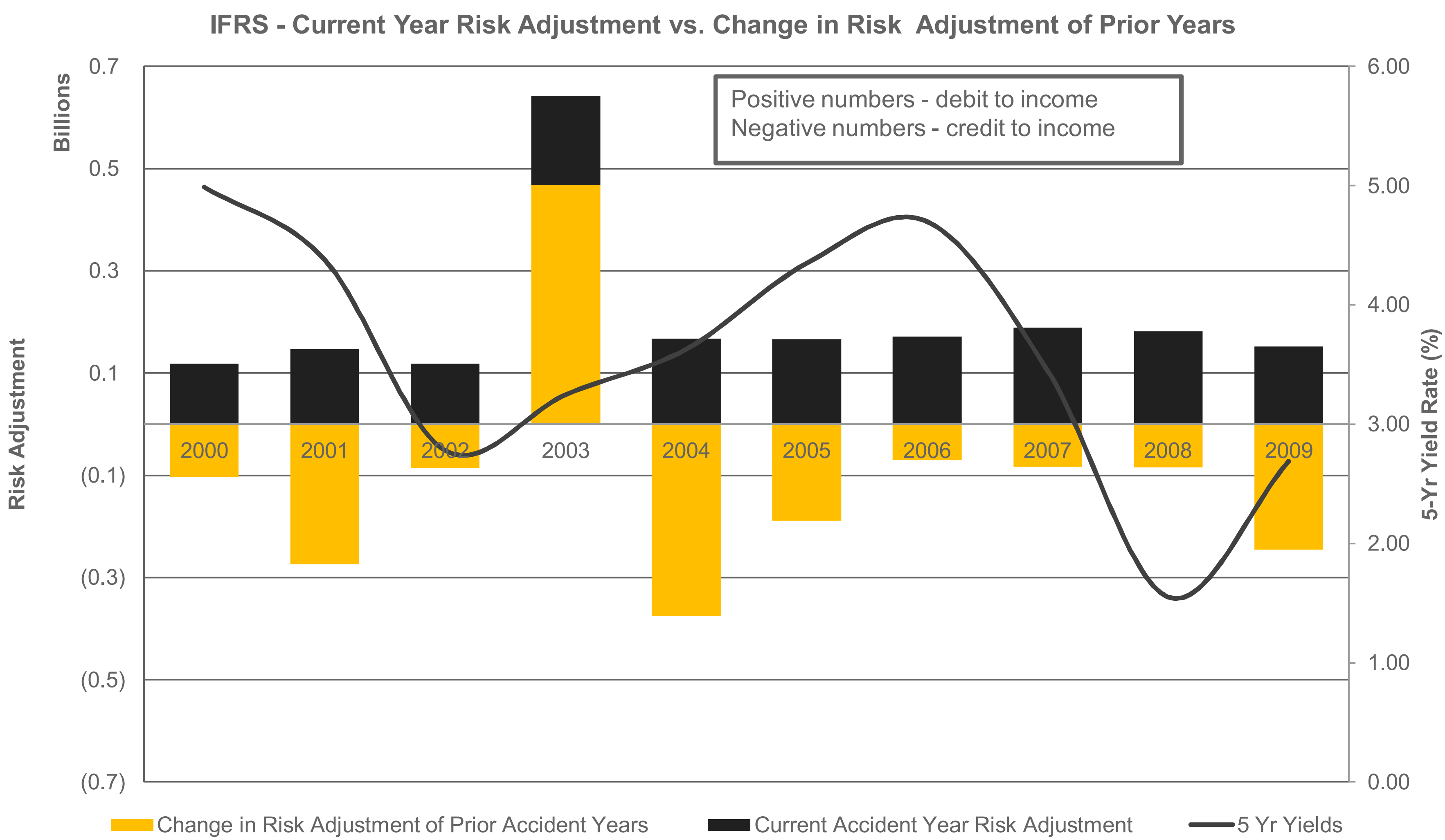
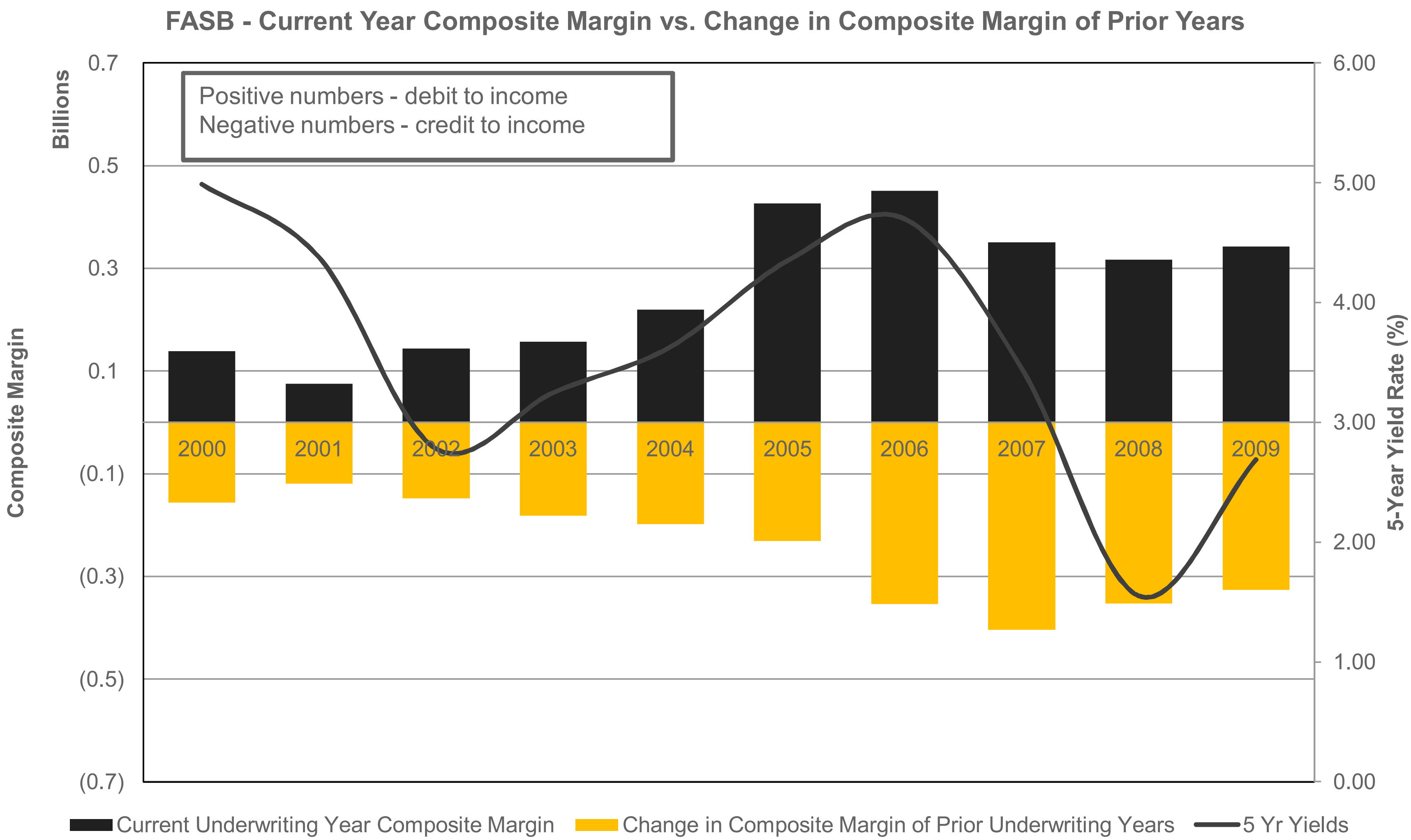
Risk adjustment – effects of changing discount rate



Composite margin – effects of changing discount rate



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